Q2 FY21 Consumer Sector Preview

17th October, 2020

Consumer Goods

Health and Hygiene products to drive the show

MARKET DATA

	Close	1D (%)	1M (%)	YTD (%)
Nifty	11,763	0.30%	2.14%	-3.44%
Sensex	39,983	0.60%	3.08%	-3.20%
Nifty FMCG	29,671	0.09%	-3.20%	-1.86%
USD / INR	73.3	-0.12%	-0.34%	-2.53%

COVERAGE STOCKS

Company	Current Price (INR)	Target* (INR)	Upside (%)	Market Cap. (INR mn)	Fwd P/E 2022E (x)	Recommendation*
Nestle India	15,430	19,088	23.7%	14,90,780	56.9	BUY
Britannia Industries	3,747	4,412	17.7%	9,02,697	45.6	BUY
Hindustan Unilever	2,151	2,556	18.9%	50,53,896	52.5	BUY
ITC Ltd	166	228	37.6%	20,40,960	11.1	BUY
Colgate Palmolive	1,439	1,507	4.7%	3,92,203	39.1	ACCUMULATE
Asian Paints	2,061	1,985	NA	19,79,784	53.9	ACCUMULATE
BlueStar Ltd	638	652	2.2%	61,545	35.9	HOLD
Symphony Ltd	838	922	10.0%	58,624	27.2	ACCUMULATE
Godrej Consumers	678	663	NA	6,95,291	37.9	REDUCE
Tata Consumers	477	516	8.2%	4,40,223	46.9	ACCUMULATE
Emami Ltd	347	355	2.2%	1,54,424	28.3	HOLD
Avenue Supermart	1,984	UR	UR	12,87,776	70.4	UR
Berger Paints	603	UR	UR	5,85,548	59.8	UR
Whirlpool India	2,065	UR	UR	2,63,893	43.1	UR

***Note: TP and recommendation has been retained from previous update reports; we will review it post detailed Q2FY21 results analysis and conference call of the said companies*
Source: Bloomberg Data as of October 16, 2020; UR stands for Under Review

SECTOR OVERVIEW

- **Demand driven by health and hygiene product portfolios including immunity boosting food:** Most consumer companies witness recoveries with genuine demand coming for health products such as immunity boosters in Q2FY21. Most new launches have either been in the health and hygiene category or focused on immunity-boosting foods. Besides, despite lockdown eases; large part of population stayed indoors thereby boosting demand of ready-to-eat/cook food items, such as biscuits, salty snacks, instant noodles, beverages, edible oils, as well as hygiene products. **We see companies such as HUL, Britannia, ITC, Tata Consumer and Nestle India as the key beneficiaries.** Almost all the companies steadily scaled up their operations to near-normal levels in Q2 with some companies expanding production capacities for in-demand products such as food and hygiene products (HUL sanitizer production ramped up by 60x from pre-COVID level, Britannia investing in capacity for biscuits and ITC for FMCG segment).

- **After washout quarter for non-essential products; demand is gradually recovering (50-60% of pre-covid level) with lockdown eases:** The pent-up demand noted in early July'20 in home appliances such as large capacity refrigerators, dishwashers, vacuum cleaners etc. (due to self-reliance in absence of domestic help and higher time spent indoors). Consumer durables formed a significant part of the retail sales in Q2 backed by strong uptake in rural markets. Whirlpool saw faster rebound backed by new product launches and sustained market share gains. Additionally, entry-level products estimated to fare better growth from tier 2 and smaller cities. Similarly, Paint companies such as Asian Paints and Berger paints witnessed strong rural demand; that has helped boost recovery for paints, in general. Further, the distribution networks improved progressively during the quarter with the unlocking of the economy in non-containment zones and free movement of goods. Nonetheless, consumers are cautious amid ongoing uncertainties, and some cut in the discretionary spends expected. We also believe customers in the hunt for value-for-money across the band of products from economy to luxury and cutting the clutter. **Overall, the Consumer sector stocks under our coverage are expected to clock an average decline of 3.7% YoY in top-line mainly due to volume decline witnessed in the discretionary category during lockdown.**

