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Confectionery Sector Risk Index

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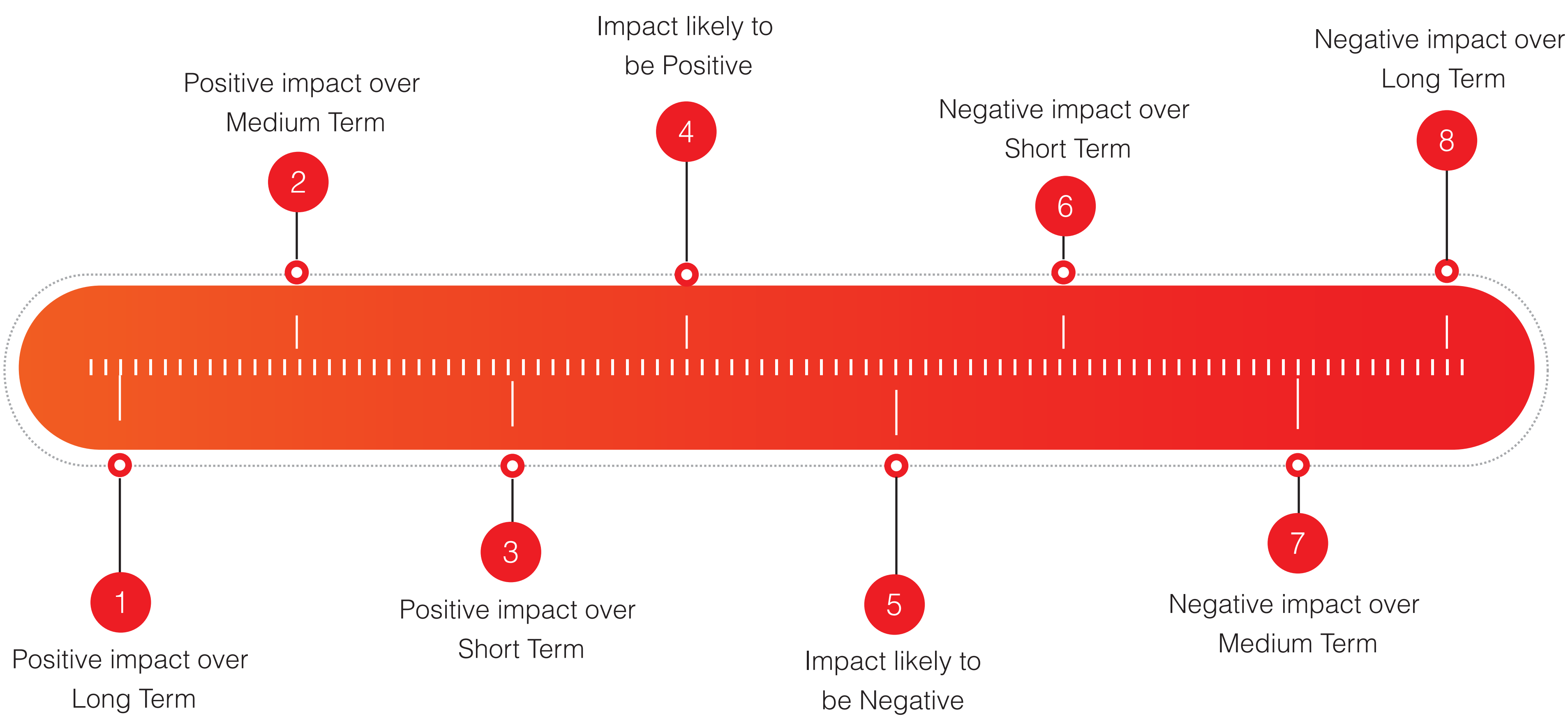
Explanation of Sector Risk Index

