July 8, 2020

Unprecedented quarter depicts FMCG resilience…

Q1FY21 has been an unprecedented quarter with the lockdown impacting manufacturing & supply chain operations for a large part of the quarter. Though supply side issues were temporary, the demand pattern could have lasting impact on some categories. Moreover, new trends have emerged in the last three months, which would aid the growth prospects of some companies in our coverage universe. We observed two broad trends during the quarter. The surge in demand for categories like atta, biscuits, edible oil, and salt is temporary given consumers stock up essential either before or during lockdown period. However, growth in categories like soaps, sanitisers, immunity boosting products (Chyawanprash, Honey), some packaged foods categories (shift in pulses from loose to package) could be structural in nature.

With the consolidation of acquired companies' revenue for HUL, Tata Consumer Product, the numbers are not comparable. We estimate 10.6% revenue decline for our coverage companies largely impacted by a significant dip in cigarette companies (ITC, VST Industries) revenues. Cigarette companies witnessed the biggest dent in the lockdown period with sales loss for 40-45 days during the quarter. Further, these companies recovered volumes to pre-Covid-19 levels only in mid-June. Hence, we estimate ~50% drop in cigarette volumes during the quarter.

Other FMCG companies restarted manufacturing only in the second half of April but permission to start plant largely depended on essential & non-essential categories. Manufacturing facilities producing packaged foods, hygiene products (soaps, sanitisers) started early (within 10 days of lockdown) compared to products more discretionary (hair oil, skin care products, cosmetics) in nature. We expect 12-17% revenue decline for HUL (ex-acquisition), Dabur and Marico. Including the acquisition numbers for HUL, we expect a revenue decline of 2.4%.

Some categories like hair care, skin care, cosmetics, ice-creams have been adversely impacted during the quarter whereas soaps, sanitisers, edible oil, health supplement witnessed healthy growth. We expect foods companies like Nestle to remain largely unaffected by the lockdown as the company was able to refill the trade pipeline in June quarter with production coming back to normal. We expect Tata Consumer Products to post 10% revenue decline (ex-acquisition). However, including acquired business numbers, it is expected to report 27.5% growth in sales. Its revenues were impacted by multiple factors. The decline in out of home consumption of tea was partially offset by in-house increase in demand. We believe acquired salt & pulses business is likely to witness strong growth in April & May given stocking up by retailers & consumers.

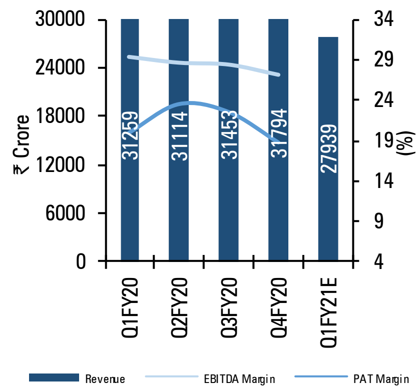
Sequence from lockdown to unlocking

Most companies were able to fulfil April (as and when distribution starts) demand from existing March inventories at companies as well as at the distributor levels. With companies reaching only ~70% of the normal manufacturing by the start of May, the trade pipeline got depleted fast while companies were unable to fulfil the entire demand in May 2020. However, in June, production levels reached near 100% of pre-lockdown levels while companies were not only able to fulfil the month's demand but were also in a position to refill trade inventory at previous levels.

