KRChoksey | Institutional

Q3FY22E Consumer Sector Preview

Earnings Preview

7th January 2022

Consumer Goods

Health and Hygiene products to drive the show

MARKET DATA

	Close	1D (%)	1M (%)	YTD (%)
Nifty	17,925	0.67	5.99	1.70
Sensex	60,223	0.61	6.13	1.76
Nifty FMCG	37,911	0.3	1.1	(0.02)
USD / INR	74.35	(0.20)	(1.08)	0.08

COVERAGE STOCKS

Company	Current Price (INR)	Target* (INR)	Upside (%)	Market Cap. (INR mn)	Fwd P/E 2023E (x)	Recommendation*
Nestle India	19,936	21,150	6.1%	1,922,120	58.4	ACCUMULATE
Britannia Industries	3,660	3,802	3.9%	881,506	40.1	ACCUMULATE
Hindustan Unilever	2,416	2,704	11.9%	5,676,143	46.5	ACCUMULATE
ITC Ltd	221	310	40.3%	2,717,758	13.9	BUY
Colgate Palmolive	1,466	1,850	26.2%	398,772	30.6	BUY
Asian Paints	3,527	3,530	0.1%	3,382,900	48.6	ACCUMULATE
BlueStar Ltd	998	1,100	10.2%	96,150	65.3	BUY
Godrej Consumers	955	1,025	7.3%	976,105	40.1	ACCUMULATE
Tata Consumers	734	1,030	40.3%	676,050	45.3	BUY
Emami Ltd	511	UR	UR	227,169	46.0	UR
Avenue SuperMart	4,687	3,750	TA	3,036,379	107.4	HOLD
Berger Paints	790	845	7.0%	767,080	59.4	ACCUMULATE
Whirlpool India	1,779	UR	UR	225,642	36.7	UR

***Note: TP and recommendation has been retained from previous update reports; we will review it post detailed Q2FY22 results analysis and conference call of the said companies*
Source: Bloomberg, NSE; Data as of Jan 05, 2022; UR stands for Under Review: TA stands for Target Achieved

SECTOR OVERVIEW

- **FMCG industry witnessed a mixed quarter:** The Indian FMCG industry witnessed a mixed quarter as though urban demand was stable, rural demand got impacted due to high inflation, coupled with the base effect of Q3FY21, when demand was elevated for the FMCG products. Some other reasons for the weak rural performance are the erratic monsoon, which has affected the kharif crop (which has a potential impact on farm incomes), and the spread of corona virus. The demand has been slow in the rural areas as the repatriation of funds from urban to rural has not happened. The FMCG sector is expected to witness double-digit revenue growth, which will be driven by price hikes (in the range of 4-5%), effected across product categories, to offset the impact of the raw material price increase. As the lockdown restrictions eased, the count of active kirana stores increased to ~30%. While the second wave benefited hygiene and in-home consumption, during Q3FY22 there has been a recovery in the demand for out-of-home categories; the hotels and restaurants segments have also witnessed signs of recovery. **We see companies such as HUL, Britannia, ITC, Tata Consumer and Nestle India as the key beneficiaries.** The consumer confidence in discretionary expenditure is expected to be significantly lower during this quarter due to the after effect of the second wave. However, on a yearly basis, we expect the Companies to post a strong growth, considering a low base effect, on account of the lockdown restrictions on manufacturers and supply issues faced by them last year same quarter. On the margin fronts, operating margins are expected to be at normal levels of 15-20% with a moderation of 80-100 bps due to increase in advertising expenses and rise in raw material prices.