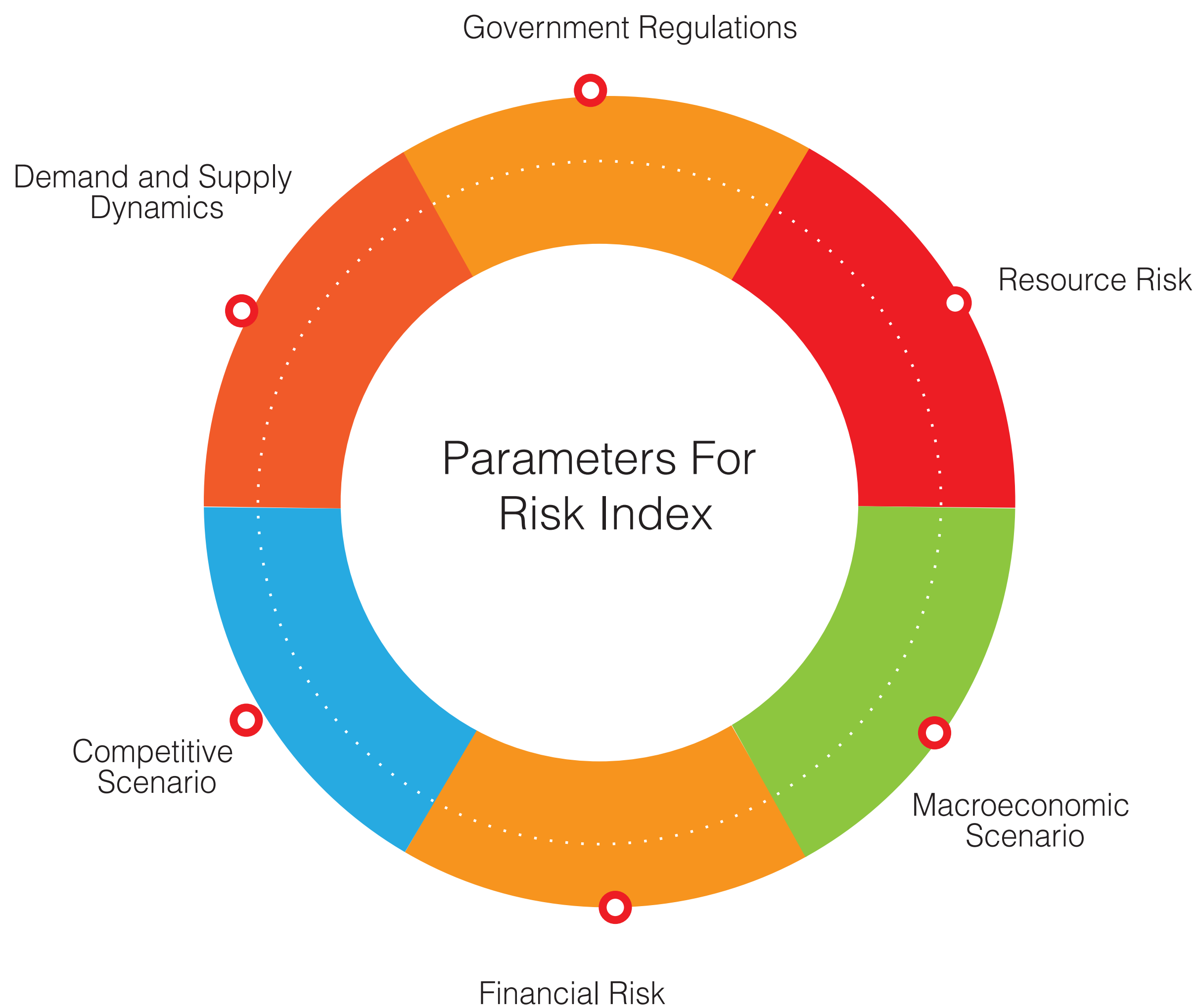
Sector Risk Index reflects the effect that the various factors have on the business prospects and operating environment of the sector over the next 12 months. The risk index arrived at is an aggregate of the individual scores assigned to the relevant sector parameters identified.

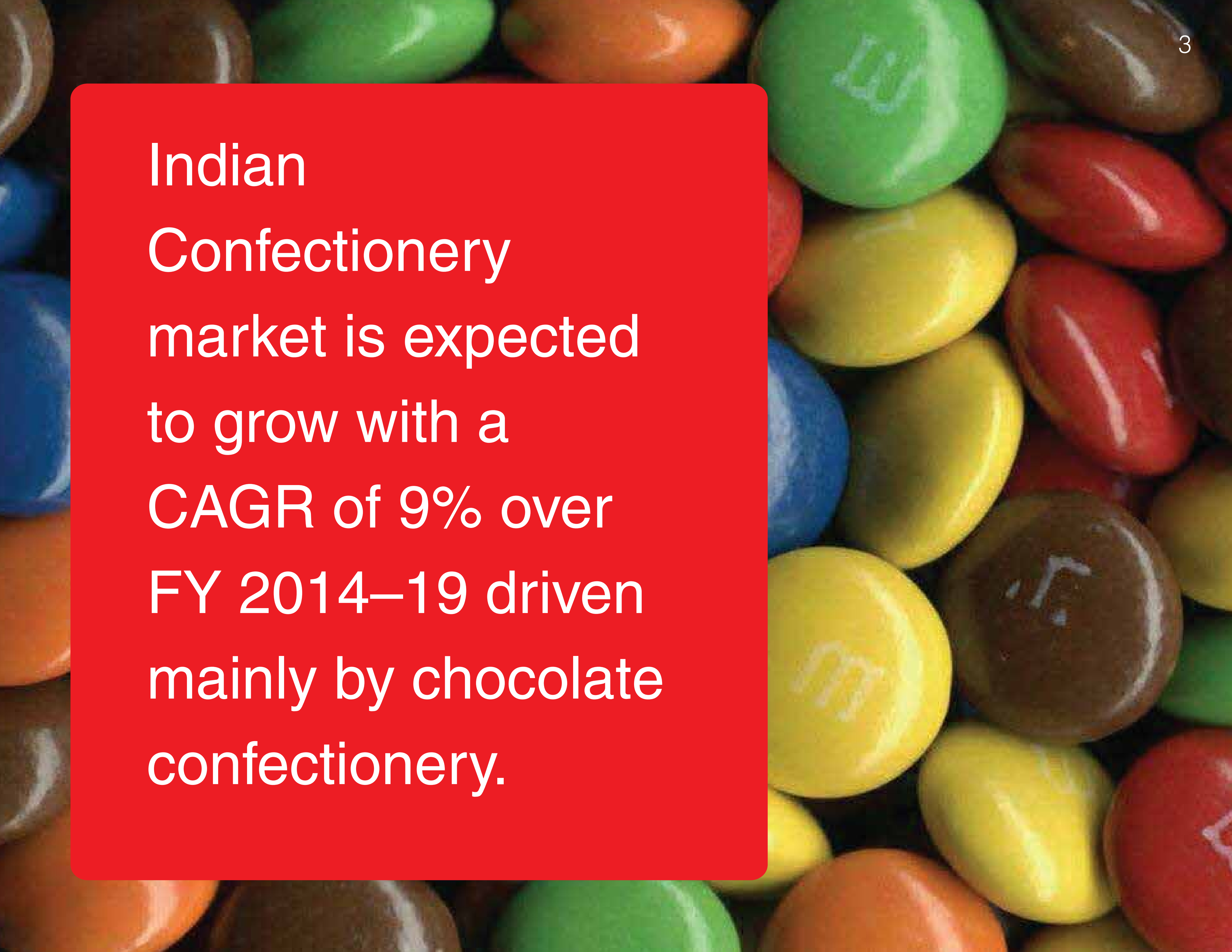
The sector risk index has been graded on an 8 point scale with 1 indicating low risk and 8indicating high risk.



