

Tata Consumer Products Ltd

BUY

CMP Rs575

Target Rs617

Upside 8%

Market share gains continue in both tea and salt; RM headwinds should normalize by 1QFY22

Tata Consumer Products (TCPL) reported a mixed performance in a difficult quarter where it faced unprecedented tea price inflation. While revenues were ahead of expectations, profitability fell short of expectations despite strong cost controls and premiumization. Other than the India tea business, most other businesses delivered a strong performance led by strong growth in the salt business, sequential recovery in Starbucks and Nourishco and strong profitability and growth in international beverages. While margin headwinds impacted tea margins, market share gains was a key positive. In the foods business, continued premiumization in salt, strong performance in pulses, and recent acquisition of Soufful brand should help achieve aggressive growth targets. Integration is also going ahead of schedule and start delivering benefits from 4Q onwards. While near-term margin headwinds remain for the tea business, sustained improvement in foods and international business margins should help offset that in addition to synergy benefits flowing in. Starbucks and Nourishco are also quickly proceeding towards normalcy and the company continues steady footprint expansion. Overall, we do not find any deviation in narrative and execution from the new leadership and continue to view TCPL as a solid structural story with both growth and margin tailwinds which can deliver industry-leading earnings growth over the next few years. We reduce our FY21 EPS estimate by 3% to build in the margin weakness, but increase our FY22 and FY23 estimate by 5% and 8% to build in higher realizations in India businesses and better growth rates in international beverages. We are building in a 12.5% revenue and 22.7% earnings CAGR over FY20-23E. We reiterate our BUY rating with a revised SOTP-based TP of Rs 617 (from Rs 574), implying 48x/42x FY22/FY23E P/E.

Financial highlights

- ✓ Standalone revenue/EBITDA growth of 34%/-5% and consolidated revenue/EBITDA growth of 23%/14%; sharp growth and margin decline mainly in account of tea price inflation in India
- ✓ India beverages business grew 43% with 10% volume growth in tea and Nourishco contributing Rs 33cr with revenue growing 9%
- ✓ India foods business grew 19% with 12% volume growth led by 19% growth in salt (2.7x growth in value-added salts) and high double digit growth in Tata Sampann
- ✓ India business EBITDA margins down 410bps to 10% despite strong cost controls and better sales mix given sharp tea price inflation, which led to sharp fall in tea business gross margins while foods business saw improved margin performance given strong growth in salt business
- ✓ International tea business grew 13% with 4% volume growth led by a 7% currency benefit; margins saw a sharp 690bps increase to 11.8% led by better mix, cost cuts and weak Kenyan tea prices
- ✓ US coffee business also saw a 19% growth with 10% volume growth and 7% currency benefit; margins flattish at 20.6%
- ✓ Tata Coffee saw 10% revenue and 6% volume growth led by ramp-up in Vietnam operations; margins up 320bps to 12.1% given better tea and pepper realizations
- ✓ Profit from associates/JVs at Rs 3.5mn with losses at Starbucks offset by tea price-led profitability improvement in associate plantations

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Presentation highlights

- ✓ **Unlocking synergies** – Integration to be completed by 4Q, realizations started from 3Q, distribution channel partner consolidation done, channel partner digitization completed for urban markets, integrated ERP to go live in 4Q, pan India CFA consolidation by 4Q, integrated demand planning to go live by 4Q.
- ✓ **Sales and distribution benefits** – Trimmed number of distributors by 63%, dedicated sales reps up by 30%, to double direct distribution in 12 months, 65% increase in outlets billed (80% outlets billed monthly), 100% channel partners automated, 50% decrease in debtor days from March moving from wholesale to retail servicing model.
- ✓ **New engines of growth** – Sampann which is up 40% YTD, value added salt up 110% YTD, coffee saw sequential improvement +3%/31%/22% in first three quarters of FY21, Nourishco now up 9% in 3Q.
- ✓ **Soulfull acquisition in foods** – Entry into breakfast, snacking, mini meals health food category with a present reach of 15000 select urban outlets which TCPL can multiply with its 2.4mn reach, valued at 156crs for FY21 revenue of Rs 33cr and margin accretive, “For Better” food products growing at 15% plus.
- ✓ **Commodity prices** – After a 70-80% growth in September-October, now prices are coming down, still 25-30% above last year levels in January.
- ✓ **Industry growth** – US tea -0.3%, bags coffee +9.5%, K cup coffee +8.7%, UK black tea -1.3%, UK non-black +12.8%, Canda black +11.2%, Canada specialty _26.4%, India volume growth of 4% and value growth of 14%
- ✓ **India beverages** - Continued market share gains in tea, 50bps qoq and 90bps yoy.
- ✓ **India foods** – Salt up 19% with highest ever volume in December, Sampann grew high double digits, margins expanded despite 2x ad spends given mix and cost controls, value added salt 2.7x yoy.
- ✓ **Nourishco** – 33 cr revenue with 9% revenue growth, Dec up 40%, Water Plus up 1.6x.
- ✓ **Tata Coffee** – Overall 1% revenue growth, 6% growth in plantations and 3% decline in extractions, Vietnam running at 93% capacity.
- ✓ **Starbucks** – December revenue at 90% of last year, 77% SSG recovery, EBITDA positive in December led by strong cost savings on rentals and other overheads.
- ✓ **UK** – 1% revenue growth with 5% volume growth with 32% growth in Teapigs, 20.3% market share.
- ✓ **US** – 6% coffee revenue growth and volume growth of 7%, 4.7% market share; Tea grew 18% and volume growth of 22%.
- ✓ **Canada** – 24% revenue growth with 19% volume growth, 41% in specialty tea , 29.5% market share.
- ✓ **Outlook**- India seems to be recovering well with in-home consumption normalizing, second wave of COVID in US and UK presents uncertainty as pantry loading not seen, tea inflation remains a near term challenge, will need to navigate near term margin pressure, distribution expansion key growth engine for foods, beverages and RTD, Soufull addition will help drive foods growth.

