

July 10, 2021

Commodity inflation pressurises margins...

The FMCG sector witnessed a high growth quarter on the back of lower sales in the base quarter, which was marred by country wise strict lockdown. Though Q1FY22 also witnessed the adverse impact of a second Covid-19 wave & subsequent state wise lockdowns, the impact on supply chain was minimal with industry, government & trade channel's preparedness. Similar to previous lockdowns, consumption of some discretionary & out of home categories were adversely impacted. We believe detergent, cosmetics, skin care products, juices, carbonated drinks would have seen muted sales during the quarter. On the other hand, packaged foods, edible oil, nutrition, immunity products would have continued the strong growth momentum. Our FMCG coverage universe is likely to see 24.1% revenue growth. With the sharp increase in many commodity prices, most companies have taken price hikes to the tune of 5-20% in the last six months. We believe element of price hikes in revenue growth is higher than usual in Q1FY22. After the one full year of aggressive new launches, the pace of new product development has de-accelerated. However, new products would continue to contribute 2-4% to the topline for FMCG companies. Within our coverage universe, Dabur, HUL, Nestlé & Zydus Wellness are likely to see strong 15-25% sales growth on the back of steep sales decline in base quarter. Marico is likely to grow 28.5% on the back of strong growth in Saffola & foods segment. Saffola & foods portfolio of Marico has been growing at a fast pace in the last five quarters. We believe the growth momentum would continue led by consumption shift from loose to packaged foods & acceleration in adoption of healthier foods habits. Cigarettes sales for ITC & VST Industries may see strong growth on the back of beleaguered corresponding quarter.

High commodity prices; limited scope to curb margin fall

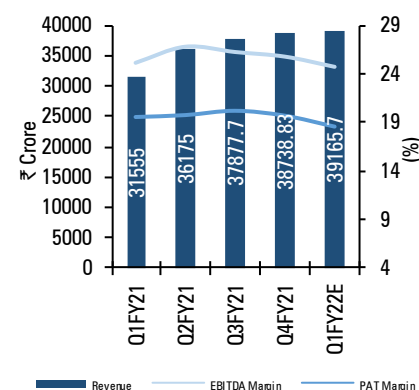
Our coverage universe is likely to witness 40 bps operating margins contraction but ex-ITC, margins are likely to fall 240 bps. The quarter has seen a steep increase in commodities costs with Palm Oil, Copra & crude prices risen sharply. On a YoY basis, average palm oil & crude prices were 2x & copra prices were up 20%. Though palm oil & copra prices started cooling off in May-2021, the impact of the decline would not bring immediate relief. In previous quarter, Nestlé & Zydus benefited from lower milk prices given these companies were holding low cost skimmed milk powder (SMP) inventories. Favourable sorbitol prices would continue to benefit margins for Colgate. However, increasing milk prices would entail price hikes, going forward. We believe scope for cutting overhead & marketing spends remains limited for FMCG companies on the back of consistent cost rationalisation throughout the FY21. We expect net profit to witness growth of 17.9% during the quarter.

Exhibit 1: Estimates for Q1FY22E: (FMCG)

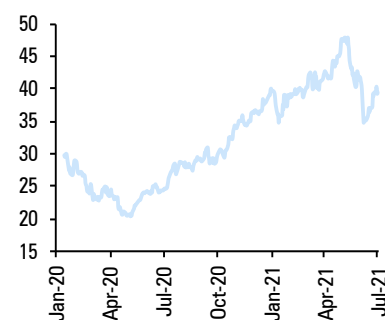
Company	Revenue		Change (%)		EBITDA		Change (%)		PAT		Change (%)	
	Q1FY22E	YoY	QoQ	Q1FY22E	YoY	QoQ	Q1FY22E	YoY	QoQ	Q1FY22E	YoY	QoQ
Colgate Palmolive	1,198.3	15.2	-6.8	368.3	19.6	-10.0	242.1	22.2	-11.7			
Dabur India Ltd	2,491.2	25.8	-1.0	495.8	19.0	-12.9	413.3	21.1	-14.4			
HUL	12,807.6	21.3	11.9	2,984.5	12.9	4.0	2,093.4	11.3	4.2			
ITC	12,284.9	29.3	2.6	3,858.3	45.8	-5.0	3,125.0	33.4	-3.3			
Marico Ltd	2,474.2	28.5	24.4	450.3	-3.5	15.8	335.7	-12.9	23.0			
Nestle India	3,707.4	21.5	4.7	883.5	18.2	0.0	583.4	19.9	-0.6			
Tata Consumer	3,282.0	20.9	18.0	381.6	-20.9	-4.5	238.3	-31.0	-12.8			
VST Industries	284.8	16.0	-5.2	105.6	6.3	-6.6	79.7	5.3	-10.0			
Zydus Wellness	635.2	18.2	85.7	149.6	22.2	451.5	137.5	54.1	LP			
Total	39,165.7	24.1	3.4	9,677.5	22.0	-2.9	7,248.4	17.9	1.9			