Parameters for Sector Risk Index

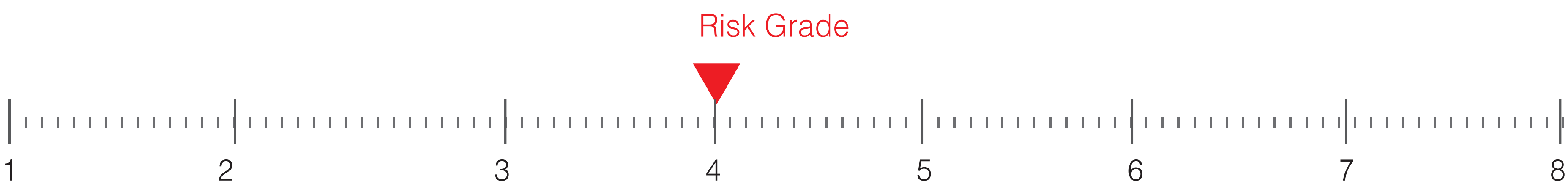
The selected parameters are government regulations, demand supply dynamics, competitive scenario, macroeconomic variables, resource risk and profitability and cost structure. The scores given to individual parameters reflect the extent of positive/ negative impact on the business operating environment.





Indian Confectionery market is expected to grow with a CAGR of 9% over FY 2014–19 driven mainly by chocolate confectionery.

Risk Index of Confectionery Sector



Demand and Supply Dynamics

Due to low consumption level of confectionery, India has a long-term growth potential.

Macro Economic Scenario

India's gross domestic product (GDP) has been growing at an average rate of approximately 6.33% during the period from FY 2011–12 to FY 2014–15

Resource Risk

India being among the largest producers of sugar and milk has fulfilled the raw materials requirement making the sector less import dependent. Price of milk and sugar have increased over the years.

Competitive Scenario

Large players have a significant presence in chocolate confectionery market while smaller players primarily operate at a regional level and have sizeable base in sugarbased confectionery market. .

Financial Risk

With increase in the price of raw materials, the margins of players have remained stretched.

Government Regulations

The stability in duties under the Central Board of Excise and Customs (CBEC) will benefit the overall growth of the sector.

Positive Negative Neutral

Executive Summary

1 Indian confectionery sector is one of the fastest growing sectors in the world with an estimated growth rate of 18–20% in financial year 2014–2015 (FY 2014–15).

2 Indian confectionery sector, which was ranked 25th globally in FY 2008–09, has jumped to 14th position in FY 2013–14.

3 The sector in India is broadly divided into three segments – sugar-boiled confectionery (SBC), chocolates, chewing gums and mints. SBC segment is dominated by unorganised players, while the major market share in chocolate segment is being captured by big brands like Cadbury and Nestle.

4 With changing lifestyle and health awareness amongst people, Indian confectionery market has shown potential to grow fastest.

5 Moreover, the stability in duties under the Central Board of Excise and Customs (CBEC) will benefit the overall growth of the sector. Currently, the sector is more concentrated on domestic consumption.

6 To conclude with, favourable factors such as the recovery in India's economy with global rise in demand, especially from developed countries, lower interest rates, minor foreign currency risk and stable duty structure may support the growth rate of the sector.