Consumer Goods

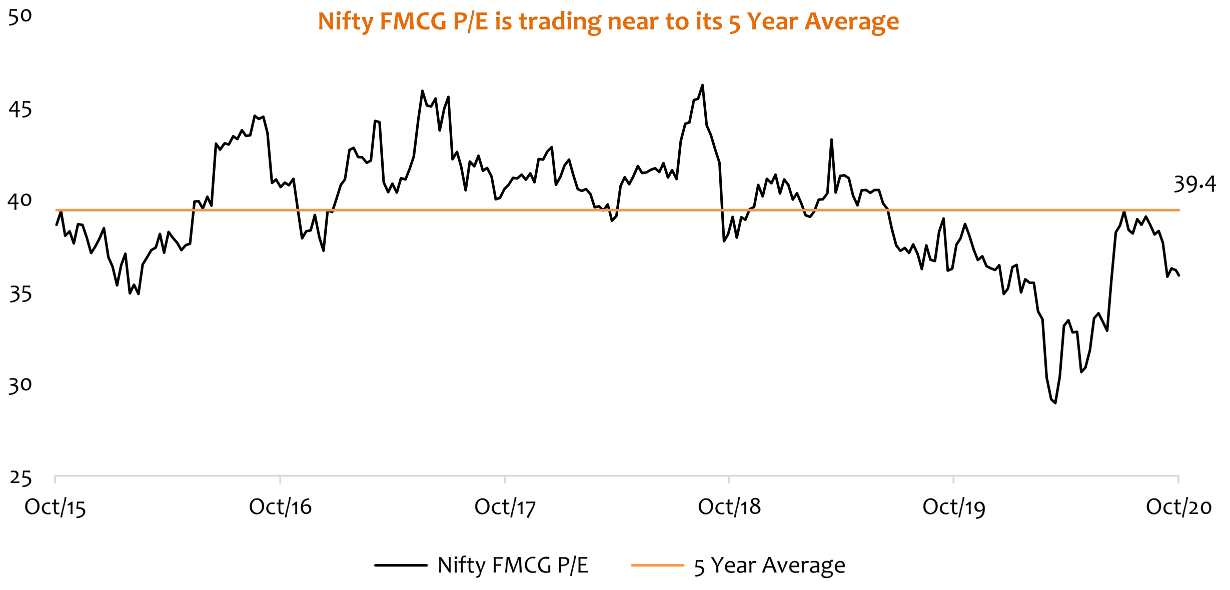
FMCG defensive against turbulent times

SECTOR OVERVIEW

- **Softening commodity prices and cost rationalization measures to aid margin performance:** On a YoY basis, increase in non-food raw materials such as Soda ash (up 3.0% YoY) is likely to impact HUL in its detergent segment while it is down on QoQ by 3.8%. Hence, sequentially it is positive for HUL. Higher HDPE (up 1.6% YoY/18% QoQ) should increase overall packaging costs for the FMCG player; consequently affecting gross margin. Furthermore, the gross margins for Britannia and HUL (palm oil) should support through lower prices for food ingredients - Sugar (down 0.9% YoY/ down 1.8% QoQ) and Wheat (down 11.9% YoY/down 6.9% QoQ) which is partially offset by increase in cost of Skimmed milk powder (+9.6% YoY/+11.5% QoQ) and Palm Oil (+22.6% YoY/ +44.1% QoQ). Nestle gross margin to be affected due to higher milk prices. Among the non-food players, decline in Brent crude oil (down 25% YoY/down 6.1% QoQ) and Titanium Dioxide (TiO2) price (flat YoY/ down 4.2% QoQ), should benefit Asian paints/Berger Paints. Ongoing decline in price trend of Mentha oil (down 21.2% YoY/ down 11.2% QoQ) is likely to favor Emami and Colgate Palmolive; whereas rise in prices of Light Liquid Paraffin oil (5.6% YoY/ 9.1% QoQ) will increase cost for Emami. Higher copper (+17.7% YoY/+10.7% QoQ) and aluminum (24.7% YoY/ 5.1%QoQ) prices are expected to negatively impact margin of BlueStar and Whirlpool. Further, digitalization and cost rationalization programs including lower advertising budget will aid to margins. **At a consolidated level, for our coverage stocks, we foresee sequential improvement in margins with ~190bps of improvement in EBITDA and NPM; while margins will be below compared to same quarter previous year.**

