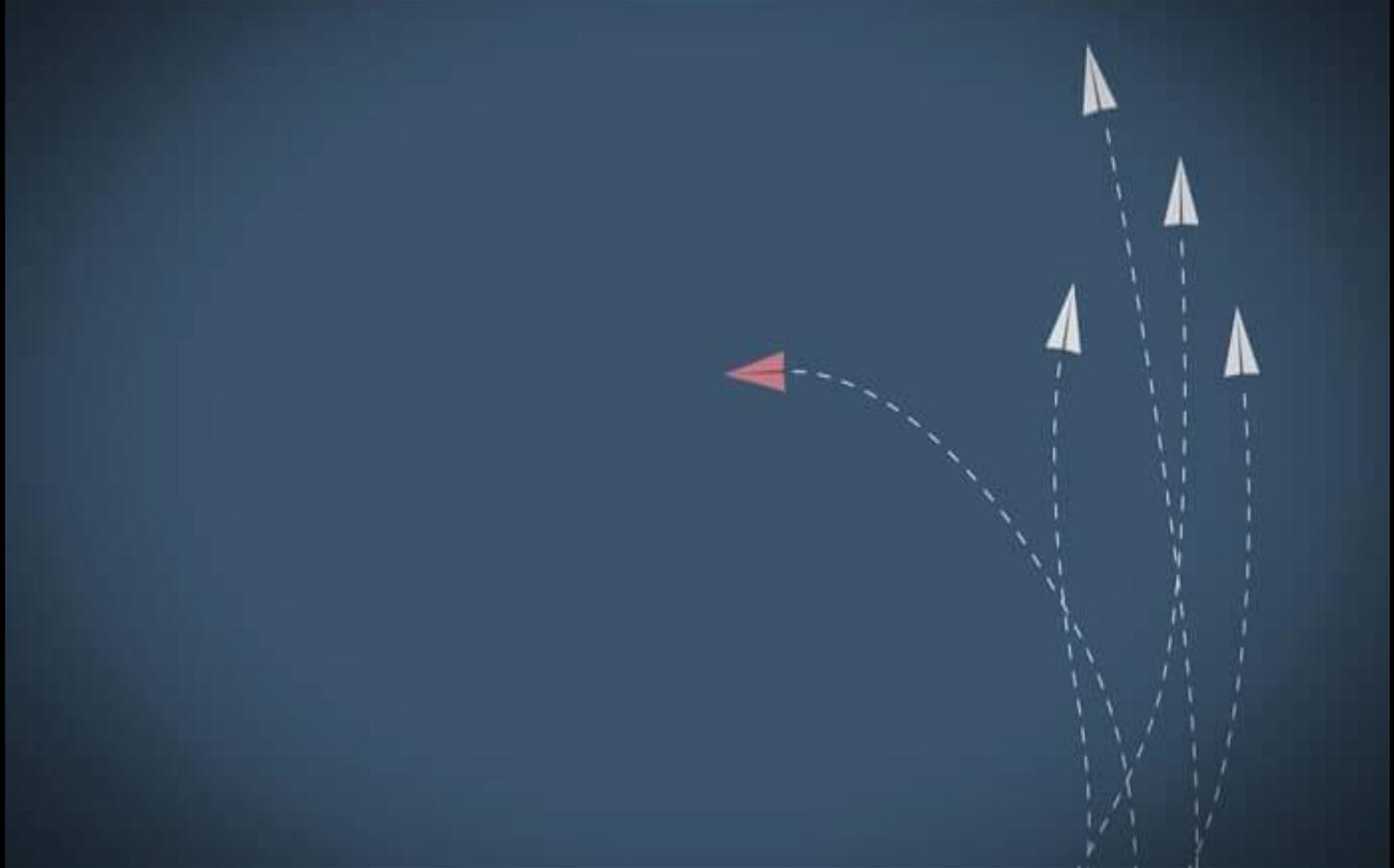


November 2019



AMBIT ASSET MANAGEMENT

GOOD & CLEAN
by Ambit

Good & Clean Portfolio



Coffee Can Portfolio



**Emerging Giants:
G&C Small Cap**

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READ ALL SCHEME RELATED DOCUMENTS CAREFULLY BEFORE INVESTING**

Disruption is inevitable: We are prepared

We at Ambit are constantly trying to stay ahead of the curve by drowning out the noise and looking ahead. In keeping with our long term investment thesis, we like to stay adept with not just the present impediments faced by your portfolio companies but also long term disruptions which can hit these companies. Hence we will regularly come out with our thoughts on disruptions in your portfolio companies/ sectors and for the second write up of this series we have chosen Britannia and the biscuit industry.