Q&A takeaways

- ✓ **Salt business outlook** – Seen strong share gains at both mass and premium end, now seeing traction in value added led by distribution expansion, ATL spends and product innovation.
- ✓ **Soulfull outlook** – Strong positioning and product pipeline, can grow just by distribution expansion in 1st phase, will not dilute niche positioning as of now; 39cr turnover in FY21 and margin accretive.
- ✓ **International beverages margin outlook** – some improvement can sustain with better mix, premiumization and channel mix while category volume rates can come off somewhat.
- ✓ **Tea pricing strategy** – margins, volume, market share will be balanced – gaining market share despite 30% price/mix hike, prices still 25-30% higher than last year levels, expected to cool off in April-May, will remain competitive; costs will be normalized in 1Q, till then margins can remain under pressure as tea inflation has not been fully passed on.
- ✓ **Synergy benefits** – Well ahead of plans to realize all synergies from the merger – should start flowing in this quarter, 2-3% synergies will be delivered ahead of time.
- ✓ **Associate/JV losses** – Starbucks has been in losses, progressively improving; plantations businesses have done well, EBITDA +ve in December for Starbucks
- ✓ **Budget disallowing depreciation on goodwill** – Studying the proposal in further detail; No accounting impact but will impact cash flows
- ✓ **Tata Coffee Grand** – Believe can make a significant dent in coffee category given Tata brand, distribution, ATL and product disruption and take away a decent market share.

Exhibit 1: SOTP Valuation

Segment	Metric	Multiple (x)	Value (Rs mn on FY23E)	Per share (Rs)	% of total value
India Beverages	EV/EBITDA	30	251,768	273	44%
India Foods	EV/EBITDA	35	221,990	241	39%
Tata Coffee	20% disc to CMP		9,564	10	2%
EOC (TGBL 50% stake)	EV/EBITDA	8	13,241	14	2%
Tetley/Others	EV/EBITDA	12	28,476	31	5%
Starbucks JV	Price/Sale	8	29,533	32	5%
Net Debt			-13,964	15	
Equity Value			568,537		
TP				617	

Exhibit 2: Summary financials

Revenue (Rs mn)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21
Standalone	9,086	8,473	8,897	7,841	14,640	14,272	14,635	13,353	16,054	17,361	19,627
Growth YoY (%)	5.7%	6.6%	4.9%	9.7%	61.1%	68.4%	64.5%	70.3%	9.7%	21.6%	34.1%
Growth QoQ(%)	27.1%	-6.7%	5.0%	-11.9%	86.7%	-2.5%	2.5%	-8.8%	20.2%	8.1%	13.1%
Tetley/ others	4,718	4,577	5,575	5,309	4,617	4,387	5,281	5,530	5,210	5,018	5,741
Growth YoY (%)	-1.2%	-11.2%	10.4%	-0.5%	-2.2%	-4.1%	-5.3%	4.2%	12.8%	14.4%	8.7%
Growth QoQ(%)	-11.5%	-3.0%	21.8%	-4.8%	-13.0%	-5.0%	20.4%	4.7%	-5.8%	-3.7%	14.4%
Tata Coffee Standalone	1,591	1,774	1,652	2,013	2,003	1,857	1,662	1,673	1,756	1,856	1,578
Growth YoY (%)	-12.3%	3.3%	-0.5%	8.0%	25.9%	4.7%	0.6%	-16.9%	-12.3%	0.0%	-5.0%
Growth QoQ(%)	-14.6%	11.5%	-6.9%	21.8%	-0.5%	-7.3%	-10.5%	0.7%	5.0%	5.7%	-15.0%
Eight O Clock	2,631	2,785	3,002	2,593	2,664	2,956	3,353	3,494	4,119	3,578	3,750
Growth YoY (%)	41.2%	32.4%	42.2%	2.0%	1.3%	6.1%	11.7%	34.8%	54.6%	21.1%	11.8%
Growth QoQ(%)	3.5%	5.9%	7.8%	-13.6%	2.7%	11.0%	13.4%	4.2%	17.9%	-13.1%	4.8%
Consolidated	18,026	17,609	19,126	17,755	23,924	23,471	24,930	24,050	27,139	27,813	30,696
Growth YoY (%)	5.8%	4.1%	10.5%	5.2%	32.7%	33.3%	30.3%	35.5%	13.4%	18.5%	23.1%
Growth QoQ(%)	6.8%	-2.3%	8.6%	-7.2%	34.7%	-1.9%	6.2%	-3.5%	12.8%	2.5%	10.4%
EBITDA Margin (%)	1QFY19	2QFY19	3QFY19	4QFY19	1QFY20	2QFY20	3QFY20	4QFY20	1QFY21	2QFY21	3QFY21
Standalone	18.4%	11.6%	12.8%	7.5%	15.9%	14.3%	14.1%	12.0%	20.3%	14.6%	10.0%
Tetley/others	3.3%	2.1%	4.9%	9.8%	8.5%	7.2%	4.9%	12.8%	8.9%	11.4%	11.8%
Tata Coffee Standalone	13.0%	8.5%	6.0%	6.7%	11.4%	9.4%	8.9%	0.4%	8.7%	6.2%	12.1%
Eight O Clock	17.3%	15.7%	15.1%	19.1%	21.0%	20.9%	21.0%	21.9%	23.2%	21.6%	20.6%
Consolidated	13.8%	9.5%	10.3%	9.8%	14.7%	13.4%	12.8%	12.8%	17.8%	14.4%	11.8%

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