- **New normal is shaping new trends in consumer behaviour:** i) With rise in unemployment, job losses, wage cuts, and a general uncertainty in future, consumers are opting for cheaper alternatives focusing on core essentials (eatables) based products which have impacted demand for premium products. ii) Consumers are focusing more on immunity, health and hygiene (fruit & veggie washes/disinfectant wipes/surface disinfectants in sachets). iii) Demand for convenience products such dish washers, large refrigerators, larger LED TVs, RACs, etc. is on rise iv) Manufacturers have laid focus on deepening their partnership with e-commerce retailers as online sales jumped manifold since customers are veering towards online shopping to avoid social distancing. **Most of these trends have lasting impact on consumer behavior and likely to remain for quite sometime.**

- **Sector Valuation:** Currently, Nifty FMCG is trading at an average P/E of 35.8x compared to its five-year average of 39.4x (implies discount of ~9%). In our view, stock specific valuation premium will continue for Tata Consumer Products Ltd (+31% over sector), Nestle (+42% over sector), Hindustan Unilever (+18% over sector), Asian Paints (+9% over sector) , Berger Paints (+19% over sector) and Avenue SuperMart (+62% over sector) on back of their solid market positioning and high demand for essentials in the light of COVID-19. We see mispricing on ITC shares, the ~81% valuation discount to sector as unwarranted and recommend a BUY. Consumer durables trading at attractive valuation with Blue Star (~24% discount over sector) whereas Whirlpool (+14% over sector).



Source: Bloomberg

Consumer Goods

Exhibit 1: Quarterly result expectation for companies under coverage

INR Cr	Q3CY20E	Q3CY19A	YoY	Q2CY20A	QoQ	Remarks
Nestle India						
Sales	3,352	3,001	11.70%	3,050	9.88%	We expect Nestle India to report a revenue growth of 11.7% YoY / 9.9% QoQ in Q3CY20 on the back of increase in demand for ready-to-eat product such as Maggi, Dairy products, KitKat and Coffee as well as volume led growth from online delivery channels. We foresee an increase in EBITDA margin due to operational efficiencies undertaken by the company and reduction in variable expenses particularly ad spends offset by rise in milk prices. The net profit margin is expected to increase by 55 bps YoY. Key Parameters: (1) Guidance on price and volume (2) Capacity utilization levels (3) Mix of segmental products (4) New product launches/ Innovations (5) Cost control initiatives
EBITDA	829	713	16.27%	748	10.83%	
Net Profit	508	438	15.93%	487	4.30%	
EBITDA (%)	24.73%	23.75%	98 bps	24.51%	22 bps	
NPM (%)	15.14%	14.59%	55 bps	15.95%	-81 bps	
INR Cr	**Q2FY21E**	**Q2FY20A**	**YoY**	**Q1FY21A**	**QoQ**	**Remarks**
Britannia Industries						
Sales	3,698	3,049	21.29%	3,421	8.11%	Sales expected to grow 21.3% YoY/ +8.1% QoQ mainly due to higher sale of biscuits (~75-% of portfolio) on account of increase in in-home consumption. Proactive measures undertaken by the company such as tie up with online delivery platforms, launching Whatsapp based store locator and efficient distribution chain is also expected to lead to market share gains. Net profit to grow strongly. Key Parameters: (1) Investment in new product launches and their marketing spends (2) Commencement of manufacturing facilities and capacity utilization (3) Inventory levels (4) Store coverages (5) Commentary on Inter-corporate loans
EBITDA	769	492	56.24%	717	7.26%	
Net Profit	580	404	43.48%	546	6.30%	
EBITDA (%)	20.80%	16.14%	465 bps	20.96%	-16 bps	
NPM (%)	15.68%	13.26%	243 bps	15.95%	-27 bps	
Hindustan Unilever Ltd						
Sales	11,020	9,852	11.86%	10,560	4.36%	We expect overall sales to grow by 11.9% YoY/ 4.4% QoQ led by health, hygiene and nutrition categories which will be partially offset by the volume decline in Discretionary category such as ice cream and out of home consumption category. Sales in the health food category (Horlicks/Boost) will grow on the back of strong distribution network of HUL. Net profit expected to grow 5.1% YoY Key Parameters: (1) Guidance on volume and price in 2HFY21 (2) Impact on premiumization and new product launches (3) Supply disruptions for raw materials and corresponding impact on cost (4) GSKCH portfolio performance
EBITDA	2,799	2,443	14.57%	2,644	5.86%	
Net Profit	1,942	1,848	5.09%	1,881	3.24%	
EBITDA (%)	25.40%	24.80%	60 bps	25.04%	36 bps	
NPM (%)	17.62%	18.76%	-114 bps	17.81%	-19 bps	
ITC Ltd						
Sales	10,152	11,871	-14.48%	9,502	6.84%	We expect sales to grow sequentially by 6.8%; driven by hygiene product (soaps handwash - Savlon), Floor disinfectant (Nimyle) and FMCG products such as Noodles, Packaged Atta and biscuits. Further, the company has launched 41 new products in last 3-4 months; which will also boost sales. Cigarette segment will likely be under pressure despite small size pack. In terms of margins, FMCG margins are on a robust trajectory on scale advantages and premiumization efforts Key parameters: (1) Guidance on price and volume (2) Cigarette inventory levels (3) Adoption of newly launched products
EBITDA	3,521	4,562	-22.83%	2,647	33.04%	
Net Profit	3,220	4,023	-19.96%	2,343	37.44%	
EBITDA (%)	34.68%	38.43%	-375 bps	27.85%	683 bps	
NPM (%)	31.72%	33.89%	-217 bps	24.66%	706 bps	

