Growth in Adversity

In last one year, Nifty50 has grown by 59.18%, whereas Nifty FMCG has grown by just 27.47%. We are of the opinion that valuations of many selected premium stocks have been narrowed down to reasonable levels and offers much balanced risk/reward profile for FY22E/FY23E driven by steady earnings growth. We have narrowed down to companies which are strongly positioned through product innovation, strong distribution reach, pricing power and optimal cost rationalization; and like Mrs Bectors Food Specialities, Prataap Snacks, Zydus Wellness, Hindustan Unilever, Britannia Industries and Jyothy Laboratories.

Company Name	CMP (INR)	Target Price (INR)	Upside potential (%)
Mrs. Bectors Food Specialities (BSL)	414	501	21%
Prataap Snacks (PSL)	676	892	32%
Zydus Wellness	2,051	2,676	31%
Hindustan Unilever (HUL)	2,409	2,448	2%
Britannia Industries	3,638	4,010	10%
Jyothy Laboratories (JLL)	158	210	33%

Source: Arihant Research
CMP as on 16th June Closing

Over the last few years, FMCG industry has faced stagnation in growth mainly led by disruptions like GST and demonetization and the broader economic slowdown. To negate the slowdown impact, the industry has heightened its launch of innovative products to drive growth. During FY19 and FY20, the FMCG companies expanded into new categories and widened their existing portfolio. In addition, the Covid 19 saw flurry of launches with health and hygiene focus. Further, the company has widened their pan India presence through increasing direct reach, focusing on rural consumption and improving cost and capital efficiencies.

The FMCG sector witnessed a growth momentum in Q2FY21 and Q3FY21 on the back of a consumption shift in key categories from the unorganized to organized sector. Further, the new product launches and increasing activity through online sales have supported the growth off-late. Even the Q4FY21 numbers were good on the back of low base (lockdown in March 2020).

India witnessed a second wave of Covid and went under a lockdown for couple of months. However, with faster recovery and drastic fall in positive rates, India is on the back of unlocking gradually. Hence, we expect the categories like packaged food, health and hygiene and some discretionary categories like cosmetics, skin care, etc will witness acceleration in demand in 1HFY22E. Essential categories are reaching normalcy while weaker performing categories like QSR, Cigarettes, etc are expected to recover well in 2HFY22E.

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Mrs. Bectors Food Specialities (BSL)

CMP: INR414
TP: INR501

Key triggers:

- BSL's domestic biscuits segment (contributes ¬37% to sales) has a strong presence in North India (market size of INR80bn – accounts for ¬25% of the total mid-premium and premium biscuit market in India. In FY20, it had a market share of ~5% of the premium and mid-premium biscuits market in North India. It is one of the largest biscuit exporters in India, delivering to 64 countries, with North America, East Africa and South Africa being its key markets.
- BSL is among the top two Indian biscuit manufacturers in the premium and mid-premium biscuits segment in Punjab, Himachal Pradesh, Ladakh and Jammu and Kashmir. It has over 9% market share in Punjab, Haryana, Jharkhand, Jammu & Kashmir and Himachal Pradesh and 5% in Rajasthan. However, its share is lower in the largest states of Uttar Pradesh (2%) and Delhi (2%).
- Post unlock, chained QSR (Quick Service Restaurant) will benefit from i) increase in shift from unorganized to organized restaurants, and ii) increase in chained restaurants within organized players. The chained restaurants had grown 18% CAGR vs 14% for organized player over CY15-CY20 on the back of A) expansion of malls and high streets in town, B) increasing frequency of eating out and socializing and, C) higher demand for quick meals. MINR BectoINR enjoys strong relationships with institutional customers (QSINR, Mondelez, exports) augurs well for adopting innovations faster to drive penetration and customer acquisitions. Further, the stringent adoption of quality standards due to these QSR customers will further help them acquire new customers.
- We expect BSL growth to be driven by (1) Expansion of domestic biscuit business in NCR and Uttar Pradesh, (2) Distribution reach expansion in existing markets and (3) Expansion of branded bakery business into metros – Mumbai and Bengaluru.
- BSL is present in ~0.5mn outlets in North India – universe of ~2mn outlets in the region. Therefore, we believe that there is tremendous scope to increase distribution reach in the existing markets in North India. This, in our opinion, will be a key driver for growth in the domestic biscuits business.
- The company generates an annual revenue throughput of ¬INR6200 per outlet is far less than ¬INR16000 per outlet of Britannia. To increase the throughput, the company through its automation tool 'Peri' has started monitoring the real-time coverage, sales, etc. We believe with this, the company will be able to find the gaps and opportunities to in distribution network which will improve the throughput going forward.
- BSL's presence in branded breads business is largely in North India and within that primarily in NCR. BSL sells it branded breads under the brand 'English Oven'. It is currently one of the fastest growing large scale bakery brands in India and is one of the largest selling brands in the premium bakery segment in Delhi / NCR. The company is increasing its proposition in the metros city in Mumbai & Bengaluru where the consumption of branded bread is high due to higher disposable income and changing meal preference.
- BSL is one of the leading companies in the premium and mid-premium biscuits segment and the premium bakery segment in North India. BSL plans to expand into the premium category within existing product segments with focus on increasing sales realisations, volume and provide differential offerings to customers. To cater to the premium segment, the company have installed dedicated lines at Rajpura (Punjab) in 2018.