A disruptive technology/ innovation is one that helps create a new market and value network, and eventually goes on to disrupt an existing market and value network (over a few years or decades), displacing conventional wisdom or technology.

This note takes a closer look at Britannia with a focus on (1) Evolution and importance of the brand (2) Entry into adjacent categories as it transitions to a total foods company and (3) Progressions and disruptions we foresee for tomorrow for Britannia (& Industry).

Britannia: Multi-decadal Disruptor continues its march

It is interesting to study the growth story and inspiring journey of some companies. Britannia, biscuits maker turned 'total foods business', is one such company that makes us feel this way. Established way back in 1892, from the earliest of times, Britannia has been an innovator and pioneer in its field. The company, throughout its history, has stayed nimble and continuously adapted to the opportunity that has come its way. As early as 1921, the company gained popularity for being the first company east of the Suez to use gas ovens to make biscuits. Later, during World War 2, it was the chief supplier of biscuits to soldiers of British India (A deal that made up 95% of the company revenue). In 1954 and 1955 the company introduced sliced bread and bourbon biscuits for the first time in India.

In its IPO in 1978, the company firmly established itself to be an Indian owned organization. Innovations and new launches continued year after year as the company grew in popularity. In 1986 and 1993, the now famous 'Good day' and 'Little hearts' biscuits were introduced. It was also in this year (1993); the company was acquired by Mr. Nusli Wadia of Bombay Dyeing fame.

Today Britannia products are available across the country in close to 5mn retail outlets and reach over 50% of Indian homes. The company's Dairy business contributes close to 5% of revenue and its dairy products directly reach 100,000 outlets. Britannia Bread is the largest brand in the organized bread market with an annual turnover of over 1 lac tons in volume and Rs.4.5bn in value. The business operates with 13 factories and 4 franchisees selling close to 1 mn loaves daily across more than 100 cities and towns of India.

Britannia Now: Aiming to be a total foods company

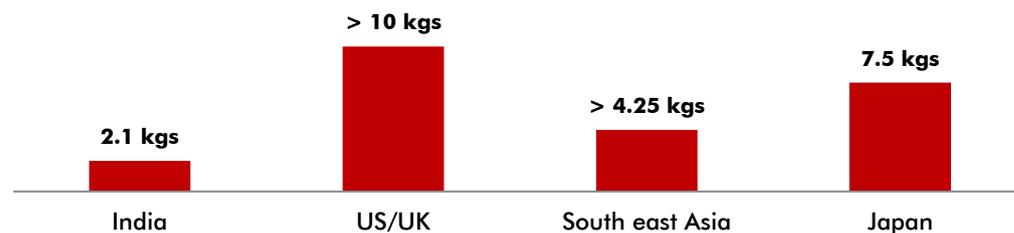
India is considered as the third largest producer of Biscuits after USA and China with a huge addressable market. Per capita consumption of biscuits in our country is 2.1 kg and as the economy prospers, the per capita consumption is likely to increase. While Britannia has been a 100% biscuit manufacturer in the past, over the years and ahead of time it has evolved to become a total foods company.

"Britannia is one of India's leading food companies in the packaged food segment and is among the most trusted food brands. Britannia's product portfolio spans Biscuits, Bread, Cakes, Rusk, Dairy and Adjacencies."

- **Britannia AR19**

In the next 2-3 years management expects biscuit share to contribute approximately 70% as other products offering start gaining scale.