- **Demand is gradually recovering:** Pent-up demand was witnessed in Q3FY22 in sector like 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 Q3FY22. Additionally, entry-level products are estimated to have fared better with growth from tier 2 and smaller cities. Similarly, Paint companies such as Asian Paints and Berger paints witnessed strong rural demand; that has helped the recovery for the paint sector. Nonetheless, consumers are cautious amidst ongoing uncertainties, and some cut in the discretionary spends are expected. We also believe customers will be on 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 a robust growth in their top line ranging from mid-single to double digit on YoY basis.**

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Consumer Goods

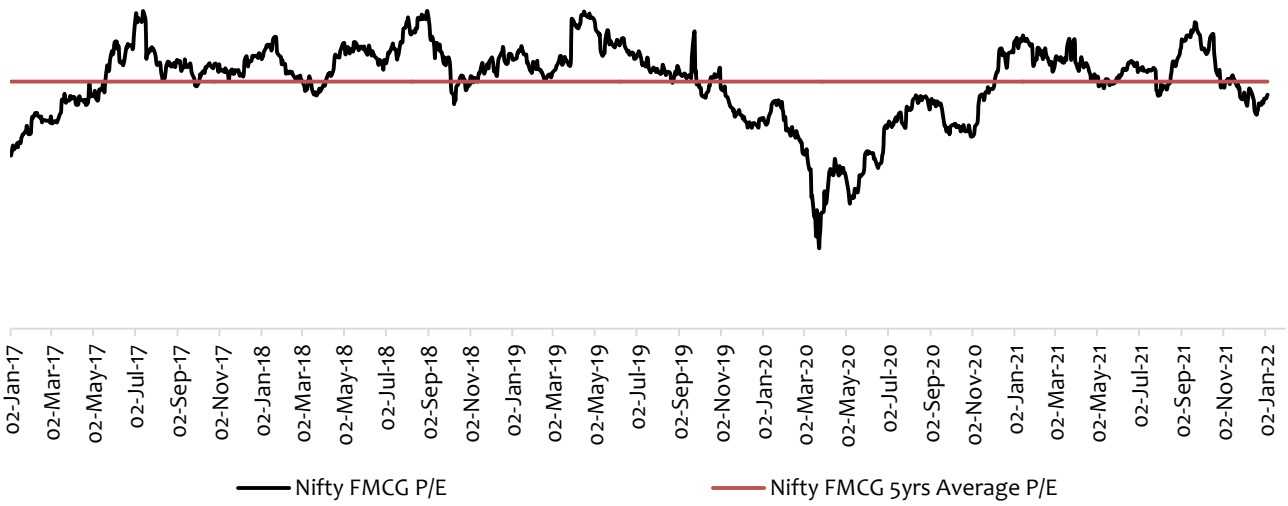
SECTOR OVERVIEW

- **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 essential (eatables) 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 as dish washers, large refrigerators, larger LED TVs, RACs, etc. is on the 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 maintain social distancing. **Most of these trends have lasting impact on consumer behavior and are likely to remain so for quite sometime.**

- **Tussle between FMCG companies and distributors over margin parity will be a short-term phenomenon:** For the last few months the FMCG companies are at loggerheads with distributors over higher margins being offered by the FMCG companies to emerging online Business-to-Business (B2B) platforms and cash-and-carry companies. Distributors in several states are threatening to boycott some brands of companies like HUL and Colgate over the above issue. FMCG companies offer a margin of 3.5-5% to traditional distributors, but new platforms are able to negotiate 12-15% margins, given their bulk orders. In turn, these platforms are able to offer discounts to retailers and kirana stores or general trade (GT) stores, who prefer to buy products from them instead of their regular distributors. GT accounts for about 80-90% of sales of leading FMCG companies; the rest is contributed by modern retail trade and e-commerce. The new platforms are trying to disrupt this process and promise an organised, technologically advanced and cost-efficient system of procuring products for general trade stores. We believe this is a short-term phenomenon and FMCG companies will reach out to the distributors and solve the issue amicably so that this does not have any adverse impact on the demand-supply dynamics of the FMCG industry. Recently HUL has met the 'All India Consumer Products Distributors Federation' (AICPDF) and held discussions to solve the issue.

