October 8, 2020

Supply restored; demand slack in urban India

FMCG companies have restored distribution supplies completely to the pre-Covid levels. However, demand remained slack in discretionary categories, specifically in urban regions, largely due to reverse migration of workers in the last six months. According to Nielsen data, rural growth was 17%, 4% in July, August, respectively, compared to pre-Covid levels. However, metro cities are still struggling to return to pre-Covid level demand and witnessing 10-15% lower sales. Though, we believe new product launches in health & hygiene space has created opportunities for companies to drive growth in newer categories, some discretionary categories like skin care, cosmetics, ice-creams and juices continue to see subdued demand conditions. There has been a wide trend of down-trading to mass brands or lower SKUs. Our coverage universe is expected to witness 6.7% growth largely led by 13.4%, 50.5% growth in HUL, Tata Consumer (TCPL), respectively, mainly on account of consolidation of their respective acquisitions. In our coverage universe, Dabur would be an outlier with 6.5% revenue growth, which would be contributed by new products introduction in immunity boosting & hygiene space. Marico is also expected to witness 7.5% growth largely led by strong growth in Saffola, foods portfolio and low base quarter effect for Parachute & VAHO. Nestlé should see dismal growth numbers with infant & baby food products witnessing subdued sales. Moreover, Maggi growth has moderated compared to Q1 sales. TCPL, on a like-to-like basis, is expected to report 18% growth largely contributed by price hikes in tea & strong growth in international business. However, we expect cigarette sales to continue to stay dismal with 4-5% volume decline given intermediate lockdowns impacting growth in July.

Mixed trend in RM cost; reduction in overhead to sustain margin

Though, on a reported basis, our coverage universe is expected to see 120 bps contraction in operating margins, ex-ITC it is expected to see 60 bps improvement in operating margins. Some commodity prices have seen a sharp dip in January-June, which should benefit FMCG companies in Q2. Palm oil prices have been volatile in the last nine months (dipped 30% from January 2020 to June 2020 and then recovered to similar levels). However, it is up ~25% YoY. Copra prices have remained stable in the last one year while crude prices have been down 20% compared to last year. The major price inflation has been seen in tea prices, which are up ~80% YoY. We believe lower crude based commodity cost would largely benefit FMCG companies with a significant reduction in packaging cost. However, a considerable increase in tea prices would impact HUL and TCPL's gross margins. FMCG companies have restored advertisement spends gradually. However, lower ad rates throughout the quarters & cost cutting measures would have helped in sustaining operating margins. Net profit of our coverage universe is down 5.5%, largely due to a lower corporate tax in the base quarter (adjusted due to a change in the corporate tax rate).

Exhibit 1: Estimates for Q2FY21E: (FMCG) (₹ crore)

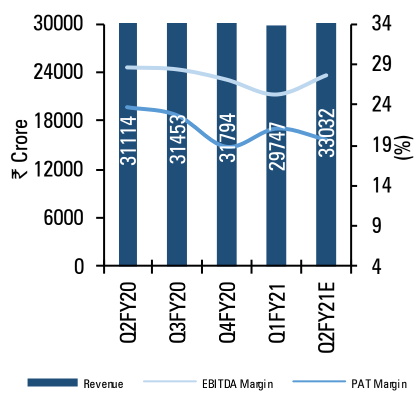
Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q2FY21E	YoY	QoQ	Q2FY21E	YoY	QoQ	Q2FY21E	YoY	QoQ
Dabur India Ltd	2,356.1	6.5	19.0	573.7	17.2	37.7	443.1	9.8	29.8
HUL	11,005.3	13.4	5.8	2,815.1	15.2	6.5	1,977.9	7.0	5.1
ITC	11,594.6	-2.3	22.9	4,090.2	-10.3	54.5	3,417.5	-15.1	45.9
Marico Ltd	1,966.2	7.5	2.1	415.0	17.6	-11.1	285.8	13.0	-26.0
Nestle India	3,055.9	-4.5	0.5	768.2	2.2	2.8	515.7	-13.4	6.0
Tata Consumer	2,760.7	50.5	1.7	381.0	62.4	-21.1	229.1	50.3	-33.7
VST Industries	293.0	-2.0	19.4	101.8	5.6	2.5	77.9	2.1	2.9
Total	**33,031.7**	**6.7**	**11.0**	**9,145.1**	**2.4**	**21.9**	**6,947.1**	**-5.5**	**18.6**

