Sharekhan by BNP PARIBAS

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Godrej Consumer Products Ltd

Revamp strategies to drive consistent growth

Consumer Goods	Sharekhan code: GODREJCP

Reco/View: Buy	↔	CMP: **Rs. 888**	Price Target: **Rs. 1,249**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

ESG Disclosure Score NEW

ESG RISK RATING 26.57

Updated Oct 08, 2021

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

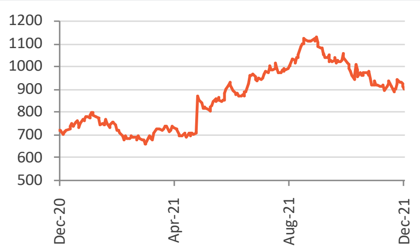
Company details

Market cap:	Rs. 90,478 cr
52-week high/low:	Rs. 1,139 / 644
NSE volume: (No of shares)	12.9 lakh
BSE code:	532424
NSE code:	GODREJCP
Free float: (No of shares)	37.6 cr

Shareholding (%)

Promoters	63.2
FII	26.6
DII	4.6
Others	5.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.8	-18.1	-0.1	25.8
Relative to Sensex	2.6	-12.7	-6.3	3.2

Sharekhan Research, Bloomberg

Summary

- Analyst conference hosted by Mr. Sudhir Sitapati, Managing Director (MD) & CEO of GCPL, was more focused on filling the business gaps to improve the revenue and earnings growth in the medium term. However, the long-term vision of the leadership was missing in the meet.
- The company is aiming at achieving double-digit volume growth through penetration gains in 50% of the portfolio, moderate share gain in 50% of portfolio, consumption-led market growth, and disruptive innovation.
- Headwinds such as raw-material inflation and pandemic-led uncertainties will keep a toll on earnings growth in the near term. However, management is confident of achieving 150-200 bps OPM expansion, driven by better mix and cost-saving measures in the stable market environment.
- The stock has corrected by 18% in the past three months and is currently trading at a discounted valuation of 39x/33x its FY2023/FY2024E EPS. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 1,249.

We attended the analyst conference of Godrej Consumer Products Limited (GCPL), which was hosted to discuss the change in business strategies under the new leadership of Mr. Sudhir Sitapati, MD and CEO of the company. Under the revamped strategy, the company would be focusing on market development of low penetrated categories (including household insecticide, air care, and hair colour crème) in key markets by increasing awareness, more sampling of products, increased media spends, and enhancing the product reach. This should help the company to achieve double-digit volume growth in the stable demand environment in key markets. Further, the company is striving for 150-200 bps expansion in OPM through reduced discounts, increased automation to drive efficiencies, and improved revenue mix.

- **Aims to achieve double-digit volume growth:** Strong product portfolio across geographies, sustained innovation, and offering quality products to consumers are some of the key strengths of the company, which aided to achieve double-digit volume growth of 15% over 2011-2015. Demonetisation and GST-led disruption in India, lost ground in the core business in Indonesia, and slower growth in Africa led to modest 5% volume growth over 2016-2020. Under the new leadership, the company is aiming at achieving double-digit volume growth through penetration gains in 50% of the portfolio, moderate share gain in half of the portfolio, consumption-led market growth, and disruptive innovation.
- **Differentiated strategies across geographies:** In India, GCPL aims to improve the per capita consumption of low penetrated categories such as household insecticide (HI) and air care through category development. It expects the soaps business to continue to grow through market share gains and has indicated that there will be no change in the category strategy. In Africa, the company is focusing on improving the penetration of wet hair products and HI category to drive sustained double-digit growth in the long run. In Indonesia, the focus will be more to regain market share in the core business of wet wipes and HI.
- **Moderate growth in the near term; Confident of double-digit growth with revamped strategy:** Headwinds such as raw-material inflation and pandemic-led uncertainties will keep a toll on earnings growth in the near term. The company is expecting moderate volume growth in the inflationary environment and price-led growth to lead topline growth. Margins would remain under pressure in H2FY2022, which would improve in FY2023. With revamped strategies and stable market environment, the company expects to get back to its double-digit growth with operating profit margin (OPM) expansion of 150-200 bps.

Our Call

View: Maintain Buy with an unchanged PT of Rs. 1,249: Under the new leadership, the company's immediate focus is to fill the gaps to achieve sustainable double-digit volume growth in the medium term. Increased penetration, cross pollination, simplifying business in key markets, and increased distribution reach are some of the key growth drivers in the medium term. Success of the revamped strategies with sustained double-digit growth will be key trigger for valuations to improve in the coming years. The stock has corrected by 18% in the past three months and is currently trading at discounted valuation of 39x/33x its FY2023/FY2024E EPS. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 1,249.