- **Sector Valuation:** Currently, Nifty FMCG is trading at an average P/E of 40.1x compared to its five-year average of 41.3x (implies discount of ~2.9%). In our view, stock specific premium valuation will continue for Nestle (+41.5% over sector), HUL (+12.5% over sector), Asian Paints (+17.7% over sector), Blue Star (+58% over sector), Tata Consumer (+9.6% over sector) , Avenue Supermarts (+160% over sector), and Berger Paints (+44% over sector) on the back of their solid market positioning and high demand for essentials in the light of COVID-19. **We believe there is mispricing on ITC shares, as the ~66% valuation discount to sector is unwarranted and hence recommend BUY on the stock. Stocks like Colgate, Godrej Consumer, and Britannia are trading at a discount of 26%, 3% and 2.8% of the 5 years average sector P/E.**

NIFTY FMCG P/E and 5 Yr Average



Source: NSE

Consumer Goods

Exhibit 1: Quarterly result expectation for companies under coverage

INR Mn	Q4CY21E	Q4CY20A	YoY	Q3CY21A	QoQ	Remarks
Nestle India						
Sales	37,930	34,326	10.5%	38,826	-2.3%	Nestle India is expected to post revenue growth of 10.5% YoY in Q4CY21, owing to double-digit growth in domestic sales, driven by increased demand for ready-to-eat food products. We anticipate significant increase for in-home and out-of-home consumption as a result of the ease in lockdown restrictions. We expect a marginal improvement in EBITDA and PAT margins due to operational efficiencies, which can lower variable costs to offset the effect of rising raw material prices. 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	9,293	7,770	19.6%	9,480	-2.0%	
Net Profit	6,069	4,833	25.6%	6,174	-1.7%	
EBITDA (%)	24.5%	22.6%	186 bps	24.4%	8 bps	
NPM (%)	16.0%	14.1%	192 bps	15.9%	10 bps	
INR Mn	**Q3FY22E**	**Q3FY21A**	**YoY**	**Q2FY22A**	**QoQ**	**Remarks**
Britannia Industries						
Sales	35,445	31,656	12.0%	36,074	-1.7%	Sales expected to grow by 12% YoY as the company revamped its largest selling biscuit brand Good Day and it has also expanded its product portfolio by adding three more variants in the premium biscuit segment. Stress on margins may likely to continue despite companies resorting to price increases and grammage reduction. We anticipate the advertising cost to be higher compared to last year impacting the margins. 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	5,689	6,115	-7.0%	5,583	1.9%	
Net Profit	4,345	4,558	-4.7%	3,842	13.1%	
EBITDA (%)	16.0%	19.3%	-327 bps	15.5%	57 bps	
NPM (%)	12.3%	14.4%	-214 bps	10.7%	161 bps	
Hindustan Unilever Ltd						
Sales	130,667	121,810	7.3%	130,460	0.2%	We expect overall sales to grow by 7.3% YoY led by health, hygiene and nutrition categories, which will be supported by the volume growth in Discretionary category such as ice cream and out of home consumption categories. Sales in the health food category (Horlicks/Boost) will grow on the back of strong distribution network of HUL. PAT Margins may improve marginally on YoY basis due to operational efficiency. The rural demand has shown some signs of stability as the distribution network under the project Shakti has doubled in FY21. Key Parameters: (1) Guidance on volume and price in FY21 (2) Impact on premiumization and new product launches (3) Supply disruptions for raw materials and corresponding impact on cost (4) GSKCH portfolio performance.
EBITDA	31,460	29,630	6.2%	32,260	-2.5%	
Net Profit	22,092	19,370	14.1%	21,810	1.3%	
EBITDA (%)	24.1%	24.3%	-25 bps	24.7%	-65 bps	
NPM (%)	16.9%	15.9%	100 bps	16.7%	19 bps	
ITC Ltd						
Sales	151,132	141,245	7.0%	148,444	1.8%	We expect sales to grow by 7% YoY; driven by increasing demand for hygiene product (soaps handwash - Savlon), Floor disinfectant (Nimyle) and FMCG products such as Noodles, Packaged Atta and biscuits. Cigarette segment will likely continue to grow in sales and volume terms. The agri business will continue to see strong traction. The hotel business is expected to recover, considering ease in the lockdown. FMCG margins are on a strong upward trend due to premiumization strategies. Key parameters: (1) Guidance on price and volume (2) Cigarette inventory levels (3) Adoption of newly launched products.
EBITDA	50,226	47,850	5.0%	50,176	0.1%	
Net Profit	38,690	35,266	9.7%	37,138	4.2%	
EBITDA (%)	33.2%	33.9%	-64 bps	33.8%	-57 bps	
NPM (%)	25.6%	25.0%	63 bps	25.0%	58 bps	