Product Profile

1 Confectionery sector in India is broadly divided into three segments – sugar-boiled confectionery (SBC), chocolates, gum-based confectionery. Of the total market, sugar confectionery dominates the market share of around 53.6% and chocolate and gum-based confectionery segments hold the rest.

2 In value terms, chocolate was the largest category in the Indian confectionery market in FY 2012 – 13, with a 40.1% share. However, in terms of volume, it was the smallest category recording 20.6% of share.

3 Sugar confectionery segment has registered higher volume sales over the recent years due to lower price than chocolate segment. However, it has been the slowest growing segment of the market with an annual growth rate of 5.5% from FY 2009 – 14.

Figure 1. Segment -Wise Volume Share of Indian Confectionery Market (In Percent)

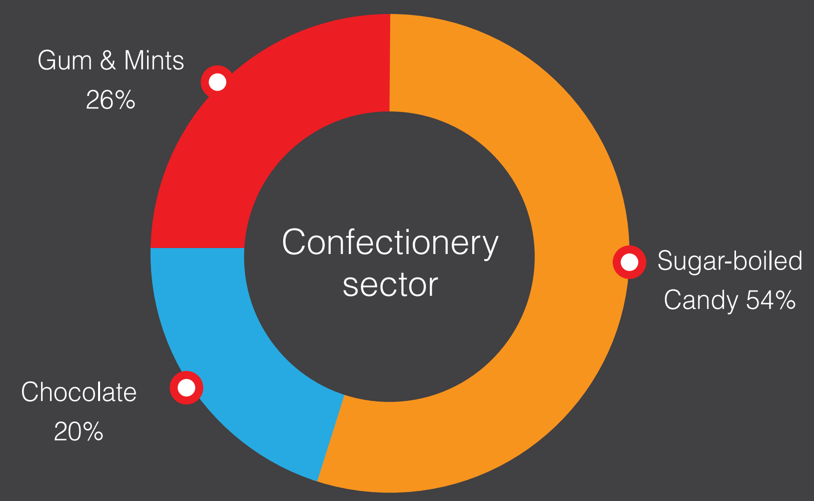
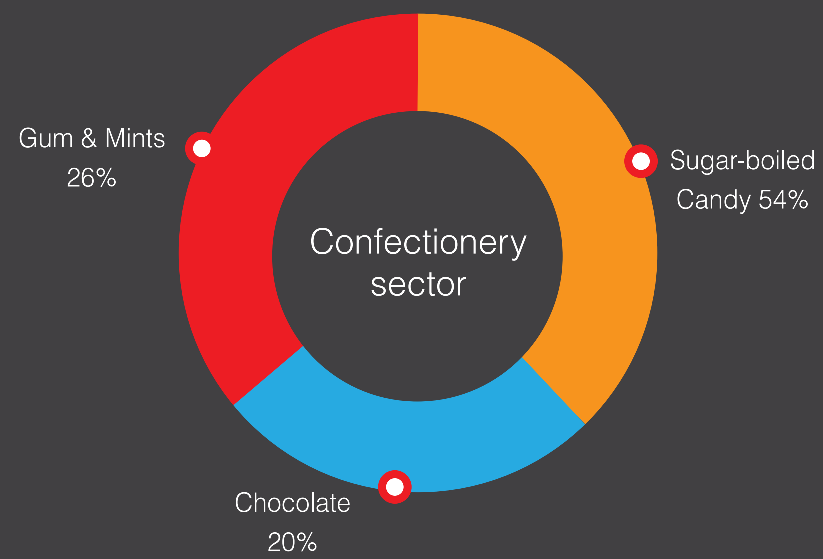


Figure 2. Segment -Wise Value Share of Indian Confectionery Market (In Percent)



Product Profile

4 Chocolate consumption is mainly centered in semi-urban and urban areas due to foreign exposure, rising disposable income and consumers' impulse buying.

5 India's chocolate confectionery market is valued at INR 58 billion in FY 2013–14, and is expected to grow at a CAGR of 16% to reach INR 122 billion by FY 2018–19.

6 India remains a very price sensitive market and appropriate pricing is key to the success of new products.

7 Players have identified age-specific niche market segments within the chocolate confectionery market and are undertaking intense advertising campaign to ensure effective brand communication and positioning.

Macro Economic Analysis

Macro Economic Growth

1 India's gross domestic product (GDP) has been growing at an average rate of approximately 6.33% during the period from FY 2011–12 to FY 2014–15 and has touched United States Dollar (USD) 2.05 in FY 2013–14.