Source: Company, ICICI Direct Research

Topline & Profitability (Coverage Universe)



Surge in palm oil prices (₹/kg)



Operating margins FMCG Coverage (%)

Company	EBITDA margin %				
	Q1'21	Q2'21	Q3'21	Q4'21	Q1'22
Colagte	29.6	31.8	30.1	40.5	30.7
Dabur	21.0	22.6	21.0	18.9	19.9
HUL	25.0	25.1	24.1	24.4	23.3
ITC	27.9	33.9	35.0	31.6	31.4
Marico	24.2	19.6	19.4	15.9	18.2
Nestle	24.5	24.9	22.6	25.8	23.8
Tata Cons.	17.8	14.4	11.8	9.9	11.6
VST Ind.	40.4	37.6	34.8	35.3	37.1
Zydus Welln	22.8	7.9	13.0	24.0	23.5
FMCG Total	25.1	26.9	26.3	25.8	24.7

Top Picks

Dabur
Tata Consumer
Zydus Wellness

Research Analysts

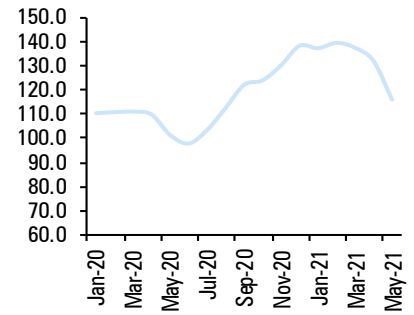
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Exhibit 2: Company Specific Views (FMCG)

Company	Remarks
Colgate	Colgate is expected to post 15.2% revenue growth in Q1FY22E on the back of sales decline in base quarter. The company witnessed 4.1% revenue decline in the base quarter. On a two year CAGR basis, growth is expected to be 5.2%. Though we believe second wave of pandemic would have impacted sales, to a certain extent, the impact would not have been as adverse as last year. We expect 114 bps operating margin improvement to 30.7% largely on the back of gross margin expansion. Net profit is likely to grow 22.2% to ₹ 242.1 crore
Dabur	Dabur is likely to witness 25.8% revenue growth on the back of sales decline in base quarter to the extent of 12.9%. We believe second wave of Covid-19 would have impacted sales in April-May given adverse impact reached rural regions. However, we believe growth in health supplement & OTC, ethnic products has been strong in continuance of FY21. We expect 168 bps gross margin contraction during the quarter given crude based raw material cost has risen sharply. Operating margin is expected to contract 118 bps. We expect net profit growth of 21.1% to ₹ 413.3 crore
HUL	HUL is likely to report 21.3% revenue growth led by 29.9% growth in beauty & personal care segment (BPC) & 22% growth in foods & refreshment segment. Both these segments were adversely impacted by lockdown in base quarter. We believe home care segment would grow at slower 3.7% given second wave of pandemic would have impacted detergent sales. With the sharp increase in palm oil prices & elevated tea procurement prices, we expect operating margins to contract 175 bps to 23.3%. We expect net profit to grow 11.3% to ₹ 2093.4 crore
ITC	We expect ITC to witness 29.3% revenue growth led by 33.7% growth on cigarettes segment mainly on account of severe adverse sales in base quarter. Though we believe cigarettes sales would have been impacted due to second Covid-19 wave, stocking at dealers levels in April would have off-set the negative impact. Similarly, paper segment sales are expected to grow 50.4% with sustained recovery in user industry. FMCG segment is likely to witness growth of 12.8% during the quarter. We expect 19.6% sales decline in agri segment due to high base & muted hotels segment sales due to second Covid-19 wave. Operating margins are likely to expand 355 bps to 31.4%. We expect net profit to grow 33.4% to ₹ 3125 crore
Marico	Marico is expected to see 28.5% revenue growth on the back of strong 30.3% domestic business sales growth & 21.8% international business growth. The expected growth was mainly on account of low base quarter impacted by lockdown. However, despite high base quarter impact on Saffola & foods, the company would continue to see strong growth in these segments. Copra prices have cooled down in May-June 2021. We expect gross margin improvement on a sequential basis. However, the company experienced very high margins in base quarter led by sharp decline in marketing spends. With the normalisation trend of marketing & overhead costs, we expect 600 bps contraction in operating margins. We expect net profit decline of 12.9% to ₹ 335.7 crore
Nestlé India	Nestlé is expected to post 21.5% revenue growth on the back of muted sales in base quarter. Though packaged food categories were positively impacted by lockdown, the company faced supply constraints during the peak of the lockdown. The company is trying to expand its distribution network to smaller towns and villages to grow its existing brands. Milk prices have risen sharply in the last three to four months. We believe the benefit of low cost SMP inventory would have been exhausted. We expect small gross & operating margin contraction during the quarter. Net profit is likely to grow 19.9% to ₹ 583.4 crore

Source: Company, ICICI Direct Research

Copra Price Trend (₹/kg)