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Consumer Goods

Exhibit 1: Quarterly result expectation for companies under coverage

INR Mn	Q3FY22E	Q3FY21A	YoY	Q2FY22A	QoQ	Remarks
Colgate Palmolive						
Sales	13,240	12,319	7.5%	13,524	-2.1%	We expect Colgate Palmolive to witness revenue growth of 7.5% YoY, driven by increase in volume in the toothpaste category. The Company showed preparedness to face the lockdown impact. Advertisement spending is likely to be on an increasing trajectory as per the company strategy. EBITDA is expected to increase by 7.9% YoY, while PAT is likely to grow by 8.7% YoY. 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.
EBITDA	3,999	3,706	7.9%	4,008	-0.2%	
Net Profit	2,699	2,484	8.7%	2,692	0.3%	
EBITDA (%)	30.2%	30.1%	12 bps	29.6%	57 bps	
NPM (%)	20.4%	20.2%	22 bps	19.9%	48 bps	
Asian Paints						
Sales	80,104	67,885	18.0%	70,960	12.9%	We expect sales to increase by 18% on YoY basis led by market share gain, expansion of product portfolio and multiple price increases taken during the quarter. We expect International revenues (12-13% of revenue) to remain subdued due to global supply disruption and lesser demand in foreign countries. EBITDA margins are expected to contract by 684bps YoY, due to increase in Brent crude prices. PAT margins also expected to contract by around 374 bps YoY. Key Parameters: (1) Sustainable volume growth (2) Raw material price trends (3) Inventory levels (4) Rural demand outlook (5) Demand for newly launched home décor product.
EBITDA	15,620	17,879	-12.6%	9,045	72.7%	
Net Profit	11,615	12,383	-6.2%	5,960	94.9%	
EBITDA (%)	19.5%	26.3%	-684 bps	12.7%	675 bps	
NPM (%)	14.5%	18.2%	-374 bps	8.4%	610 bps	
Blue Star						
Sales	13,037	11,239	16.0%	12,397	5.2%	We expect sales to grow 16% YoY on the back of strong order book and healthy order inflow in the EMPS segment. The subdued growth on QoQ basis is due to slow execution pace of the orders, due to partial lockdowns and company's preference of being balance-sheet prudent, with prompt payment from customers over its overall growth. EBITDA and margins may also get impacted due to subdued execution of the projects. 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.
EBITDA	782	816	-4.1%	707	10.6%	
Net Profit	391	368	6.2%	314	24.7%	
EBITDA (%)	6.0%	7.3%	-126 bps	5.7%	30 bps	
NPM (%)	3.0%	3.3%	-28 bps	2.5%	47 bps	
Godrej Consumer Products						
Sales	33,278	30,554	8.9%	31,637	5.2%	As per the disclosures by the company, the demand trend remained stable and improved sequentially across key geographies. We expect sales to grow by 9% YoY led by hygiene (including soap) and household insecticide categories. The notable recovery has been witnessed in hair color, personal care and air fresheners, on quarterly basis. Within International business, Indonesia revenue is expected to recover due to measures taken by govt to improve macroeconomic factors, while the growth momentum may continue in rest of regions. Key Parameters: (1) Impact on working capital (2) Strategies to manage the supply disruption (3) Capacity utilization levels (4) Cost cutting measures.
EBITDA	7,321	6,935	5.6%	6,596	11.0%	
Net Profit	5,243	5,021	4.4%	4,789	9.5%	
EBITDA (%)	22.0%	22.7%	-70 bps	20.8%	115 bps	
NPM (%)	15.8%	16.4%	-68 bps	15.1%	62 bps	