-**Britannia 2QFY20 conference call for Investors**

Exhibit 1: Biscuit category already has a high penetration in India (>90% households) however per capita consumption (Kg) has potential for growth


Source: Ambit Asset Management

While as recently as FY14, 84% of Britannia's sales were from biscuits. The Britannia of today derives 75% of its revenue from biscuits. Further in the next 2-3 years, management expects the share from biscuits to contribute approximately 70% as other products offering start gaining scale. This shift is important to address as biscuit penetration in India is ~90% and so the major growth for a biscuit company would essentially need to come through: (a) Increase in per capita spends/consumption/Premiumisation (b) Existing portfolio strengthening (c) New product categories/diversification.

The company has taken some decisive steps in FY2019 to achieve its stated ambition of becoming a 'total foods company'. The company has entered into four new categories and launched new variants and extensions in the existing categories too. Recent product launches of the company are gross margin accretive, according to the management.

New Adjacent categories:

- **Salted snacks:** This is a Rs 250bn category growing at >20% pa. The company launched its snack brand 'Time Pass', three variants of groovy chips (Minty Pudina, Pickled Mango, and Spicy Tomato) and two variants of funsticks (Tomato Twist and Masala Munch). Pricing was in line with the current market leaders and launches were carried out in select market. This is a category that requires substantial investments to achieve critical scale.
- **Cream filled croissant:** Britannia had launched two variants (vanilla and cocoa) of packaged croissant under the brand 'Treat' with a compelling price point of MRP Rs 20 and an introductory price Rs 15. This is a nascent category, which has potential given the rise in the younger population as part of the demographic.
- **Cream wafers:** Another category (Rs 5bn, >25% growth) that the company is quite positive on. The company entered the segment with the launch of Treat cream wafers in four variants – Choco, strawberry, orange and vanilla. The company would be the first branded player with a large national presence in this category. For Wafers, the company has achieved 10%+ market share and is now No.3 brand in the country.
- **Dairy beverages:** Britannia entered this category (Rs28 bn, 27% growth pa) with the launch of brand Winkin' Cow in four variants – vanilla, mango, chocolate and strawberry. AR commentary suggests that this has been one of the most successful launches for Britannia in its history. The imminent opportunity lies in the shift of organized share from 20% (presently) to 30% by 2023 and the value added dairy products segments. In milk shakes as well, the company has achieved 20%+ market share and is now the No.2 brand in less than a year of launch.

Exhibit 2: New adjacent category launches: salted snacks, wafers, croissants and dairy



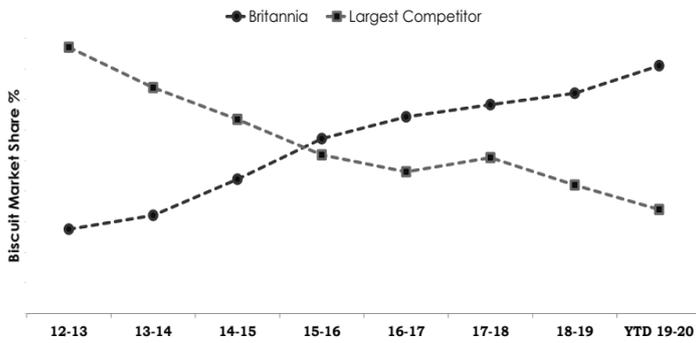
Source: Ambit Asset Management, Company presentation

Exhibit 3: There is a constant focus to launch new test products and rebrand as may be required by the company or business environment



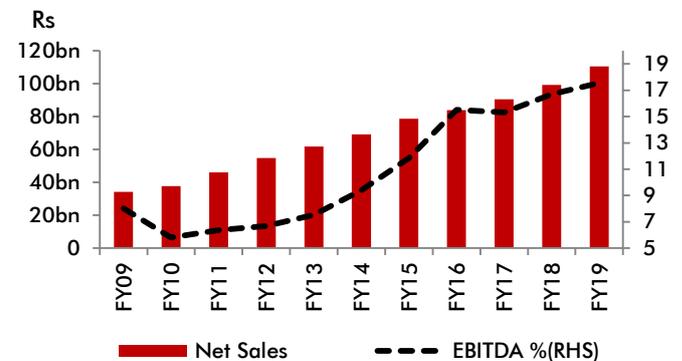
Source: Ambit Asset Management, Company presentation

Exhibit 4: In recent times Britannia has consistently grown through an innovation led approach...