Crude Price Trend (USD / barrel)

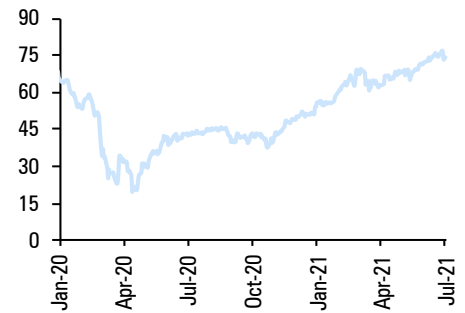


Exhibit 3: Company Specific Views (FMCG)

Company	Remarks
Tata Consumer (TCPL)	<p>TCPL is likely to witness 20.9% revenue growth largely led by sharp price increases in tea segment. It is important to note that base quarter had normalised sales as a sharp increase in 'at-home' consumption during lockdown benefited the company. Tea procurement prices remain elevated with lower production during March-April due to lack of rains in tea producing states. We expect 580 bps gross margins contraction similar to Q4FY21. Operating margins were high in the base quarter due to sharp cut-down in overhead spends. We expect operating margin contraction to the tune of 180 bps during the quarter. Net profit is likely to de-grow 31% to ₹ 238.3 crore</p>
VST Industries	<p>We expect VST Industries to post revenue growth (net of excise) of 16% to ₹ 284.8 crore mainly on account of low base quarter. The corresponding quarter witnessed sharp cigarettes volume de-growth due to lockdown. We expect gross margin contraction of 570 bps given very high margins in base quarter due to withdrawal of promotional offers. We estimate normalise promotional offers during the quarter. We expect operating margin contraction of 337 bps to 37.1%. We estimate net profit growth of 5.3% to ₹ 79.7 crore</p>
Zydus Wellness	<p>Zydus Wellness is likely to report 18.2% revenue growth on the back of 13.4% revenue decline in base quarter. We believe skin care category (Everyuth) & Nutralite butter sales would have been impacted by second wave of pandemic due to reduced out of home activity & closures of restaurants. However, we believe Sugarfree, Glucon-D & Nycil sales would have been stronger. We expect gross margins improvement of 140 bps & operating margin improvement of 80 bps during the quarter. With the expected reduction in interest cost due to re-payment of debt, net profit is likely to witness strong 54.1% growth</p>

Source: Company, ICICI Direct Research

Exhibit 4 : ICICI Direct coverage universe (FMCG)

	CMP		TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)			Rating	(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21
Colgate (COLPAL)	1,725	1,900	Buy	42,892	38.1	39.1	42.7	45.3	44.2	40.4	8.9	8.3	7.7	106.4	110.4	111.7	88.8	85.1	86.1
Dabur India (DABIND)	594	620	Buy	94,540	9.6	10.9	12.2	62.0	54.3	48.7	9.9	8.7	7.9	24.5	26.5	27.1	22.1	22.9	23.2
Hindustan Unilever (HINLEV)	2,451	2,715	Buy	554,458	33.9	40.5	45.0	72.4	60.5	54.4	12.2	10.6	9.8	18.9	25.6	27.7	17.1	20.0	21.6
ITC Limited (ITC)	202	240	Hold	258,136	10.7	12.5	13.9	18.8	16.1	14.5	5.4	4.9	4.5	28.7	32.9	34.8	22.5	25.4	26.8
Jyothy Lab (JYOLAB)	175	160	Hold	5,324	5.2	6.3	7.1	33.8	27.7	24.6	2.8	2.6	2.4	26.0	27.2	28.5	20.4	22.7	23.7
Marico (MARLIM)	534	490	Buy	53,027	9.3	9.6	10.7	57.5	55.5	49.9	6.6	5.9	5.3	40.3	42.5	45.5	37.0	37.4	39.7
Nestle (NESIND)	17,621	19,300	Hold	164,840	216.0	254.8	283.8	81.6	69.2	62.1	12.4	11.2	10.2	54.6	62.7	69.1	103.1	124.2	142.1
Tata Consumer Products (TAT)	766	725	Buy	57,963	10.1	12.4	14.5	75.8	61.7	52.8	5.0	4.4	4.1	8.0	9.1	10.0	6.4	7.6	8.5
VST Industries (VSTIND)	3,591	3,600	Hold	5,090	201.3	218.8	234.9	17.8	16.4	15.3	4.6	4.2	3.9	43.4	45.6	48.2	33.0	33.9	36.1
Varun Beverage (VARBEV)	770	800	Buy	33,343	8.4	14.1	20.7	92.1	54.4	37.2	5.2	4.2	3.6	10.9	17.4	23.4	10.3	15.4	19.1
Zydus Wellness (ZYDWEL)	2,209	2,800	Buy	13,502	18.7	60.8	72.0	118.4	36.3	30.7	7.2	6.4	5.8	6.2	7.8	9.1	5.5	8.1	9.4

Source: Company, ICICI Direct Research

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