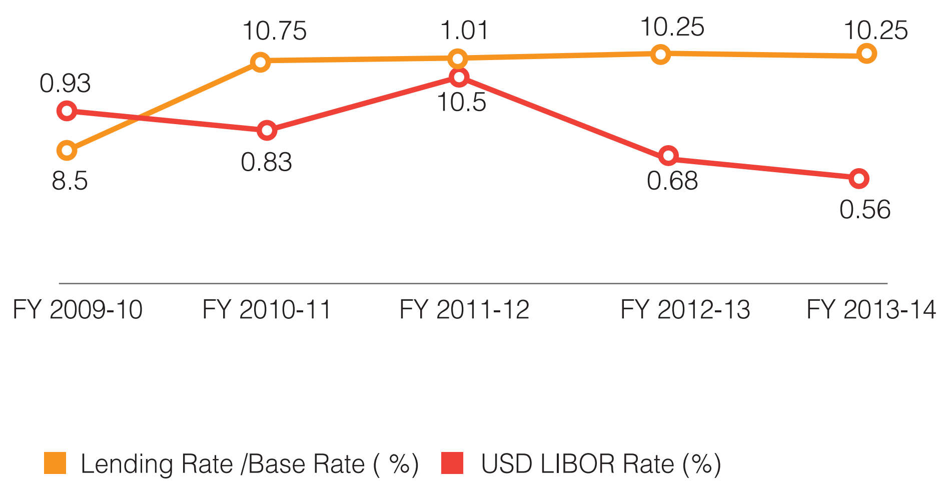
2 Rising disposable incomes and changing lifestyles have contributed considerably to the growth of Indian confectionery sector.

3 India has a huge young population ageing 15–35 years, whose consumption behaviour is changing very fast as their disposable income is increasing. Their preference is changing from being saving-oriented to consumption-oriented.

Interest Rate Risk

Interest rates have remained stable in the domestic market at an average of 10% from FY 2010–11 to FY 2013–14. However, the interest rates in the international market have dropped down significantly on account of the slump in the global economy.

Figure 3. Interest Rate Trends (Domestic and International)

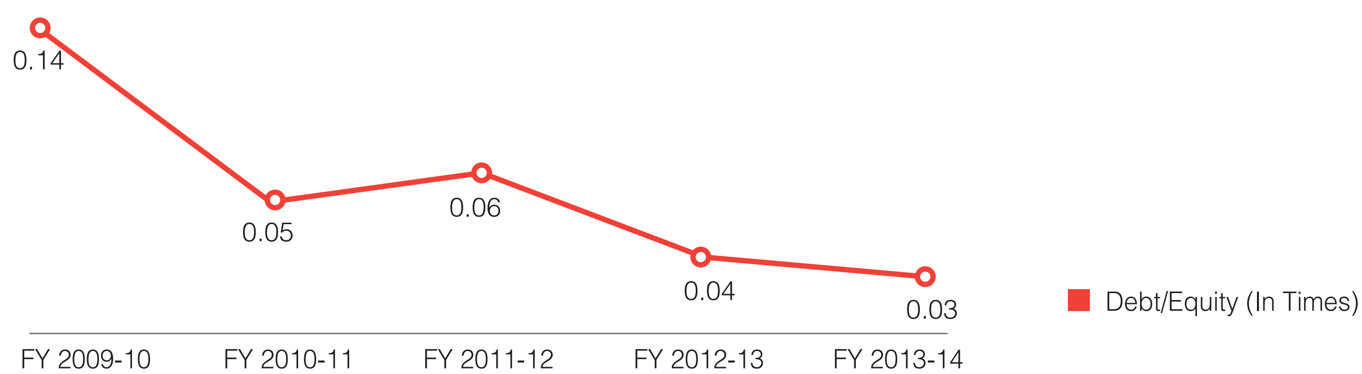


Source: Reserve Bank of India

Macro Economic Analysis

The confectionery companies have been showing a decreasing trend in debt-equity ratio ranging from 0.14 times to 0.03 times during the FY 2008–09 to FY 2012–13. The sector is considered as less capital intensive, hence requires limited amount of capital.

Figure 4. Interest Rate Risk



Foreign Exchange Fluctuations

The confectionery sector in India is more concentrated on domestic consumption so the risk associated with foreign exchange fluctuation is negligible.

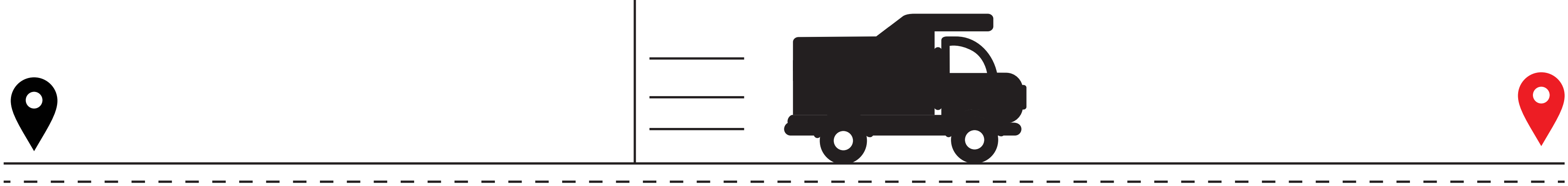
Source: Reserve Bank of India

Government Regulations

Duty Structure

The excise duty levied on sugar confectionery and cocoa preparations stood at 12% as per union budget FY 2013–14 which remained unchanged since FY 2005–06. This has helped in maintaining the price at stable level considering the rise in price of raw materials.