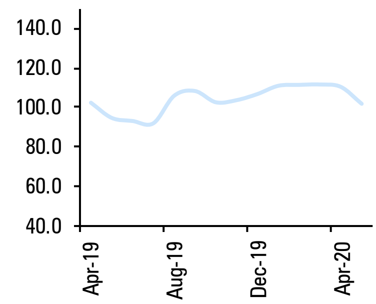
Result Preview

ICICI Securities – Retail Equity Research

Topline & Profitability (Coverage Universe)



Copra price trend (₹/kg)



Operating margin trend (%)

Company	EBITDA margin %				
	Q1'20	Q2'20	Q3'20	Q4'20	Q1'21E
Dabur	20.1%	22.1%	20.9%	18.9%	18.9%
HUL	26.2%	24.8%	24.9%	22.9%	26.5%
ITC	39.7%	38.4%	38.4%	36.5%	28.5%
Marico	21.3%	19.3%	20.4%	18.9%	21.0%
Nestle	23.2%	23.4%	21.5%	23.9%	24.7%
Tata Cons	14.0%	12.8%	12.2%	12.8%	13.2%
VST Ind.	37.8%	32.2%	31.5%	32.5%	21.2%
FMCG	**29.5%**	**28.7%**	**28.5%**	**27.0%**	**24.9%**

Top Picks

Dabur

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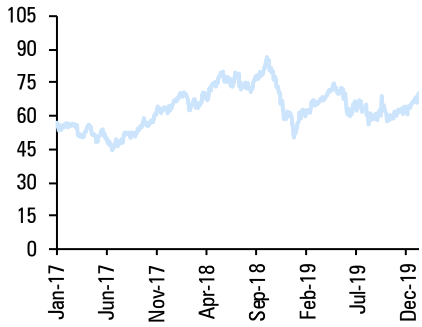
Crude oil prices trend ($/barrel)



Benign commodity cost offsets negative operating leverage

The sharp decline in crude based commodity prices is likely to reduce packaging cost for FMCG companies. This coupled with stable commodity prices are expected to result in an up-tick in gross margins (except Tata Consumer Products), which is expected offset the negative operating leverage impact on operating margins. Excluding ITC & VST, we expect similar margins (23.3%) for our coverage companies. Copra, palm oil & sugar prices have remained largely stable whereas milk prices, which were at elevated levels before lockdown, dipped sharply in April. However, tea prices rose ~20-40% in June with 140 million kg of lower production between January-June due to lower availability of labour. This would negatively impact operating margins for Tata Consumer Products & HUL's tea business. Our coverage universe net profit is expected to decline 16.3% largely impacted by a decline in ITC's earnings.

Exhibit 1: Estimates for Q1FY21E: (FMCG) (₹ crore)

Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q1FY21E	YoY	QoQ	Q1FY21E	YoY	QoQ	Q1FY21E	YoY	QoQ
Dabur India Ltd	1,887.6	-17.0	1.2	357.2	-21.9	1.4	286.2	-21.3	1.6
HUL	9,872.8	-2.4	9.6	2,618.0	-1.1	26.8	1,892.9	7.9	24.6
ITC	8,558.7	-25.6	-25.1	2,437.8	-46.6	-41.4	2,105.9	-33.7	-44.5
Marico Ltd	1,860.9	-14.1	24.4	390.6	-15.3	38.5	279.8	-16.3	40.6
Nestle India	3,188.8	6.3	-4.1	787.3	12.9	-0.8	502.7	14.8	-4.3
Tata Consumer	2,418.0	27.5	0.5	319.9	20.8	3.7	167.5	18.2	LP
VST Industries	152.3	-50.0	-47.8	32.3	-72.0	-65.9	24.7	-67.3	-65.0
Total	**27,938.9**	**-10.6**	**-6.3**	**6,943.1**	**-24.6**	**-13.8**	**5,259.6**	**-16.3**	**-16.1**

Source: Company, ICICI Direct Research

Exhibit 2: Company Specific Views (FMCG)