Source: Ambit Asset Management, Company presentation

Exhibit 5: ...notably margins improved as the company ditched price competition to focus on innovations, and new launches

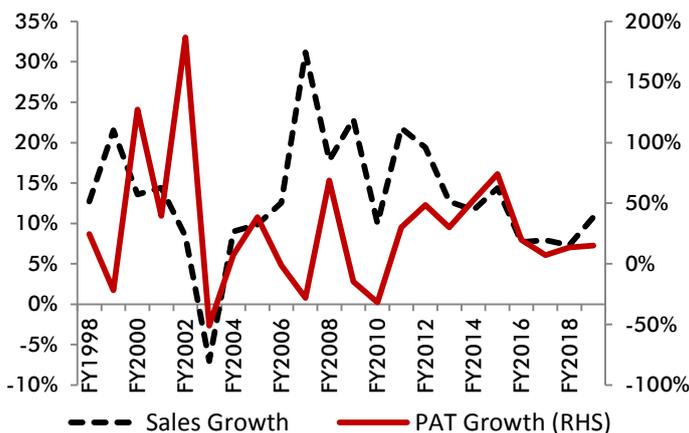


Source: Ambit Asset Management, Company

Potential progressions to disruptions at Britannia

1. Who comes next? What will he/she bring? Since 1993 the company has seen 3 distinct phases under the stewardship of Sunil Alagh (1993-2003), Vinita Bali (2004-2014) and Varun Berry (2014-present). Each has brought along with them a unique brand of management and drive that has fueled the growth at the company. Currently Varun Berry who has been with the company since 2013 has recently been reappointed as managing director of the company for a period of 5 years from 1st April 2019.

Exhibit 6: As it becomes immediately apparent that the business growth can vary greatly year to year...



Source: Ambit Asset Management, Company

Exhibit 7: ...and so the importance of innovations, new launches and timing is pivotal and comes from the top management team/thought leader

Average for periods	Sunil Alagh 1995-2003	Vinita Bali 2004-2014	Varun berry 2015-2019
Gross Margins	42.5%	38.5%	39.0%
EBITDA	7.1%	8.4%	14.2%
PAT	3.9%	5.8%	9.4%
ROCE	30.2%	34.5%	58.6%
RONW	31.0%	36.5%	43.4%

Source: Ambit Asset Management, Company, Note: Data for 1993/4 not available, data from 1995-2006 is depicted as standalone

2. Change in industry composition: Unorganised players/regional organised

Although a shift from organised to unorganised may seem counter intuitive it is a potential risk and disruptor. It can include:

- **Unorganised players showing a united front in biscuits:** The organized biscuit industry in India produces around 60% of the total production, the balance 40% being contributed by unorganized bakeries. In the biscuit industry, the coming together of unorganised local bakeries to a common platform to provide pan India delivery service for freshly baked biscuits or cookies in line with demand for fresh foods can create a disruption.
- **Regional organized:** A large and growing chunk of the market (27%) is dominated by local, regional players with North and East being the regions where they dominate. Regional preferences can interfere in the growth of a pan India player who has uniform nationwide strategies.
- **Preference amongst unorganised players to deal with non-profit cooperatives:** On the other hand the dairy Industry is more fragmented with the organised sector accounting for just 20%. In the drinking milk industry unorganised players are prevalent. Amul is not only the market leader but also one established by years of trustworthy dealing with rural participants/farmers. Amul is set up as a non-profit cooperative and so farmers might be reluctant to deal with 'for profit' commercial enterprises like Britannia while options like Amul exist.

3. Change in consumer preferences (Gradual/Sudden)

A) Transition to healthier/instant meal options (gradual)

- Traditionally healthy snacks are seen as boring, tasteless and tedious to have on a regular basis. However there has been a massive shift towards healthier eating options over the recent years. This is in line with what has already taken place in developed economies where there is a clear preference for fresh foods, diet options and non-processed foods (everything that biscuits are not).
- Going ahead the preference for health, matched with affordability and innovations, designed to overcome taste barriers, can play a role in how the shift takes place. For instance, Britannia has launched chocolate oat cookies to cater to the "Tasty & Healthy" tagline, however, a lot more companies can come with new and innovative products to cater to the trend and see a sudden shift in popularity.