- The company plans to reduce the contribution of low margin glucose biscuits to improve the margin going forward. Further, the margin will also likely to expand through targeting developed and emerging markets for the sale of biscuits in export market.
- BSL has recently introduced new premium products sub-breads, frozen doughs, pizzas, garlic breads, cheese garlic bun fills and frozen cookies. The company is installing a dedicated line at Greater Noida facility and also intends to dedicate its Khopoli (Mumbai) facility for manufacturing premium bakery products. We believe this will drive the margin going forward. The weighted average realisation of biscuits and branded breads & bakery products has grown at a CAGR of 4.51% and 3.89% from FY18-20.
- The ongoing Greenfield project in Dhar, MP will help company to cater the newer markets and provide further geographical diversification.
- The company grew by Revenue CAGR of ¬9% over FY16-FY21 which got impacted by capacity constraints, GST, demonetization and lockdown due to Covid. However, we expect the company to report a CAGR of 17.7%/20.5%/21.5% of Revenue/EBITDA/PAT to INR1,221cr/INR205cr/INR106cr, respectively over FY21-FY23E on the back of growing its premium biscuits and bakery segment to improve its overall margins, expand to newer geographies in Indian and international markets through required capex, expansion of their distribution network and increase brand awareness.
- **We have valued the company on PE of 27x on FY23E at an EPS of INR18.6 per share and arrived at a target price of INR501, gives an upside of 21%. We have a BUY rating.**

Prataap Snacks (PSL)

CMP: INR676
TP: INR892

Key triggers:

- Prataap Snacks (PSL) is one of the fastest growing players in the savoury segment and has transformed itself from a regional player to a pan India player. The company has increased its market share from <1% in 2008 to +4% in FY21.
- PSL has established itself as a) value for money player, b) introduction of new and innovative products and has created its positioning under – potato chips, extruded, namkeen & sweets, and c) strong footprints of 1.7mn retail outlets across 30 states and Union Territories.
- The company effectively uses its strong distribution network to increase its penetration into the existing key markets North and West. The company is also increasing its presence in Gujarat (highest snacks market in terms of per capita consumption) and Southern markets as these markets are largely dominated by regional players with high competitive intensity.
- PSL is also planning to go for 2 tier distribution model and will do away with super stockist in due course of time. As of now, co will do away with super stockist in big city (consolidating the small distributors) but will continue to have super stockist in smaller city as they are used as a stock replenishment for distributors and retailers. In 2 years time, company will save 4% if channel optimization happened at 100% of sales. However, the company expects 2-2.5% margin improvement in 2 years time and will be visible from Q3FY22E onwards.
- The company follows asset light model where the contract manufacturing or 3P (third party) which stood at 0% in FY16 has increased to 24% in FY21. This 3P further helps in reducing the distribution cost as it reduces the lead distance to end markets as well as increase the efficiencies in the raw-material procurement.
- Going forward, the company is expected to increase the 3P model as it's lucrative in terms of expanding rapidly without significant outlay, rapid innovation and rolling swiftly in the market.
- The company has forayed into sweet snacks (relatively higher gross margin than salty snacks) which currently forms 3% of the total revenue and is highly under penetrated; providing immense growth opportunity. Scaling up these products, through existing distribution network followed by an entry into hitherto untapped modern-trade channels will further enhance margins and maintain the high revenue growth trajectory.
- PSL acquired Avadh snacks in Gujarat to cater the biggest snacks market in terms of per capita consumption. Gujarat is dominated by regional players. Avadh synergy with PSL: Gujarati namkeen & pellet production): 1) no overlap of business, 2) complimentary business, 3) to take Avadh outside Gujarat, like MP, Maharashtra, and 4) Pellet big contributor (9-10% of revenue).
- In terms of demand, PSL witness a soft demand across Jan-March and could not take the benefit of low March base, as this year, the demand was impacted by the second wave of covid. The institutional business (railways, bus depots, etc), which forms 10-12% of total revenue was impacted the most due to low mobility. However, with unlocking in place and easing of restrictions, we expect the company to achieve FY20 revenues in FY22E.