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INR Mn	Q3FY22E	Q3FY21A	YoY	Q2FY22A	QoQ	Remarks
Tata Consumer Products						
Sales	33,053	30,891	7.0%	30,331	9.0%	We expect overall sales to improve by 7% YoY. We believe the incremental revenue from merger with Tata Chemical consumer business segment and with volume growth across all segments will support the topline. In addition, demand for essential products such as salt, staples and tea is expected to be higher due to higher in-house consumption amidst recovery in consumption level. We expect margin improvement led by better product mix and operational efficiency. Key Parameters (1) Performance of the FMCG portfolio (2) Digitalization of distribution channels / Cancellation of agreement with distributors (3) Outlook for rest of FY22E and FY23E (4) Steps undertaken to mitigate the supply disruptions.
EBITDA	4,958	3,613	37.2%	4,133	20.0%	
Net Profit	3,140	2,182	43.9%	2,680	17.1%	
EBITDA (%)	15.0%	11.7%	330 bps	13.6%	137 bps	
NPM (%)	9.5%	7.1%	244 bps	8.8%	66 bps	
Emami Ltd						
Sales	9,807	9,340	5.0%	7,888	24.3%	We expect sales to improve 5% YoY/24% QoQ due to low base in the same quarter last year and increase in volume for Zandu, and hygiene products. Gross margin expansion is expected to be under pressure due to spike in raw material prices. EBITDA and PAT margins are also expected to remain under pressure due to inflationary trends in the raw material prices. Key Parameters (1) Guidance on price and volume for rest of FY22E and FY23E (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	3,285	3,406	-3.5%	2,772	18.5%	
Net Profit	2,059	2,093	-1.6%	1,853	11.2%	
EBITDA (%)	33.5%	36.5%	-296 bps	35.1%	-164 bps	
NPM (%)	21.0%	22.4%	-141 bps	23.5%	-248 bps	
Avenue SuperMart						
Sales	98,046	75,420	30.0%	77,889	25.9%	We expect sales to grow by 30% YoY to INR 98,046 Mn on the back of increasing footfall in the stores, store expansion and ease in lockdown restrictions, in the last quarter. EBITDA margin is set to grow by 36 bps YoY to 9.5%, while PAT margin is expected to grow by 30 bps YoY to 6.2%, due to low corporate taxation. 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	9,314	6,891	35.2%	6,686	39.3%	
Net Profit	6,103	4,470	36.6%	4,178	46.1%	
EBITDA (%)	9.5%	9.1%	36 bps	8.6%	92 bps	
NPM (%)	6.2%	5.9%	30 bps	5.4%	86 bps	

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Consumer Goods

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INR Mn	Q3FY22E	Q3FY21A	YoY	Q2FY22A	QoQ	Remarks
Berger Paints						
Sales	23,724	21,182	12.0%	22,250	6.6%	We expect Berger paints revenue to grow 12% YoY led by low base and 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. Nearly 70% of the demand is for repainting. International business (5-7%) is expected to be affected due to disruption and halt in export. The recent spike in the input cost likely to put pressure on the margins. 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	3,796	4,150	-8.5%	3,540	7.2%	
Net Profit	2,705	2,748	-1.6%	2,189	23.6%	
EBITDA (%)	16.0%	19.6%	-359 bps	15.9%	9 bps	
NPM (%)	11.4%	13.0%	-157 bps	9.8%	156 bps	
Whirlpool						
Sales	16,807	14,940	12.5%	16,071	4.6%	We expect sales to grow 12.5% YoY, mainly due to lower base in the corresponding quarter of last year, sales are likely to be driven on the back of higher demand for refrigerators due to more in-home consumption mainly from Tier 2 & 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	1,933	1,006	92.1%	1,294	49.4%	
Net Profit	1,429	714	100.2%	4,132	-65.4%	
EBITDA (%)	11.5%	6.7%	477 bps	8.1%	345 bps	
NPM (%)	8.5%	4.8%	372 bps	25.7%	-1,721 bps	

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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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