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INR Cr	Q2FY21E	Q2FY20A	YoY	Q1FY21A	QoQ	Remarks
Colgate Palmolive						
Sales	1,251	1,222	2.37%	1,041	20.17%	We expect Colgate Palmolive to witness revenue growth of 2.4% YoY/20.2% QoQ, driven by increase in volume in the toothpaste category. Recently launched hygiene product is expected to continue see growth. Advertisement spending is likely to be on an increasing trajectory as per the company strategy. EBITDA is expected to increase by 5.3% YoY/10.4% QoQ, while PAT is likely to grow by 4.1%YoY/28.3% QoQ.
EBITDA	340	323	5.26%	308	10.39%	
Net Profit	254	244	4.10%	198	28.28%	
EBITDA (%)	27.18%	26.43%	75 bps	29.59%	-241 bps	Key Parameters: (1) Status check of distribution channels (2) Volume and Price impact (3) Market share gains (4) Outlook on advertisement spends (5) Ramping up of new products
NPM (%)	20.30%	19.97%	34 bps	19.02%	128 bps	
Asian Paints						
Sales	4,203	5,051	-16.79%	2,923	43.79%	We expect sales to decline 16.8% YoY however, up by 43.9% QoQ led by pent-up demand noted in Q2. Volume surge attributed to unlock after sharp decline in April/May-20. International revenues (~12-13% of revenue) will be subdued due to global supply disruption and lesser demand in foreign countries. Reduction in Brent crude oil and Titanium dioxide likely to aid gross margin. However, negative operating leverage to lead to substantial decline in EBITDA margin despite cost cutting initiatives.
EBITDA	765	955	-19.88%	484	58.06%	
Net Profit	432	823	-47.54%	218	98.17%	
EBITDA (%)	18.20%	18.90%	-70 bps	16.56%	164 bps	Key Parameters: (1) Sustainable volume growth and price after Unlock (2) Raw material price trends (3) Inventory levels (4) Rural demand outlook (5) Demand for newly launched home décor product
NPM (%)	10.28%	16.30%	-602 bps	7.46%	282 bps	
Blue Star						
Sales	897	1,249	-28.21%	626	43.29%	Sales expected to decline 28.2% YoY whereas up by 43.3% sequentially followed by recovery in discretionary spending in rural market. The company noted pent-up in demand in the months of July. Sales is expected to be mainly driven by Unitary segment post lockdown as well as new launches that offers protections from Covid-19 and other virus. However, margin likely to be stressed due to provisioning of doubtful receivables in the EMS segment on YoY basis
EBITDA	26	74	-64.66%	1	1811.76%	
Net Profit	5	41	-87.91%	-20	-125.43%	
EBITDA (%)	2.90%	5.89%	-299 bps	0.22%	268 bps	Key Parameters: (i) Guidance on price and volume (2) Plans and strategies for consumer revival (3) New launches and product innovations (4) Cost cutting measures (5) Extension of credit period (6) Impact of price cut across industry
NPM (%)	0.56%	3.31%	-275 bps	-3.14%	370 bps	
Symphony Ltd						
Sales	2,394	2,720	-12.00%	1,540	55.43%	For Q2FY21, we expect Symphony to report revenue degrowth of 12% YoY and expect recovery on a sequential basis led by ramp up of overall operations, ease of supply chain restrictions and uptick in consumer sentiments. EBITDA margin is expected to decline by 440bps YoY to 18.76% due to lower revenues and operating leverage. On sequential basis EBITDA is expected to come back in positive territory led by operating leverage. We expect Symphony Ltd to report profit after tax of INR 344 Mn for Q2FY21 and Net profit after tax margin of 14.39%.
EBITDA	449	630	-28.71%	-50	NA	
Net Profit	344	580	-40.63%	20	NA	
EBITDA (%)	18.76%	23.16%	(440bps)	-3.25%	NA	
NPM (%)	14.39%	21.32%	(692bps)	1.30%	NA	Key Parameters: 1) Demand outlook 2) Performance of subsidiaries 3) Channel Inventory