Source: Company, ICICI Direct Research

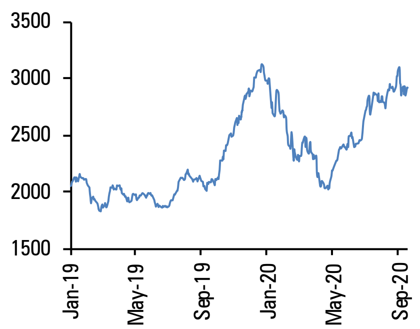
Result Preview

ICICI Securities – Retail Equity Research

Topline & Profitability (Coverage Universe)



Surge in palm oil prices (₹/kg)



Operating margins FMCG Coverage (%)

Company	EBITDA margin %				
	Q2FY20	Q3FY20	Q4FY20	Q1FY21	Q2FY21E
Dabur	22.1%	20.9%	18.9%	21.0%	24.4%
HUL	24.8%	24.9%	22.9%	25.0%	25.2%
ITC	38.4%	38.4%	36.5%	27.9%	35.0%
Marico	19.3%	20.4%	18.9%	24.3%	21.1%
Nestle	23.4%	21.5%	23.9%	24.5%	25.1%
Tata Cons	12.8%	12.2%	12.8%	17.8%	13.8%
VST Ind.	32.2%	31.5%	32.5%	40.4%	34.7%

Top Picks

Dabur
Tata Consumer

Research Analysts

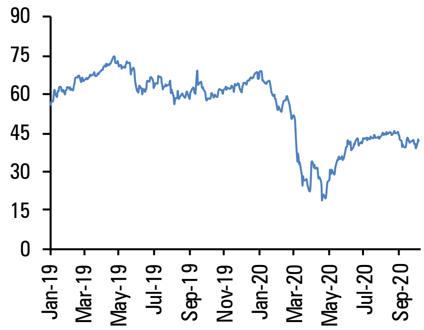
Sanjay Manyal
sanjay.manyal@icicisecurities.com

Exhibit 2: Company Specific Views (FMCG)

Company	Remarks
Dabur	Dabur is expected to witness 6.5% growth in consolidated sales with the volume recovery in domestic sales to pre-Covid levels. We expect the domestic business to post 8.2% growth largely led by health supplements, oral care, sanitisers, disinfectants and OTC categories. The growth trend in these categories has been supported by increased sales of Ayurveda & immunity boosting products. We believe launch of more than 50 new products & variants since March 2020 largely in health & hygiene space has been driving the recovery. We expect international business to continue to witness dismal numbers with sales growth of mere 2%. With benign commodity cost & continued cost cutting measures, operating margin is likely to improve by 222 bps. Net profit is expected to grow moderately by 9.8% to ₹ 443.1 crore
HUL	HUL is likely to witness 13.2% sales growth mainly on account of consolidation of acquired horlicks and boost brand. Home care and personal & beauty care businesses would see flat sales during the quarter. We believe intermediate & localised lockdowns in July would have impacted growth. Though rural sales has been growing strongly, urban sales has been impacted by down trading & shift of the migrant population to villages. Foods business is expected to grow 52% mainly due to inclusion of horlicks, boost sales. We expect 150 bps gross margin contraction due to sharp increase in tea prices. Tea prices have been up ~80% during the quarter. However, we expect lower ad spends & other cost cutting measure to result in sustainable operating margins at 25.2%. Net profit is expected to grow 7% to ₹ 1977.9 crore
ITC	We expect ITC to report 1.6% decline in sales mainly on account of continued dismal performance of hotels business and only 80-90% recovery in paper & paperboard business. We expect cigarette business to witness 5% growth despite ~10% price hike. Cigarettes volumes are expected to dip ~4% in due to intermediate lockdowns. FMCG is likely to see 12% revenue increase with strong growth (some moderation from Q1) in atta, biscuits, and noodles segments. Moreover, Savlon in the hygiene space is witnessing robust growth with several new launches. We believe Classmate brand would continue to see a steep decline in sales with schools remaining closed. Hotels business continued to suffer with occupancies largely around 18-20%. Moreover, ARR has also been down by 50% during the quarter. We expect a 10% decline in operating profit mainly due to increase in excise duty on cigarettes in Budget. Net profit is likely to decline 15% to ₹ 3417.5 crore due to low tax rate in the base quarter
Marico	We expect Marico to post 7.5% growth on the back 7% growth in domestic & 9.4% growth in international business. We expect domestic growth to have been led by moderate growth in Parachute, recovery in value added hair oils (VAHO) segment and continued healthy growth momentum in Saffola & foods business on account of increased 'at home' consumption. The strong growth in international business is expected to be aided by Bangladesh business. Though we expect 100 bps contraction in gross margins, lower ad spends & cost cutting measures are likely to improve operating margins by 180 bps. We expect 13% growth in net profit to ₹ 285.8 crore
Nestlé India	Nestlé India is expected to witness dismal numbers with 4.5% decline in sales. There has been some moderation in growth for Maggi with June, July peaking sales post pandemic. Promotions were back in Maggi, which would have negatively impacted realisation by ~1-2%. Further, lower demand conditions has been particularly impacted infant food, baby food products and chocolates.The company has not come up with festive gift packs this year given demand for such packs would have been muted given lower social interactions. We believe operating margins would improve 170 bps with milk prices declining significantly in the last six months. We expect net profit decline of 13.4% to ₹ 515.7 crore, largely due to a lower tax rate in the base quarter
Tata Consumer (TCPL)	TCPL is expected to report robust sales growth during the quarter with a recovery in tea volumes & continued growth momentum in international business. Further, the company has taken ~15% price hike on the back of a steep increase in tea prices. We expect 50% sales growth largely due to consolidation of acquired consumer business. However, on a like to like basis, we expect 18% sales growth during the quarter. With tea prices going up ~80% in Q2, we expect a 478 bps contraction in gross margins. However, with the consolidation of acquired consumer business, lower ad spends & cost cutting measures, operating margin is likely to witness 100 bps increase to 13.8%. We expect net profit to grow 50.3% to ₹ 229.1 crore
VST Industries	VST Industries is expected to witness 2.1% decline in sales (net of excise). We expect 22% growth in cigarettes sales largely on the back of ~11% price increase after the excise hike in Budget 2020 & lower trade promotions in the last six months due to pandemic induced lockdowns. We expect volumes to decline 5% during the quarter due to intermediate and localised lockdowns in July. With cost cutting measures, operating profit is expected to grow 5.6%. We estimate 2.1% growth in net profit