Under the import policy notes the custom duty on chewing gums is 45% while for sugar boiled confectionery items and cocoa products is 30% in FY 2013–14. The custom duty has also remained the same since FY 2005–06. The duty is high but since the sector is not much dependent on imports, it will hardly affect the sector.



Government Regulations

Government Initiatives

1 Confectionery (excluding chocolates, Toffees and chewing gums) is reserved for exclusive manufacture by the Small Scale Sector.

2 With the concept of make in India and 100% FDI allowance in food processing sector, country's food sector is poised to hit the INR 186.48 billion mark. Some of the successful ventures results of the policy are Perfetti, Cadbury, Godrej-Pilsbury, Nutricia International, etc.

Demand-Supply Dynamics

Demand Growth

1 Global confectionery market was worth nearly USD200 billion (INR 11,987.52 billion) in FY 2013–14, and grew by an annual rate of 2% over the previous five years.

2 The USA is the biggest consumer of confectionery and creating the largest demand in the world. Brazil, China, India and Italy are the major players to fulfill the demand of the USA and in FY 2013–14 the nations have contributed around 45%, 20%, 16% and 10% respectively against the total demand of the USA.

3 Indian confectionery market in comparison to other developed markets, is in the initial phase of growth, and will continue to evolve. It is expected to reach INR 60.19 billion in the FY 2015-16. It is believed that the sugar confectionery is likely to see a constant value CAGR of 8% over the next few years. The growth will be driven by the increasing consumption of sugar confectionery facilitated by the launch of new flavours by leading companies.

4 The sector has been growing on a year on year basis due to the gradual increase in the global demand of confectionery products consequently leading to the increase in export

Demand-Supply Dynamics

Demand Drivers

1. Changing lifestyle and preferences of the consumer: Rapid urbanization, increase in the number of working women, less time devoted in the household have changed a lot of habits of the Indian families. All these factors have created a demand for processed food

2. Wide Product Range: Companies are offering a wider range of products to the consumers as a result of their investments into product innovation, research and development. New entrants are trying to entice the markets and capture market share by offering new flavours and localized versions of international products.

3. Growing Brand Consciousness: Increase in per capita income, literacy rate and consumer awareness has driven the consumer to looking for value added products for which consumer is going for branded products

4. Growth in Organised Retail: Organized retail has helped a greater penetration in the rural and tier II markets in India and has improved the shopping experience of the consumers. It has also helped to maintain the shelf life of the packaged food by providing the required infrastructure.

5. Strong Marketing Campaigns: Large confectioners spend 12–13% of their sales revenue on advertising and brand building. This is intended to create a desire amongst the consumer for confectionery items and at the same time also target audience of varied interest

Demand-Supply Dynamics

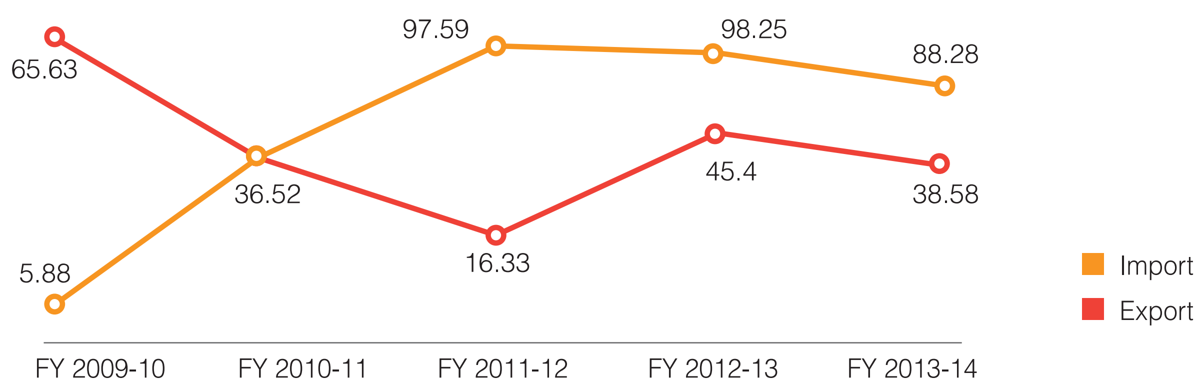
Import-Export Scenario

1 Indian confectioners are increasing their efforts in product development and promotional activities, and exporters will face stiffer competition from the domestic sector. The import of confectionery has decreased at a CAGR of around 10.08% during the period FY 2009–10 to FY 2013–14.

2 The consumption of imported raw material stood at 6.11% of the total raw material consumed in the FY 2013-14 indicating that the sector is less dependent on imports for its raw material requirement.

3 There has been a growth at a CAGR of 71.91% in the export of Indian confectionery during the period FY 2009–10 to FY 2013–14.The export as percentage of total sales stood at 1.94% in the FY 2013-14. India exports major proportion of confectionery to the USA, UAE and Europe.