Key Risks

The company's ability to improve the growth trajectory under revamp strategies, sustained high raw-material inflation, and pandemic-led uncertainties in key markets would act as a key risk to earnings estimates.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	11,029	12,650	14,040	15,780
OPM (%)	22.2	21.1	22.2	22.9
Adjusted PAT	1,765	1,947	2,344	2,749
Adjusted EPS (Rs.)	17.3	19.0	22.9	26.9
P/E (x)	51.5	46.7	38.8	33.0
P/B (x)	9.6	8.6	7.5	6.5
EV/EBIDTA (x)	37.9	34.5	29.4	25.3
RoNW (%)	20.4	19.5	20.7	21.0
RoCE (%)	18.3	20.2	22.3	23.4

Source: Company; Sharekhan estimates

Key strengths of the company

The company's growth has been based on some of its strengths, which includes innovation culture (the company has a legacy of being on the forefront with respect to product innovation), quality obsession (management has indicated that quality is of utmost priority for the company, no decisions are taken such that they will compromise the customer quality of any product), frugal cost mindset (steps are being taken towards being cost efficient in various operations), strong processes (a chain of processes is followed, which ensures the best decision making), good in-market distribution (the company's products have a good visibility across outlets, which aids in pushing demand for the products), urban-centric approach in Indonesia (the company has wider presence (70%) in urban areas of Indonesia in the modern trade channel). The strengths of the company along with the strong portfolio, which is concentrated in four countries (80% of revenue) and with ~40% of revenue and 60% of profits coming from four products with less than 20% penetration provide a huge scope for expansion and growth in the medium-long term.

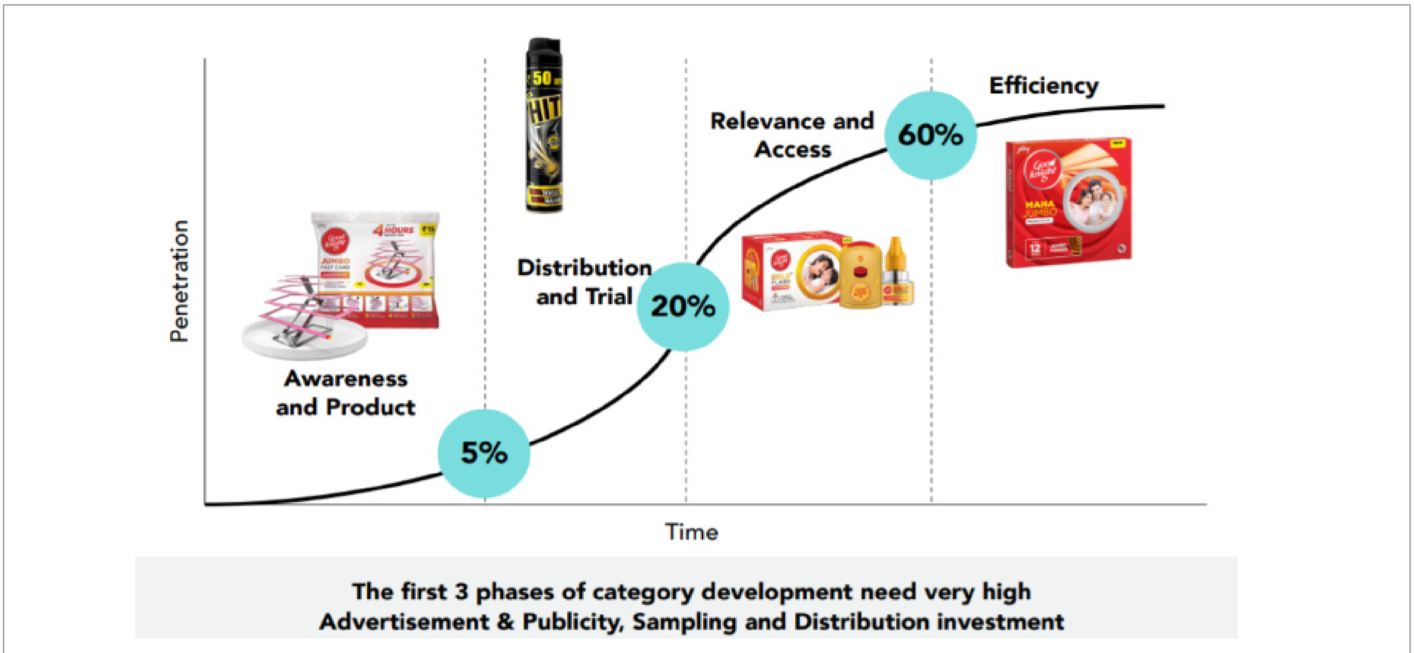
Working on some of the weaknesses to improve growth prospects