- Due to covid, FY21 was a washed out year for the company, as these products are mainly OOH (out of home consumption), and with lockdown, low socializing, schools being closed, PSL reported a Revenue/EBITDA/PAT CAGR of 4.8%/(10.1%)/(31.5%) over FY18-FY21. With the high raw-material cost, shut down of plants and high freight cost, the EBITDA margin also declined by 315bps over FY18-FY21 to 5.4% in FY21.
- We believe multiple triggers going ahead for PSL. The company has pan India presence with strong balance sheet. We believe higher possibility of margin expansion going forward. Key triggers for growth would be margin expansion led by in product mix & revamping distribution strategies, pick up in newer geographies, ramp up of product portfolio to other geographies, rising consumption specially in non metro and rural segment and a shift from unorganized to organised would be key drivers for the company. Hence, we expect PSL to report a Revenue/EBITDA/PAT CAGR of 18.5%/43.1%/107.3% over FY21-FY23E.
- **We have valued the company on an EV/EBITDA basis of 16x with a target price of INR892, which comes to a PE of ¬35x on FY23E, an upside of 32%. We have a BUY rating.**

Zydus Wellness

CMP: INR2,051
TP: INR2,676

Key triggers:

- The company holds a leadership position in Glucon-D with 58.4% market share. Zydus continues to enjoy a dominant market share in sugar substitute category with 'Sugar Free' commanding more than 93% market share. Nycil increased its market share by 225bps to 35.8% in Prickly heat powder category. Similarly, Everyuth Scrub saw 174bps market share increase to 35.8% in facial Scrub category. Everyuth Peel off holds market share of 77.9% in peel off category. Complan is the fourth largest brand in the MFD category with 5.5% market.
- The company doubled its direct reach to 5.5 lakh outlets under project 'Vistar' and is also driving outreach programmes to increase penetration in hinterland. It has a presence in more than 800 towns now and will be increasing its footprints. In addition, the company is increasing its digital presence, and owing to that it's digitizing its sales force and distribution network to improve its inventory replenishment.
- Due to covid led lockdown, many companies have increased their online presence. The company's e-commerce channel sales increased 3x in FY21 and is now contributing 3.6% of sales.
- Export business has grown 200% in FY21 and is currently contributing 3% to sales. The company is considering expanding in the Nigeria and UAE markets. Further, it believes Bangladesh and Nepal provide a fairly large opportunity to expand its sales. ZWL aspires to increase its overseas sales contribution to 8-10% of total sales. This provides a growth visibility going forward.
- The company would be unable to avail of the income tax benefit for the goodwill write off. However, its income tax rate would remain at zero till FY24 due to accumulated losses, 80i benefits & MAT credits available.
- The management has given a guidance of 22%-23% operating margins by FY23E led by judicious price hikes and cost rationalization measures and integration of acquired brands is complete. The company has reported an operating margin of 18%/18.4% in FY20/FY21, respectively.
- We expect Zydus to report a Revenue/EBITDA/PAT CAGR of 11.8%/23.5%/35.4% over FY21-FY23E to INR2335cr/INR495cr/INR460cr, respectively, on the back of new launches, increasing distribution strength, increasing the presence through existing brands in the sizable opportunity in health & nutrition space and improving strong gross margin gives the company a leeway to spend more on advertisements for brand building exercise. With the strong revenue, improving operating margins, present in top 2 in some of the brands in the market and earnings growth, we believe that the stock can command higher multiple compared to its broader peers.
- **Hence, we have valued the company on a PE basis of 37x in FY23E and EPS of INR72.3 per share, with a target price of INR2,676 per share, provides an upside of ~31%. We have a BUY rating.**

Hindustan Unilever (HUL)

CMP: INR2,409
TP: INR2,448

Key triggers:

1. HUL is a consumption growth play in India and is effectively using the strategy to enter the naturals category and showing exceptional growth. The company has proved its ability to price hike to combat rising raw-material prices and has grown ahead of the market.
2. We believe HFD (Health & Food) segment will emerge as a key driver of growth given A) launch of INR2 and INR5 pack of Horlicks and Boost to drive penetration, and B) Company continues to increase its premium segment through science based HFD under plus range.
3. We feel, in the near term, inflationary raw materials may continue to impact gross margin with rising raw-material cost like palm oil, etc. However, going forward, we expect cost-saving initiatives such as zero-based budgeting, efficiency in ad spends, changes in route-to-market, etc to help. The acquisition of GSK's (GlaxosmithKline Consumer) portfolio will also aid overall margin expansion.
4. During FY21, the company witnessed higher innovation intensity with 150 plus SKU launches, top brands saw 5x growth rates vs FY20, premium products grew 2x vs core, WIMI created market development opportunities, health, hygiene and nutrition portfolio grew 12% in FY21.
5. We continue to remain constructive on HUL owing to A) 87% of business has been gaining penetration and 82% of the business reported market share gains, B) 80% of the business comprises Health, Hygiene and Nutrition continues to witness healthy growth and recovery, C) As per management, the complete integration with GSK will be over in 1HFY22E providing synergies to flow though into the financials, D) Gains from digitization strategies like WIMI and SHIKHAR (0.5mn outlets, indicating rapid digitization) will drive distribution led gains, E) increasing distribution reach through multiple distribution models, F) chemist channel footprint has expanded post GSK acquisition, G) Restoration of supply chain, and H) pricing power led by product innovation initiatives.
6. HUL had report a Revenue/EBITDA/PAT CAGR of 9.4%/14.4%/14.9%, over FY19-FY21 to INR47028cr/INR11626cr/INR8000cr, respectively.
7. We expect the company to report Revenue/EBITDA/PAT CAGR of 11.2%/14.5%/18.7%, over FY21-FY23E to INR58,146cr/INR15,234cr/INR11,280cr, respectively.
8. **Hence, we have valued the company on a PE basis of 51x in FY23E and EPS of INR48 per share, with a target price of INR2,448 per share, provides an upside of ~2%. We have a NEUTRAL rating.**

Britannia Industries

CMP: INR3,638
TP: INR4,010

Key triggers:

- The biscuit category is expected to grow in mid-single digit providing significant growth opportunity for Britannia going forward. In current scenario, despite Britannia being a market leader in biscuit segment, it enjoys just market share of mid-30s, which opens enough space for the company to garner market share going forward with the new product launches, improving its presence in the glucose segment through Tiger and Milk Bikis (Parle is a market leader), gaining leadership in the premium segment, creating its strong positioning in the Hindi Hinterland region and growth in overall category.
- The company has a lower market share of 4% in the Glucose and Milk Biscuits category and looks to better the same. Britannia and competition offers the biscuits at a similar price point, however, Britannia has a premium pricing as it sells a lower grammage per pack compared to Parle-G. The company's Milk Bikis is one of its most profitable brands and is based predominantly in Tamil Nadu & Kerala, and it aims to upgrade a portion of Parle-G consumers. The product offering is 100% atta based and Britannia is targeting other states with increased focus in Hindi Belt.
- The broad Packaged Foods market (estimated at USD40–50bn) presents the strongest structural opportunity in India's consumption space. In FY21, Britannia did revenue of just ~USD1.8b which is a just fraction of this addressable market. We feel that the growth opportunity is immense and Britannia has a strong potential to garner a sizeable market going forward.
- The company has been working relentlessly to increase its presence in pan India and especially rural where the consumption is relatively strong. For this, the company has increased its direct reach to 2.3mn outlets, which is next to Hindustan Unilever.
- Given its strength in brand building, the company has been successful in scale up of non-biscuit category led by cream wafers and milkshakes; which accounts for ¬2% of total sales. Even the salty snacks which is present only in Andhra Pradesh offers promise. We feel that these segments provide immense growth opportunity from a medium to long term perspective.
- The company moved to the cutting-edge S4 Hana ERP, Arteria data management system, and a new vendor management system in Q4FY21. These initiatives will give Britannia much needed edge over its competition and benefits are expected over couple of quarters.
- Britannia's financial performance over the last decade has been splendid, with ~12% sales CAGR, and EBITDA and PAT CAGR of ~27% each. This splendid performance was a result of A) huge market share gains, B) strengthening direct distribution reach, and C) better product development/innovations compared to its competition.
- We expect Britannia to report a Revenue/EBITDA/PAT CAGR of 11%/7.8%/7.5% to INR16,200cr/INR2,920cr/INR2,150cr, over FY21-FY23E, respectively.
- **Hence, we have valued the company on a PE of 45x on FY23E and EPS of INR89.1 per share, and arrive at a target price of INR4,010 per share, an upside of ~10%. We have an HOLD rating.**