Consumer Goods

Exhibit 1: Quarterly result expectation for companies under coverage

INR Cr	Q2FY21E	Q2FY20A	YoY	Q1FY21A	QoQ	Remarks
Godrej Consumer Products						
Sales	2,925	2,630	11.21%	2,327	25.68%	As per the disclosures by the company the demand trend remained stable and improved sequentially across key geographies. We expect sales to grow by 11.2% YoY/25.7% QoQ led by hygiene (including soap) and household insecticide categories. The notable recovery witnessed in hair colour and air fresheners on quarterly basis. Within International business, Indonesia (~15% revenue) expected to report 3-5% YoY CC sales growth this quarter, led by the Household Insecticides and Hygiene categories however GAUM region (~24% of revenue) is expected to report decent sequential recovery in Q2. Key Parameters: (1) Impact on working capital (2) Strategies to manage the supply disruption (3) Capacity utilization levels (4) Tie-up with food delivery startups- Zomato and supply chain startup Shopkirana (5) Cost cutting measures
EBITDA	589	572	2.99%	473	24.44%	
Net Profit	490	414	18.39%	395	24.09%	
EBITDA (%)	20.14%	21.74%	-161 bps	20.34%	-20 bps	
NPM (%)	16.75%	15.74%	102 bps	16.97%	-21 bps	
Tata Consumer Products						
Sales	2,815	1,834	53.48%	2,714	3.72%	We expect sales to grow sharply by 53.5% YoY/ 3.7% QoQ due to incremental revenue from merger with Tata Chemical consumer business segment as well as with volume growth across all segments. In addition, demand for essential products such as salt, staples and tea expected to be higher due to higher in-house consumption amid partial lockdown. While EBITDA margin expansion expected due to higher sales, gross margin improvement and rationalization of discretionary expenses. Key Parameters (1) Performance of the FMCG portfolio (2) Digitalization of distribution channels / Cancellation of agreement with distributors(3) Outlook for H2FY21E (4) Steps undertaken to mitigate the supply disruptions
EBITDA	512	235	118.20%	483	6.07%	
Net Profit	355	138	157.73%	328	8.37%	
EBITDA (%)	18.19%	12.79%	539 bps	17.79%	40 bps	
NPM (%)	12.61%	7.51%	510 bps	12.07%	54 bps	
Emami Ltd						
Sales	661	660	0.14%	481	37.32%	We expect sales to improve 0.14% YoY/ 37.3% QoQ due to increase in volume for Zandu, and hygiene products. Gross margin expansion expected mainly due to softening of Mentha and Light Liquid Paraffin (LLP prices) which are the key raw materials. Coupled with cost rationalization and low advertising spends, EBITDA expected to improve sequentially by 53.68% QoQ. The company has kept the cost reduction target of INR 50-60 Cr. Key Parameters (1) Guidance on price and volume for H2FY21E (2) Lockdown impact on manufacturing facilities and capacity utilization (3) COVID-19 impact on international business (4) Strategies to be undertaken for consumer revival (5) Diversification into hygiene space (6) Promoter pledging details. (7) Rural outlook (8) Performance of new hygiene category space
EBITDA	189	193	-2.06%	123	53.68%	
Net Profit	87	96	-9.37%	40	119.70%	
EBITDA (%)	28.59%	29.24%	-64 bps	25.55%	304 bps	
NPM (%)	13.16%	14.54%	-138 bps	8.23%	493 bps	