Company	Remarks
Dabur	We expect Dabur to witness 17% sales decline in the June quarter as operations largely remained disrupted in April. Since then, it gradually returned to normal in June 2020. We believe juices would have been the worst impacted category by lockdown given Q1 is peak season for the category. Further, among discretionary category, hair oil segment would have also been negatively impacted. However, the company has started witnessing strong growth in immunity boosting products like Chyawanprash and Honey. We expect a 120 bps contraction in operating margins due to negative leverage despite an uptick in gross margins. PAT is likely to dip 21.3% during the quarter
HUL	HUL is likely to witness a revenue decline of 2.4% (including acquired company's sales). Though the company was able to start manufacturing in mid-April, it only reached the previous year's levels by June 2020. However, we believe HUL would have been able to refill the inventory at the distributor level by the end of June 2020, which would have absorbed some of the lost sales in April & May. On the demand front, we believe personal care (cosmetics) & ice-creams would have been severely impacted with a near washout quarter for both categories. However, soaps, sanitisers would have seen strong growth induced by increased consumer awareness about hygiene. We expect 12% & 13% revenue decline in home care & BPC (beauty & personal care) categories, respectively. With benign raw material cost, reduction in A&P spends and other cost cutting measures, we expect the company to maintain operating margins at 26.5% (35 bps higher). PAT is likely to grow 7.9% aided by profits from GSK acquisition & lower income tax

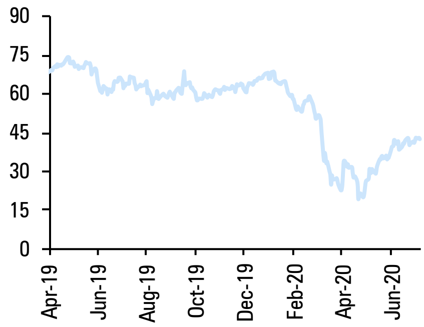
Source: Company, ICICI Direct Research

Exhibit 3: Company Specific Views (FMCG)

ITC	We expect ITC to post 25.6% decline in sales given the company lost 40-45 days of cigarettes sales, which is a permanent loss (it cannot be recovered with future sales). We expect 50% dip in cigarettes volumes during the quarter. The company had taken ~10% price hike after excise duty increase in Budget 2020. We expect 30% decline in agri & paper businesses revenues with supply chain remaining disrupted in April & May. Hotels business was the worst hit with occupancy dropping to single digits. We expect 80% decline in sales in a near washout situation. FMCG business would have been silver lining given most categories like atta, biscuits, packaged foods, soaps & sanitisers are part of the essentials & started manufacturing within 10-15 days of lockdown. Further, demand for packaged foods increased significantly given increased in-home consumption. Operating margins are likely to witness significant contraction due to negative operating leverage. We expect earnings to decline 33.7%
Marico	Marico is expected to post 14.1% decline in sales given parachute & VAHO production & distribution were negatively impacted in April & billing only started at the end of April. However, Saffola edible oil & foods portfolio witnessed strong growth with increase in-home consumption & growing preferences towards healthier food. Pantry sales declined 50% during the quarter. We expect the company to maintain operating margins at 21% (30 bps lower) given significant dip in commodity prices, cut in media spends & other cost cutting measures. Net profit is likely to decline 11.3% to ₹ 279.8 crore
Nestlé India	Nestlé is likely to witness 6.3% sales growth during the quarter as manufacturing & supply chain operations remain disrupted during the quarter. Given, large part of Nestlé's product portfolio is essentials (milk, infant food), the manufacturing in those plants started quickly. In the second half of April, the company was able to supply goods from the carry forward stock of March. However, the company struggle to fulfill some of the categories (noodles) demand in May. With the steep decline in commodity cost and reduction in A&P (promotions were largely withdrawn), operating margins are likely to perk up by 145 bps to 24.7%. We estimate earnings growth of 12.7%
Tata Consumer	Tata Consumer is likely to witness 27.5% revenue growth aided by inclusion of acquired consumer business of Tata Chemical. We believe acquired salt business would have witnessed a strong growth given increased stocking by consumers & retailers. Excluding the acquired business, revenue decline would have been ~10%. Tea prices sharply rose ~20-40% in June 2020 after 140 million kg production cut mainly impacted by lockdown. This would adversely impact gross margins. We expect operating margin contraction of 70 bps to 13.2%. With Starbucks stores closed for most of the quarter, loss from associates is expected to increase from ₹ 7.4 crore to ₹ 28 crore. Considering all these factors, we estimate net profit growth of 18.2% to ₹ 167.5 crore
VST Industries	VST is expected to see 50% decline in sales with ~60% decline in volumes given no sales was booked for 40-45 days. The company took more than 10% price hikes after the excise increase in 2020 Budget. Further, manufacturing & distribution operations gradually returned to normal by June 2020. Operating margins are expected to dip sharply owning to the negative operating leverage. Net profit is expected to dip 67.3% to ₹ 24.7 crore