Figure 5. Import-Export Trend (INR Billion)



Source: Directorate of Foreign Trade

Demand-Supply Dynamics

Capacity Addition/ Capital Expenditure

1 Mondelez India is setting up a multi-category food campus in Sri City in Andhra Pradesh, which will be its largest chocolate production plant in India and the largest for Mondelez International in Asia Pacific. This plant will also position India as an exporting hub for the region. Mondelez is spending close to INR 10.00 billion on this expansion.

2 Chocolate manufacturer Mars is planning to set up its first chocolate plant in India. The company has inked a memorandum of understanding with the Maharashtra state government in Mumbai for INR 10.04 billion set up in Pune.

Price Trends

1 The consumer in confectionery segment is price conscious. Because of the competition, companies cannot afford to price the product at a premium, thereby sacrificing volume.

2 With growing demand for branded and superior quality products the prices for the high end confectionery products are likely to rise.

Competitive Scenario

Sector Structure

1 Confectionery sector in India is well consolidated with top players holding a major share of the market; local subsidiaries of global confectioners are among the leading players in India.

2 Large players have a significant presence in chocolate confectionery market while smaller players primarily operate at a regional level and have sizeable base in sugar-based confectionery market.

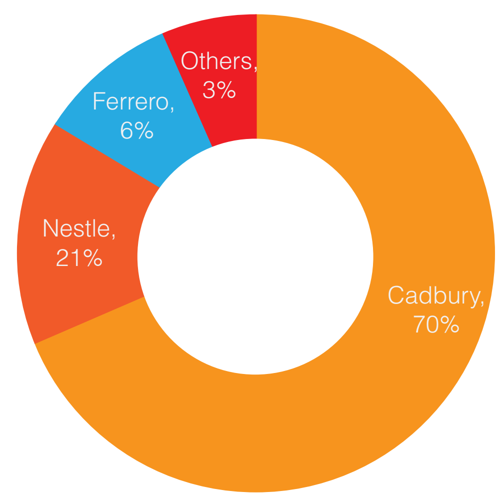
3 The confectionary market in India is mainly dominated by multinational players such as Mondelez (formerly Cadbury India), Nestle, Perfetti Van Melle, Mars India and Lotte as well as large domestic players such as Amul, Parle, ITC, Ravalgon and Candico.

4 Multinational companies such as Ferrerro, Hershey’s and Lindt have a strong presence in the premium chocolate market. In the chocolate confectionery segment, Cadbury holds a market share of around 65-70%, followed by Nestle at around 20%

5 In recent years, multinational players have emerged dominant in sugar confectionery market, which was traditionally reigned by regional players. With the emergence of branded quality products, the competition in sugar confectionery has swelled further.

6 Conversely, low penetration and consumption levels provide ample growth opportunities and make competition less of a constraint.

Figure 6. Major Players in India's Chocolate Market



Source: CMIE Prowess

Resource Risk

1 The major raw materials for confectionery sector are sugar, milk, glucose and cocoa which are obtained domestically.

2 India being among the largest producers of sugar and milk has fulfilled the raw materials requirement making the sector less import dependent.

3 Various government initiatives like providing financial support to farmers in the form of subsidy, heavy investment in research and development to improve upon the seed quality, better farming techniques, improve in quality of cattle breed have resulted in increased production of milk and sugar.

4 The less dependence on import has resulted in a low risk of currency fluctuation. But due to inflation in recent years, the price of milk as well as sugar has gone up significantly in the last few years.

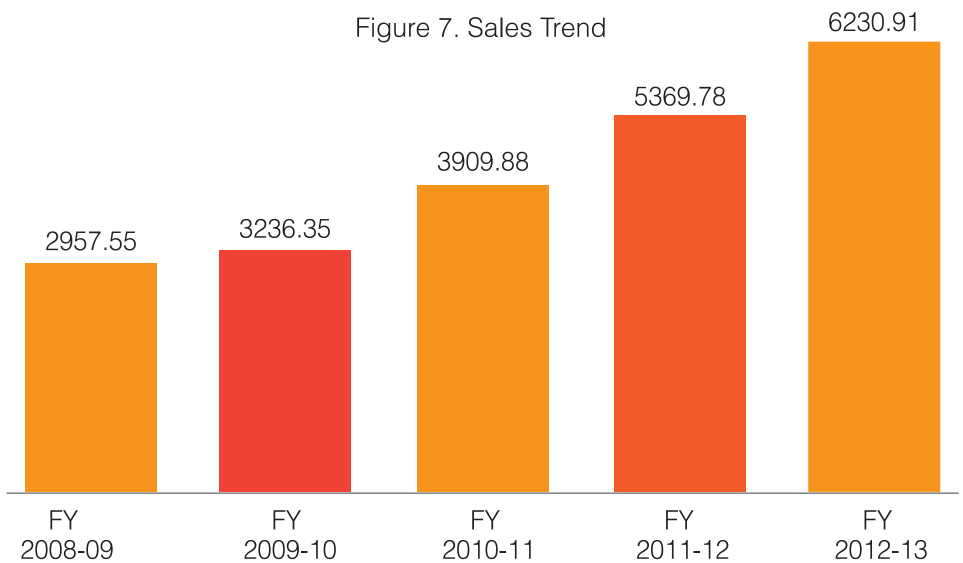
5 The price of milk has increased by INR 4-9 per litre since FY 2008–09 while that of sugar has risen from INR 81.18 per quintal to INR 210.00 per quintal.