The company has stated the inability to drive category development as its key weakness area as it has failed to develop the categories in which its products are present and the category penetration stops at ~25% of the population with the fear of downgrading. Another issue faced by the company is the complexity of its business across geographies and categories. Few examples to illustrate the same include Kenya, which is a Rs. 60 crore FMCG business, has a portfolio of 13 brands. In India, the company has 500 SKUs, but each store keeps only 12. The effects of these are higher cost and inventory (GCPL has 1.7x inventory as compared to its best in class Indian peer) and loss of focus from the core business (loss in core categories is not compensated by growth in new products leading to lower growth rate). Another weakness of the company is that it does not have good global collaboration, which can benefit the company. Lastly, the company's strategy of being frugal comes at a cost of higher fixed overheads (GCPL's consolidated fixed overheads are 1.7x of the top three Indian peers), lack in automation of the company's production, and lower media spends.

Growth lies in making a few changes in its strategies

GCPL plans to work on simplifying business in some of the key geographies, work more on global collaborations, reduce the cost by reducing discounts, and reduce overheads through automation, while undertaking higher media spends and investing on talent in the coming years. Moreover, the company will focus on improving penetration of some of the key categories (including household insecticide, hair colour crème, and air care products) through category development by creating more awareness, higher media investments, and improving the distribution.

Category development timeline (Mosquitos category)



Source: Company presentation

Aim to achieve penetration led volume growth

GCPL is aiming at achieving double-digit volume growth through penetration gains in 50% of portfolio (contributes ~50% of revenue), moderate share gain on 50% of portfolio (contributes ~15% of revenue), consumption-led market growth (25% contribution to revenue), and disruptive innovation (10% contribution to revenue). To fuel the company's growth, GCPL plans to invest in media and sampling, increased salaries rather than giving discounts, spend on automation, and digitalisation leading to savings in overheads, invest in widening its distribution network, and incur capital expenditures and cut down on inventory spends. The company is confident of achieving 2.0-2.5x of GDP growth in low penetrated categories in the coming years. It is anticipating 150-200 bps margin expansion through improvement in mix and cost-saving measures.

Category penetration of the company's products

Category penetration	FY21
Air Fresheners (Indonesia)	28%
Household Insecticide Aerosols (Indonesia)	23%
Liquid Vapourisers (India)	28%
Hair Colour Crème (India)	13%

Source: Company presentation

Differentiated strategies across geographies

In India, GCPL aims to improve the per-capita consumption of low penetrated categories such as HI and air care through category development. It expects the soaps business to continue to grow through market share gains and has indicated that there will be no change in the category strategy. India's penetration in the liquid vapourisers is 28% while that for aerosols is around 10%. Further non-mosquito HI (cockroach) and aircare has 10% category penetration and has strong potential to grow in long run. In Africa, the company is focusing on improving the penetration of wet hair products and HI category to drive sustained double-digit growth in the long run. As per management, the dry hair business, which is a high-margin business, is doing extremely well with 60%+ category penetration. In Indonesia, the focus will be more to regain market share in the core business of wet wipes and HI. New product launches are performing well. However, the company believes macro environment will take some time to revive and, hence, growth in the Indonesian business is expected to recover gradually.

Geography-wise performance

	2016-20	FY21	H1 FY22
GAUM growth	13%	8%	32%
Avg. EBITDA	14%	10%	11%
Lat Am growth	(3%)	19%	11%
Avg. EBITDA	13%	14%	17%