Source: Company, ICICI Direct Research

Crude oil prices trend ($/barrel)



Copra price trend (₹/kg)

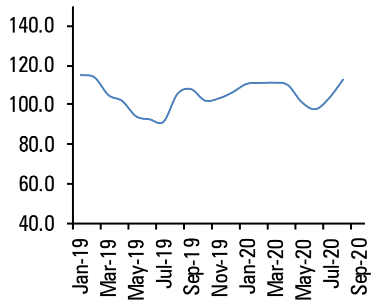


Exhibit 3: ICICI Direct coverage universe (FMCG)

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)	1,452	1,540	Hold	37,208	30.0	31.0	34.3	48.4	46.9	42.3	8.3	8.1	7.4	60.7	68.0	76.0	51.2	52.1	58.3
Dabur India (DABIND)	523	565	Buy	88,708	8.2	8.8	10.3	63.8	59.3	51.0	10.2	10.1	8.7	26.1	24.0	24.7	21.9	20.9	21.4
Hindustan Unilever (HINLEV)	2,159	2,410	Hold	480,922	31.2	32.4	40.1	69.2	66.6	53.8	12.6	11.3	0.0	89.5	26.7	33.0	85.7	20.3	25.4
ITC Limited (ITC)	167	250	Buy	218,801	12.5	11.7	13.0	13.4	14.2	12.8	4.7	4.6	4.1	29.4	28.3	36.1	23.8	21.7	27.7
Jyothy Lab (JYOLAB)	144	150	Hold	5,141	4.3	5.3	5.8	33.5	27.1	24.7	3.1	2.9	2.6	24.3	29.7	29.9	21.7	24.2	24.1
Marico (MARLIM)	373	380	Hold	45,802	8.1	8.5	9.6	46.1	43.8	38.9	6.3	6.2	5.5	41.0	42.3	46.2	34.5	35.6	39.5
Nestle (NESIND)	16,301	18,000	Hold	151,669	204.3	230.3	268.9	79.8	70.8	60.6	12.3	11.4	10.0	56.9	59.3	65.9	101.9	114.2	123.6
Tata Consumer Products (TATGLC	488	525	Buy	49,578	5.0	9.8	11.7	97.8	49.9	41.8	5.1	4.6	4.3	6.9	8.8	9.4	4.6	6.6	7.5
VST Industries (VSTIND)	3,350	4,450	Buy	5,530	196.9	202.1	222.6	17.0	16.6	15.1	4.5	4.6	3.9	52.1	46.3	44.8	38.6	34.2	33.0
Varun Beverage (VARBEV)	676	700	Hold	19,948	16.4	9.7	17.8	41.3	69.4	37.9	2.8	3.3	2.7	15.5	11.3	16.3	14.2	8.8	14.2
Zydus Wellness (ZYDWEL)	1,782	2,300	Buy	10,782	24.6	43.4	66.4	72.5	41.1	26.8	6.1	5.8	5.2	5.9	7.0	8.3	5.4	5.9	8.6

Source: Company, ICICI Direct Research

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Pankaj Pandey | Head – Research | pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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