6 The price of cocoa beans has inflated from INR 1.05 Lac per metric ton in April 2008 to INR 1.83 Lac per metric ton in February 2015.

Source: Reserve Bank of India

Financial Risk

Figure 7. Sales Trend



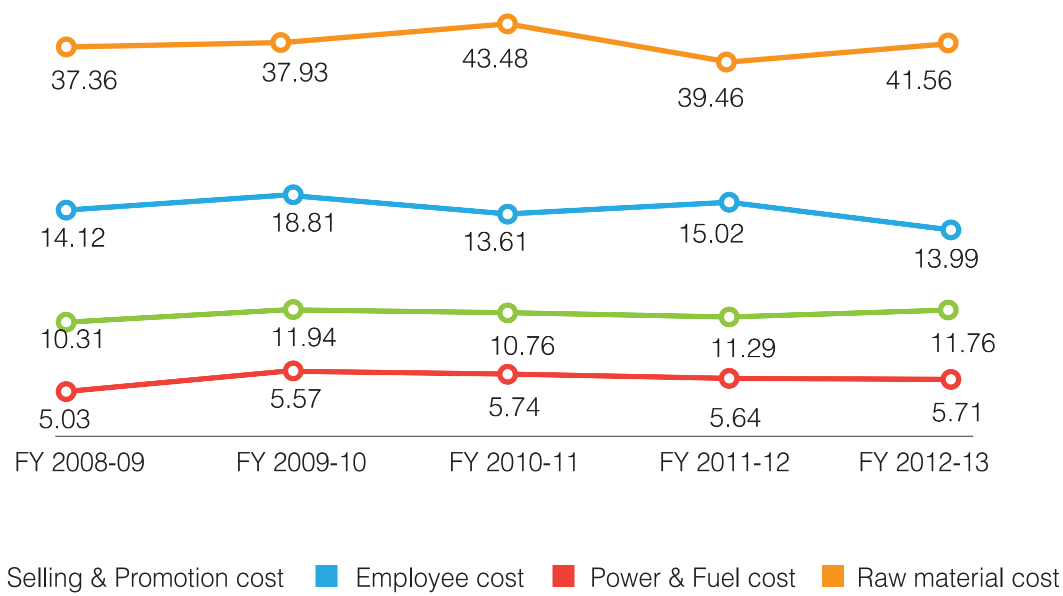
Sales in INR Million

The net sales of confectionery sector have grown with a CAGR of approximately 20.47% during the period from FY 2008–09 to FY 2012–13.The sector has been showing a constant increase which can be attributed to the growing consumption level followed by wide product range.

Source: CMIE Prowess

Financial Risk

Figure 8. Cost Structure (In Percent)



The raw material cost as a%age of sales stood at around 41.56% in the FY 2012-13 which has increased by 11.25% from the FY 2008-09 due to the increase in the prices of raw materials. On the other side, the employee cost as a%age of sales stood at 13.99% in the FY 2012-13. The employee cost has decreased by 0.90% in the FY 2012-13 from the FY 2008-09. The power and fuel cost contributing the least with 5.71% in sales has increased by 5.64% whereas the selling and promotion expense remained range bound during the period from FY2008-09 to FY 2012-13.

Source: CMIE Prowess

Financial Risk

Key Indicators	Unit	FY 2012-13
EBITDA Margin	%	-2.19
Net Profit Margin	%	-5.70
Current Ratio	Times	0.82
Quick Ratio	Times	0.49
Debtor Days	Days	13
Payable Days	Days	68
Inventory Days	Days	97
Sales to Capital Employed	Times	0.76
Debt-Equity Ratio	Times	0.70
Asset Turnover	Times	0.81

Sample Set : 8 Companies

Source: CMIE Prowess

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About Onicra

Onicra Credit Rating Agency is one of the leading performance and credit rating agencies in India. It provides ratings, risk assessment and analytical solutions to individuals, MSMEs and corporates. Third party performance and credit rating and assessment helps to create "trust" between players in markets that underpins transactions.

Onicra plays a central and critical role in collecting and analysing a variety of financial, operational, industry and market information, then synthesising that information, and providing autonomous, reliable assessments of the entity, thereby providing stakeholders with an important input for their decision-making process.

To realise our goal we have committed ourselves to providing the stakeholders with objective, timely, independent and forward-looking credit and performance opinions. The foundation of that dedication is embedded in several core principles — objectivity, quality, independence, integrity and transparency.

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