Jyothy Laboratories Ltd (JLL)

CMP: INR158
TP: INR210

Key triggers:

- Jyothy Laboratories Ltd (JLL) is an Indian FMCG player with products across Fabric care, Dishwashing, Mosquito repellents & Personal Care.
- Covid-19 and Work from home trends have changed consumer preferences more towards essential & hygiene products. JLL's ~85% of the product portfolio comprises of essential & hygiene products.
- The Company has gained market shares across a wide range of its products in CY20 compared to CY19. Market share gain for Exo Bar was 120 bps, Pril –130bps, Maxo Coil – 170 bps, Maxo LV – 40 bps, Ujala FB – 60 bps, Ujala IDD – 100 bps. The Company has been able to gain market share from competition. This has happened more in the rural markets.
- JLL's enhanced focus on essential hygiene products along with strong rural demand aided volume growth in FY21. The rural growth was better than urban and the company is enhancing rural coverage by adding more sub-stockists & Van coverage and has introduced low unit packs across brands. JLL is enhancing its rural distribution network by adding 500 sub-stockists in FY21. In urban regions, it has increased its direct distribution reach to ~9 lakh retail outlets.
- The General Trade (GT) & E-Com channel is doing well, supported by strong rural growth while Modern Trade & CSD (Canteen Sores Department) channels witness gradual recovery with improving urban consumption. The Company has launched SFA Retailer App for direct delivery and increased visibility across all ecommerce platforms.
- The company has also rationalised trade pipeline by 10 days from 20-25 days after implementing continuous replenishment system (CINR). We believe distribution upgradation & expansion would drive growth in dishwashing category for the company.
- Fabric wash category has been adversely impacted in FY21 given reduced out of home activity resulted in lower usage of detergent & post wash products. This segment is the high margin business for the company. We believe that post normalization of situation after vaccination drive would boost fabric wash revenue, which in turn will improve the overall margins for the company.
- Household Insecticide's (HI) operating profit turned positive after a long time and the Management is hopeful of maintaining it going forward provided the share of liquid vapourisers continue to rise in the overall HI basket vis-à-vis coils. We believe that the Management is trying to push hard the sales of liquid vapourisers, which currently comprise 35-38% of the segment as liquid vapourisers generate a high gross margin compared to coils. Once the steady shift happens from coils to liquid vapourisers in the medium to long term, the segment would show consistent profitability.
- Under the dishwashing category, the company have launched smaller packs at interesting price points and were able to pull consumers in the rural areas. We believe, this is sustainable going forward provided low penetration in the rural areas (rely on ash for washing utensils).
- The personal category driven by Margo brand registered a strong growth of 38.4% YoY in Q4FY21 resulted by the strong customer acceptance of neem infused soap proposition. A strong growth in the segment will result in overall improvement of margins going forward as the margin in this segment is high. The contribution from this segment is in high single to low double digit.

- Compared to commodity basket inflation (5-6% range), the company has taken a 2-3% price increase in Detergents and Soaps and reduced trade schemes. The management refrained from margin guidance, unlike its usual practice, given the current volatile scenario.
- The company has turned net debt free during FY21.
- NWC days have fallen to 15 days from 35 days in FY20. As per the management, the current NWC days can be maintained going forward.
- Tax rate will be ~18% for the next two years.
- JLL is not looking at acquiring companies/brands amid the lockdown, it is open to acquiring regional brands or smaller national brands later.
- Going forward the company would focus on higher volume led growth. There would be increased focus on brand investment and innovations, technology, distribution infrastructure and reach.
- The company registered a Revenue/EBITDA/PAT CAGR of 2.6%/5.8%/4.1% to INR1909cr/INR315cr/INR214cr, over FY19-FY21, respectively.
- We expect JLL to report a Revenue/EBITDA/PAT CAGR of 9.8%/11.4%/9.4% to INR2300cr/INR390cr/INR256cr, over FY21-FY23E, respectively on the back of higher volume led growth in addition with increased focus on brand investment and innovations, technology, distribution infrastructure and reach.
- **Hence, we have valued the company on a PE of 30x on FY23E at an EPS of INR7 per share, and arrive at a target price of INR210 per share, an upside of ~33%. We have a BUY rating.**

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Stock Rating Scale	**Absolute Return**
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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