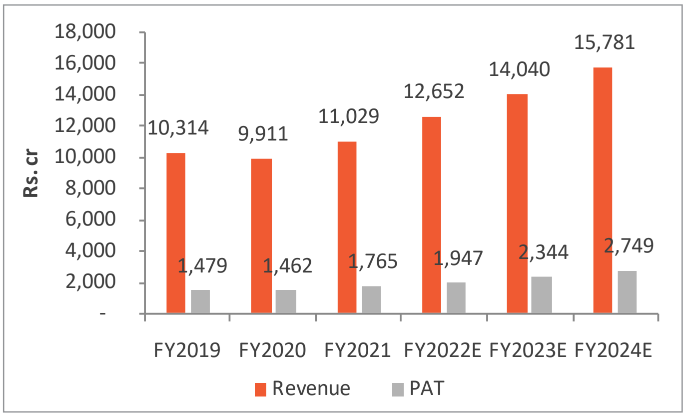
Source: Company presentation

Moderate growth in the near term led by raw-material inflation and pandemic-led uncertainties

The company expects moderate volume growth in H2FY2022 on the backdrop of inflationary environment with price growth expected to stay ahead of volume growth, which will lead to high gross margin dilution and moderate EBIDTA dilution. In FY2023, the company expects moderate volume growth and high price growth. Gross margin is expected to recover strongly, while EBIDTA margin expansion will be lower than gross margin expansion due to higher media spends and investment on distribution. Overall, GCPL will focus on category development with needful innovation to drive growth in the coming years.