Exhibit 8: Healthier biscuits could replace high calorie biscuits in the mid premium to premium segment



Source: Ambit Asset Management, Company

Exhibit 9: Ready to cook food substitutes can also replace the need to eat biscuits to address between meal hunger/craving



Source: Ambit Asset Management, Company

Exhibit 10: Change in preferences towards healthier options-not boring ones

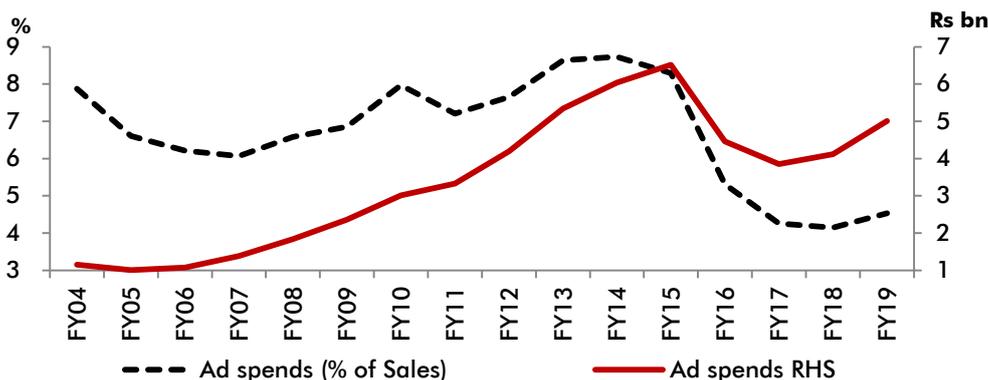
Particulars	Overview
Biscuits	<ul style="list-style-type: none"> ▪ Launch of nutrition based healthier options would need to go hand in hand with innovative and widespread marketing and information campaigns to make people aware on the launch of biscuits which can also be healthier.
Easy to prepare hot food options rather than biscuits	<ul style="list-style-type: none"> ▪ When we look at biscuits as a snacking item in between meals it can also be replaced by other competing food items. ▪ Reduction in consumption of products considered 'less healthy' will effectively limit the demand significantly given penetration for biscuits in India are as high as 90% already. ▪ Instant noodles (Maggi), ready to eat porridge, upma, Indian snacks (Haldirams) and other easy to prepare snacks can be looked upon as more favorable options than flour and sugar based biscuits.
Dairy Products	<ul style="list-style-type: none"> ▪ Increasing awareness of nutrition and health benefits of various Dairy categories like Cheese and Yoghurt. ▪ Changing lifestyles, leading to a shift from home- made traditional Dairy products (like Ghee and Curd) to packaged forms. ▪ Demand for niche product offerings like homogenized cow milk (Sarda farms, Pride of cows) and Greek yoghurt (Epigamia)
Rusk	<ul style="list-style-type: none"> ▪ Double baked bread or Rusk is a traditional category. Launch of healthier offerings like Multigrain Rusk (currently done by Britannia)
Bread	<ul style="list-style-type: none"> ▪ The category has been undergoing significant transformation to healthier variants. ▪ Britannia has been at the forefront of this health revolution so far but preference for local and artisanal loafs of bread can disrupt the industry.
Granola bars/protein bars	<ul style="list-style-type: none"> ▪ Granola based bars and protein bars serve as a healthier option to meet hunger pangs felt between meals essentially replacing the desire to snack on biscuits in between meals.

Source: Ambit Asset Management, Company

B) Brand is about trust with food companies (possibility of sudden change)

Britannia, India's Most Trusted Food Brand: In the reputed 'Most Trusted Brands' survey conducted every year by The Economic Times Brand Equity, Britannia won the coveted position of Most Trusted Food brand in the country in 2019.