Source: Company, ICICI Direct Research

Crude oil price trend ($/barrel)



Palm oil price trend (₹/kg)

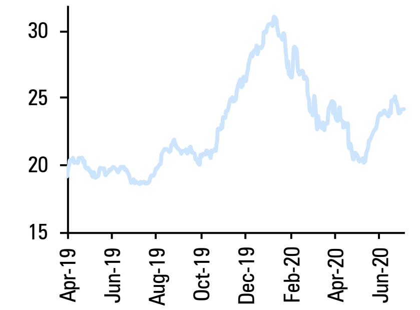


Exhibit 1: ICICI Direct Coverage universe FMCG

Sector / Company	CMP	TP		M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)	Rating	(₹ Cr)	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Colgate (COLPAL)	1,395	1,350	Hold	37,942	30.0	29.3	33.6	46.5	47.5	41.5	8.5	8.3	7.6	60.7	66.2	77.5	52.2	51.2	50.8
Dabur India (DABIND)	477	520	Buy	83,785	8.2	8.8	10.3	58.2	54.2	46.4	9.6	9.6	8.3	26.1	25.7	28.3	21.9	22.5	24.8
Hindustan Unilever (HINLEV)	2,158	2,250	Hold	507,235	31.2	33.5	41.3	69.2	64.3	52.2	13.3	12.6	0.0	82.5	24.4	30.3	85.7	20.2	25.0
ITC Limited (ITC)	197	250	Buy	239,304	12.5	11.6	13.6	15.8	17.0	14.5	5.2	5.4	4.7	29.4	28.0	30.9	23.8	21.5	23.7
Jyothy Lab (JYOLAB)	124	115	Hold	4,553	5.3	4.3	4.1	23.6	28.9	30.1	2.6	2.7	2.9	28.6	24.3	23.3	22.6	21.7	18.8
Marico (MARLIM)	352	300	Hold	45,415	8.1	7.8	9.5	43.5	44.9	37.2	6.2	6.5	5.5	41.0	40.1	46.9	34.5	33.8	40.3
Nestle (NESIND)	16,955	18,000	Hold	163,480	204.3	230.9	269.4	83.0	73.4	62.9	13.3	12.3	10.8	56.9	59.3	65.9	101.9	114.1	123.1
Tata Consumer Product (TATGLO)	432	440	Buy	39,809	5.0	8.7	10.9	86.5	49.8	39.7	4.1	3.9	3.6	6.9	7.9	8.8	4.6	5.9	7.1
VST Industries (VSTIND)	3,216	4,000	Buy	4,966	196.9	124.8	216.3	16.3	25.8	14.9	4.0	4.5	3.5	52.1	32.9	45.6	38.6	24.3	33.7
Varun Beverage (VARBEV)	685	580	Reduce	19,451	16.6	9.9	18.1	41.2	69.2	37.8	4.9	3.8	2.7	15.5	11.3	16.3	14.2	8.8	14.2
Zydus Wellness (ZYDWEL)	1,363	1,530	Buy	7,859	32.2	31.6	50.3	42.3	43.1	27.1	4.4	4.7	3.9	5.9	5.7	7.4	5.4	5.1	7.5

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