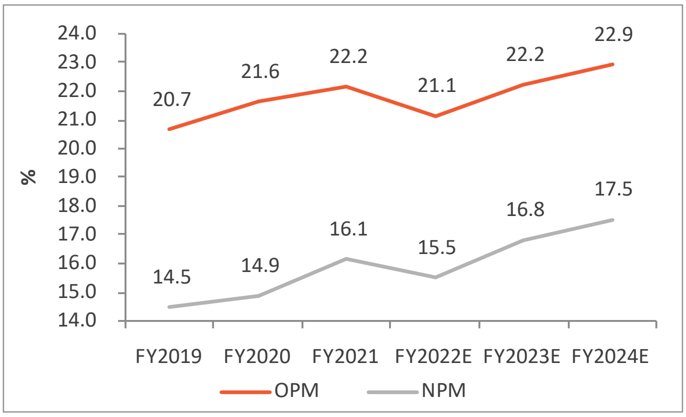
Financials in charts

Revenue and PAT to grow at 12 and 19% CAGR



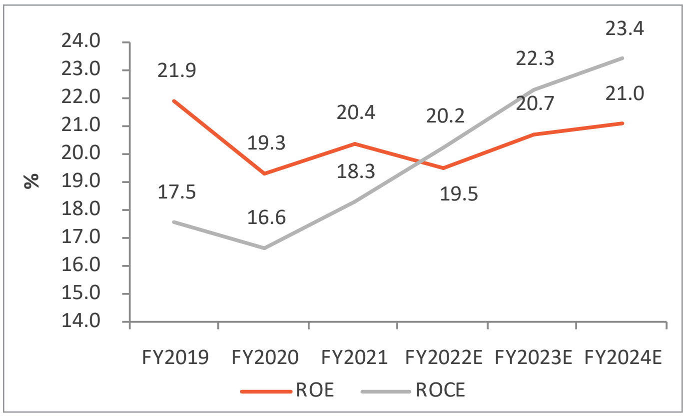
Source: Company, Sharekhan Research

Margins to improve from the current level



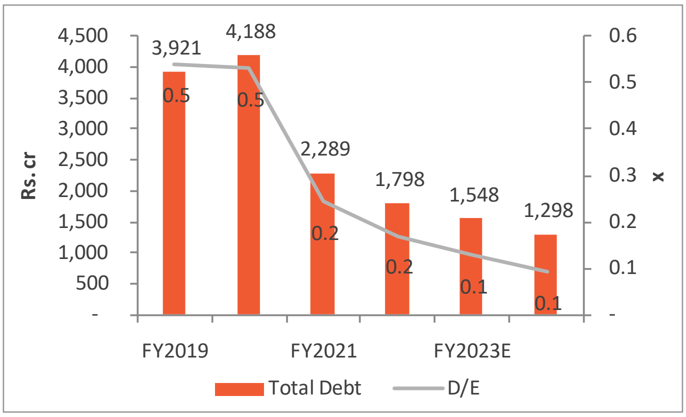
Source: Company, Sharekhan Research

Return ratios to rise going ahead



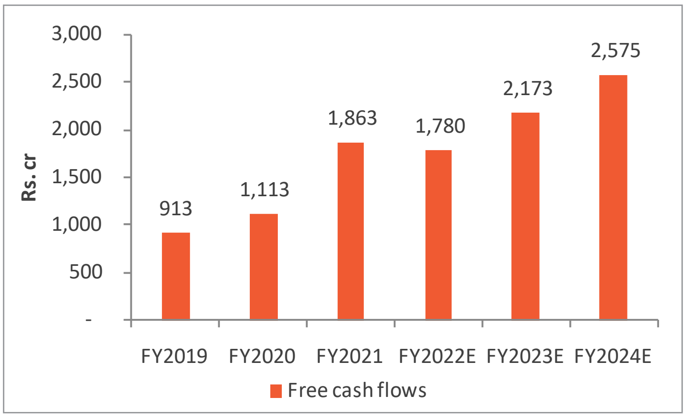
Source: Company, Sharekhan Research

Improvement in debt position



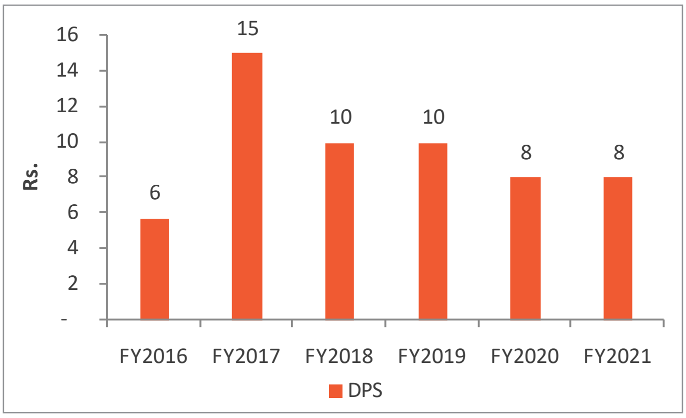
Source: Company, Sharekhan Research

Significant free cash flow generation



Source: Company, Sharekhan Research

Consistent dividend payout



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Medium-term growth remains intact

After the second wave disruption in April-May 2021, companies witnessed faster recovery in performance in June-July 2021. With improving mobility, demand for out-of-home categories such as colour cosmetics, beverages and juices, deodorants and hair colour has increased. Rural demand has softened a bit in the past few weeks due to higher inflationary pressure but is expected to come back with better agri production and government support. Thus, we expect consumer goods companies to post better sales volume in the quarters ahead. Raw-material inflation would sustain in the medium term and would put pressure on the margins of consumer goods companies. However, improving revenue mix and better operational efficiencies would help in mitigating inflationary pressures. Lower penetration in key categories, improving per capita income, shift to branded products, and improving penetration in rural India are some of the key growth drivers for the company in the medium term.

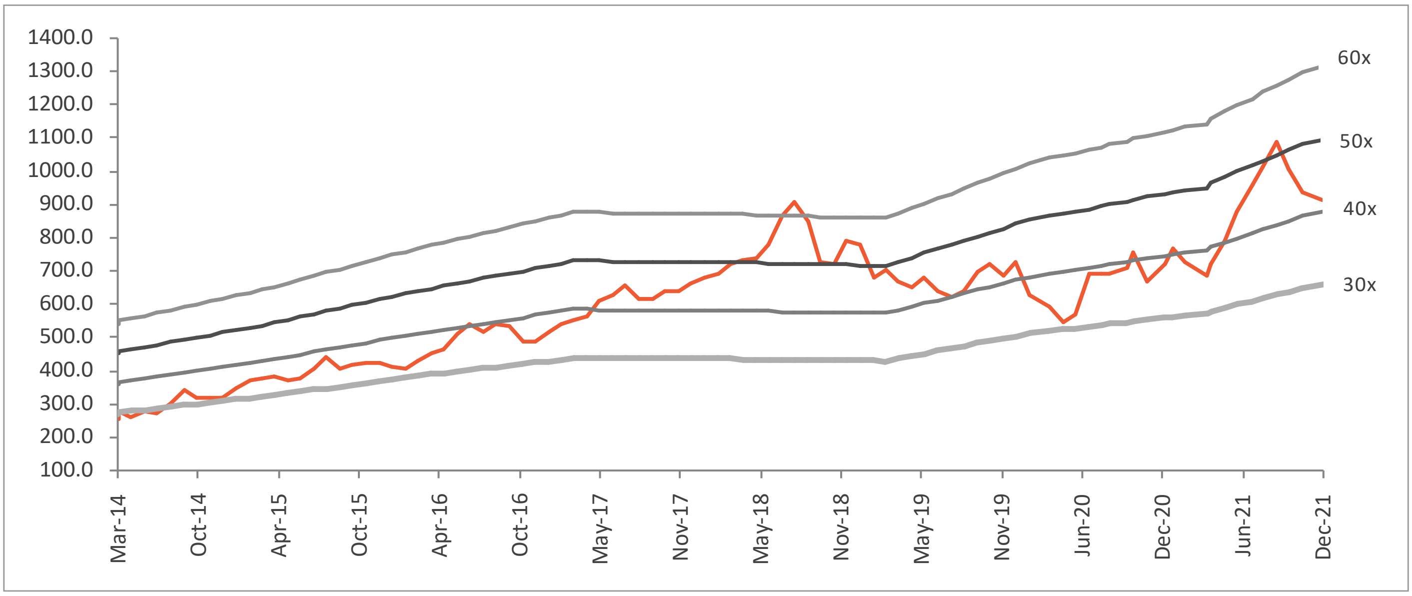
■ Company outlook - Change in leadership likely to drive consistent growth ahead