Exhibit 11: Given the importance of branding and importance top of the mind recall for the consumer: Companies like Britannia spend heavily here



Source: Ambit Asset Management, Britannia Company

"Brands provide your Company a competitive edge and hence keeping them vibrant, relevant and the preferred choice of consumers is paramount."

- Britannia AR17

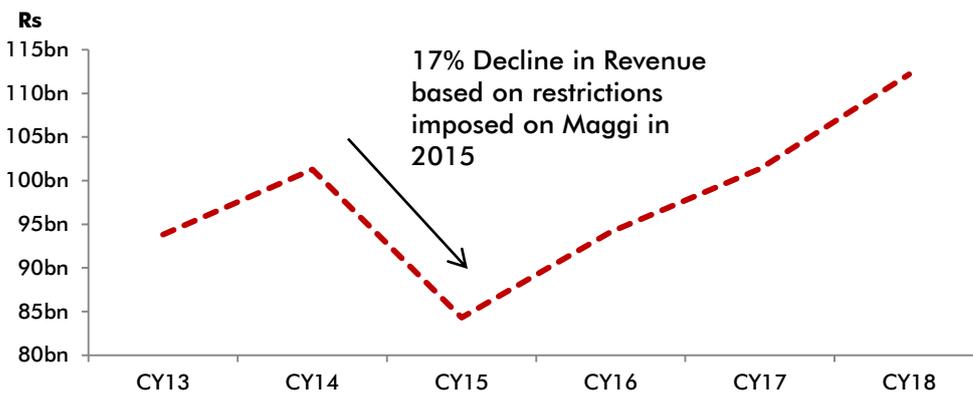
"Brands are the pillars of your Company's current business and its future."

- Britannia AR14

Mc Donald’s USA mini case study on beef oil controversy: breach of trust! (Sudden change):

- Mc Donald’s is undoubtedly one of the most well known and loved brands in the world however it too got caught in the beef oil scandal, which led many to boycott their products specially in Hindu dominant countries like ours (India).
 - In the US, Mc Donald’s used beef tallow in its fries but replaced it with vegetable oil in the 1990s. In 2001, the company was presented with legal action by a group of Hindus who were protesting against the use of beef in what they assumed was a vegetarian product. At the time, a McDonald's company spokesman said that, "The natural flavoring consists of a minuscule amount of beef extract".
- 4. Regulatory disruptions in eatables:** Regulations are quite stringent in the food and beverages space and have a huge potential for disruption.
- **Disruption at Nestle:** Regulatory disruption in food immediately reminds one of the grave troubles that Nestle’s Maggi faced few years back when India’s food regulator banned Maggi in 2015 after tests showed it contained excessive lead and for alleged mislabelling over flavour enhancer MSG the product returned to shelves only after the restriction was lifted. [\(Source\)](#)
 - **100% hike in excise duty in 2001:** Biscuit is a comparatively low margin food product in the PMCG (Packaged Mass Consumption Goods) sector. The commodity is also price sensitive, as a consequence of which when the Excise Duty was doubled in 2001, biscuit manufacturers, including the major brands could not extend the steep increase in the Duty to the customer. The annual growth of the biscuit industry showed a decline of 3.5% in 2000-01, mainly due to 100% hike in Central Excise Duty (from 9% to 16%). [\(Source\)](#)
 - GST impact led to benefit flowing to unorganised players who fail to meet stringent compliance requirements. Given the inability to raise prices and the consumer slowdown-Parle’s Mayank Shah attributed the slowdown to higher rates in GST and lack of adequate government stimulus. (August 2019)

Exhibit 12: Disruptive influence of regulation in food industry was recently noted in Nestle’s Maggi noodles, required recall/ban by food regulator



Source: Ambit Asset Management, Nestle Company

- 5. Buying process gets altered:** There are a wide variety of ways in which the buying process can be altered. One big noticeable change towards online shopping, use of social media marketing and social influencers is a well-known trend. Use of delivery apps, shift to veganism and the like can be potential disruptors.