Consumer Goods

Exhibit 1: Quarterly result expectation for companies under coverage

INR Cr	Q2FY21E	Q2FY20A	YoY	Q1FY21A	QoQ	Remarks
Avenue Supermarts						
Sales	4,365	5,949	-26.63%	3,833	13.86%	We expect sequential recovery in Q2 with 13.9% QoQ growth. Overall gross margins will be under pressure as discretionary high margin categories are not yet at near pre COVID-19 levels while food and essential sales is at 80% of pre COVID-19 levels. Hence, we foresee flat EBITDA and Net profit margin compared to previous quarter. In September 2020, DMart has closed its first store indicating its move to give more emphasis on E-commerce. However, we remained cautious on e-commerce uptake as the company's strength lies in physical store manner Key Parameters: (1) New store additions (60 stores in FY21 and FY22) (2) Penetrate further into its e-commerce operations (3) Product/ category mix (4) DMart Ready outlet additions (5) Measures to tackle supply disruptions (6) Cost cutting initiatives undertaken (7) Inventory write offs
EBITDA	132	515	-74.39%	109	21.26%	
Net Profit	63	333	-81.11%	50	27.12%	
EBITDA (%)	3.02%	8.66%	-564 bps	2.84%	18 bps	
NPM (%)	1.44%	5.61%	-416 bps	1.29%	15 bps	
Berger Paints						
Sales	1,211	1,599	-24.25%	931	30.11%	We expect Berger paints revenue to grow 30.1% QoQ led by recovery in rural economy including tier II, III, and IV towns. However, there is slower improvement in decorative paint sale in metro and other urban markets. 70% of the demand is for repainting. International business (~5-7%) is expected to be affected due to disruption and halt in export. Softness in Brent crude oil is likely to support gross margin Key parameters: (1) Performance of industrial and automotive segment (2) Raw material cost fluctuations (3) Crude Price Impact (4) Commentary on the lockdown impact of manufacturing facilities (5) Timely commencement of Jejuri plant
EBITDA	132	251	-47.44%	92	43.34%	
Net Profit	24	197	-87.80%	15	62.82%	
EBITDA (%)	10.90%	15.71%	-481 bps	9.89%	101 bps	
NPM (%)	1.98%	12.30%	-1,032 bps	1.58%	40 bps	
Whirlpool						
Sales	1,221	1,393	-12.38%	1,027	18.88%	We expect sales to grow 18.9% QoQ/ down 12.4% YoY amid ongoing state level (partial) lockdown across major cities. Nonetheless, sales are likely to be driven on the back of higher demand for refrigerators due to more in-home consumption mainly from Tier2-3 towns. Additionally, entry-level products would see better growth from tier 2 and smaller cities, which would benefit Whirlpool through its strong distribution reach. Key Parameters (1) Guidance on price and volume (2) Supply environment for domestic & international business (3) New product launches (4) Share of Elica JV (49% stake) (5) Urban and rural mix
EBITDA	69	142	-51.32%	47	47.94%	
Net Profit	74	129	-42.75%	16	367.78%	
EBITDA (%)	5.65%	10.17%	-452 bps	4.54%	111 bps	
NPM (%)	6.03%	9.24%	-320 bps	1.53%	450 bps	

Consumer Goods

Rating Legend (Expected over a 12-month period)	
Our Rating	**Upside**
Buy	More than 15%
Accumulate	5% – 15%
Hold	0 – 5%
Reduce	-5% – 0
Sell	Less than – 5%

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