Under the new leadership of Mr. Sudhir Sitapati, the company will focus on achieving consistent double-digit revenue growth in the medium term. Improvement in penetration of HI in rural markets, scale up in performance of new categories such as hygiene (including hand wash/surface cleaners), sustained double-digit growth in Africa business, and recovery in Indonesia business are key medium-term revenue growth drivers for the company. Indonesia will take time to get back on the growth path. The company expects to mitigate input cost pressures by improving revenue mix, better cost-saving initiatives in key geographies, and prudent price hikes in key SKUs.

■ Valuation - Maintain Buy with an unchanged PT of Rs. 1,249

Under the new leadership, the company's immediate focus is to fill the gaps to achieve sustainable double-digit volume growth in the medium term. Increased penetration, cross pollination, simplifying business in key markets, and increased distribution reach are some of the key growth drivers in the medium term. Success of the revamped strategies with sustained double-digit growth will be key trigger for valuations to improve in the coming years. The stock has corrected by 18% in the past three months and is currently trading at discounted valuation of 39x/33x its FY2023/FY2024E EPS. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 1,249.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21E	FY22E	FY23E
Hindustan Unilever	65.5	58.1	47.2	46.6	41.0	34.0	36.5	25.2	31.1
Dabur India	58.4	52.7	41.8	47.3	41.2	32.4	26.4	27.8	31.8
Godrej Consumer Products	51.5	46.7	38.8	37.9	34.5	29.4	18.3	20.2	22.3

Source: Company, Sharekhan estimates

About company

GCPL is a leading emerging market company with a turnover of more than Rs. 10,000 crore. The group enjoys the patronage of 1.15 billion consumers globally across businesses. GCPL is present in key product categories such as soaps, hair colour, and HI. The company's power brands include Godrej No.1 soap, Godrej expert range of hair colours, and Good Knight. GCPL operates internationally in Indonesia, Latin America, and AUM (Africa, US, and Middle East) regions.

Investment theme

GCPL has a '3 by 3' approach to international expansion by building presence in '3' emerging markets (Asia, Africa, and Latin America) across '3' categories (home care, personal wash, and hair care products). The company has a leadership position in most categories in the domestic and international markets. Sustained innovation, cross pollination, enhanced distribution reach, and foray into new categories have remained the company's key growth pillars. The company saw good recovery in key domestic categories such as HI and international markets (including Indonesia and Africa), which will drive earnings growth in the near term.

Key Risks

- Currency fluctuation in key international markets, including Africa and Indonesia, will affect earnings performance.
- Increased prices of key raw materials such as palm oil would affect profitability and earnings growth.
- Increased competition in highly penetrated categories such as soaps would threaten revenue growth or any competition from illegal entrants in the HI category would affect its performance.

Additional Data

Key management personnel

Adi Godrej	Chairman, Godrej Group
Nisaba Godrej	Chairperson
Sudhir Sitapati	Managing Director & CEO
Sameer Shah	Chief Financial Officer
Rahul Botadara	Company Secretary & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	First State Investments ICVC	2.97
2	Temasek Holdings Pte. Ltd.	2.46
3	Capital Group Cos Inc.	1.76
4	St James Place Asia Pacific	1.18
5	Vanguard Group Inc.	1.17
6	BlackRock Inc.	1.09
7	Republic of Singapore	1.07
8	Kotak Mahindra Asset Management Co.	0.48
9	DSP Investment Managers Pvt. Ltd.	0.42
10	Veritas Asset Management LLP	0.33

Source: Bloomberg (old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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