Exhibit 13: The Buying process gets significantly altered

Particulars	Overview
Hyper local food delivery apps	<ul style="list-style-type: none"> ▪ Given the plethora of richly funded food delivery apps in India with high rate of cash to burn to grow their business through discounts and low/nil delivery charges (earlier was free delivery too). This can encourage spend our money towards, warmer, tastier and healthier options delivered to your doorstep. (eg. Swiggy, Zomato)

E-commerce	<ul style="list-style-type: none"> There are a wide variety of ways in which the buying process can be altered. One big noticeable change has been towards online shopping. It is given the increased ability to interact with target audiences online that gives companies good reason to launch digital only brands at times (eg. Britannia Little hearts was reinvented as a digital only brand) Good Day Chunkies premium gourmet cookie partnered with YouTube to launch a first-of-its-kind Dessert Carnival with 'Do It Yourself' recipe videos from the country's top pastry chefs and YouTube creators that got an organic reach of 15mn views.
Preference for convenience shopping by millennials	<ul style="list-style-type: none"> According to the International Food Information Council's 2017 Food and Health Survey, 55%of millennials say convenience is a top driver when buying food, while baby boomers say taste matters more.
An Innovative company with potential to price low competing food items	<ul style="list-style-type: none"> Biscuits are popular in nature due low unit pricing. However it is possible that other non-biscuit food companies can supply low price point food/drink at on demand too. In the US one such example can be a company ('Too Good To Go')that helps food stores sell their surplus food (lower price) instead of throwing it away. This can lead to cheaper competing options which can be delivered to customers home and can meet hunger pangs more effectively than biscuits/snacks.
Trending Veganism	<ul style="list-style-type: none"> An emerging trend for some time now has been veganism which might lead to lower reliance and use of processed foods or milk. This would lead to destruction of demand for a company. The trend has been so popular that Netflix even released a popularly watched documentary on the benefits of veganism called 'Game changers' which is now become the new rage. A mass switchover can lead to massive corrections in sales for dairy/biscuit companies.

Source: Ambit Asset Management

6. Competitive intensity: Any weakness can lead to disruption/attack by peers

- The major Brands of biscuits in India are Britannia, Parle Bakeman, Priya Gold, Elite, Cremica, Dukes, Anupam, Horlicks, Craze, Nezone, besides various regional/State brands. A large and growing chunk of the market (27%) is dominated by local, regional players with North and East being the regions where they dominate.
- A lot of well-established and organized brands are also strong in their categories/segments/geographies and so once they have gained supremacy/recall become hard to compete with. For instance ITC is popular in cream biscuits and Parle agro in Glucose biscuits.

HUL acquisition of GSK consumer business

- HUL recently bought GSK consumer for a consideration of little over Euro 3bn. The company is now trying to make it stand for various breakfast products & biscuits under the brand name Horlicks.
- Threat of a large organized player like HUL (with a reach of upto 6mn touchpoints) with strong balance sheet and earning power swooping in to target and capture market share within a particular segment is always a possible disruptor. A large player like HUL once it establishes itself in a category over few years would be hard to dislodge.
- Intense competition requires companies like Britannia to plan carefully and in many cases requires test launches and limited regional launch of products before national rollout. One such example is croissant sales by Britannia which began in 1QFY20 and has been confined to only West Bengal and Tamil Nadu as a test market for next 3-4 months before PAN India expansion.
- A big failure of 1-2 new category products with heavy investments can lead to catastrophic destruction and so companies need to exercise caution or risk being disrupted and obsolete by competitors waiting to claw any weakness of its peer group.

At Ambit we believe in wealth creation by long term equity investment and through the power of compounding. We constantly try and stay ahead of the curve on what may possibly impede the growth our portfolio companies. While Britannia has been a leader in the Biscuits industry, we do a long term scenario analysis on what could be the possible disruptions and if our portfolio companies are prepared for it. In our view, rising competition, change in consumer preference, health awareness and regulation are things to watch out for in the case of Britannia.

“The other interesting thing about our journey was our realization that we could not talk to today’s tweens through traditional media vehicles. So we decided to be present on platforms most frequented by today’s tweens and make Little Hearts a digital-only brand.”

**-Ali Harris Shere
VP Marketing, Britannia Industries**

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