Sharekhan by BNP PARIBAS

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Godrej Consumer Products Ltd

Soft Q1; focus on improving growth in key markets

Consumer Goods	Sharekhan code: GODREJCP

Reco/View: Buy	↔	CMP: **Rs. 850**	Price Target: **Rs. 959**	↔

↑ 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 26.88

Updated Jul 08, 2022

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 86,919 cr
52-week high/low:	Rs. 1,139 / 660
NSE volume: (No of shares)	15.4 lakh
BSE code:	532424
NSE code:	GODREJCP
Free float: (No of shares)	37.6 cr

Shareholding (%)

Promoters	63.2
FII	24.4
DII	6.1
Others	6.3

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	2.1	12.4	-7.9	-14.1
Relative to Sensex	-7.6	6.1	-7.1	-21.3

Sharekhan Research, Bloomberg

Summary

- Q1FY2023 was a soft quarter for Godrej Consumer Products (GCPL) as consolidated volumes declined 5% (6% volume decline in India business) while revenue growth of 8% was primarily price-led. OPM fell by 407 bps y-o-y to 17.0% due to higher input prices.
- Management expects revenue growth trajectory to improve ahead given focus on category development of low-penetrated categories such as household insecticides, air and hair colour in India, higher media spends in Indonesia and simplification of Africa business' structure.
- Decline in raw material prices would help margins improve in Q3; expects to maintain OPM on y-o-y basis at ~20%. Targets OPM to remain in the range of 20-22% in the medium term.
- Stock has underperformed its peers for the past one year and is trading at 42.9x/36.7x its FY2023E/24E earnings. We maintain our Buy on the stock with an unchanged PT of Rs. 959.

Godrej Consumer Products Limited (GCPL) delivered yet another soft quarter with consolidated revenue growth of 8% y-o-y (volume decline of 5%) to Rs. 3,125 crore. The India business posted growth of 12% y-o-y, with personal care segment growing strongly by 25% y-o-y while homecare declined by 4% y-o-y. Internationally, Africa, the US, and Middle East businesses maintained double-digit growth momentum and grew by 12% y-o-y on CC terms, while Indonesia business stayed affected posting a decline of 9% y-o-y on CC terms. Consolidated gross margins declined by 558 bps y-o-y, while OPM declined by 407 bps y-o-y to 17% due to higher input cost inflation. EBITDA margin of India and Indonesia business registered a decline of 380 bps and 810 bps y-o-y, respectively. Operating profit decreased by 12.8% y-o-y to Rs. 532.6 crore. Adjusted PAT decreased by 16.5% y-o-y to Rs. 347 crore.

Key positives

- Company gained market share in ~90% of the categories in India business.
- Three-year volume growth CAGR stood at 3% for the consolidated business and 4% for India business
- AUM region delivered 12% y-o-y growth in CC terms (3-year CAGR of 11%).

Key negatives

- Indonesia business witnessed sales decline of 12% y-o-y in CC terms.
- Gross margin/OPM declined by 558/407 bps y-o-y due to higher raw material prices

Management Commentary

- Category development and launch of blockbuster innovations are key growth strategies for the company in its India business. The focus is on further democratising the category by making it more affordable to consumers and spending on improving market positioning of key products in India. Household insecticides are expected to recover in the medium term.
- In Indonesia, the base of sanitor will reduce by Q3 and with an improvement in the macro environment, the growth is expected to comeback in Indonesia in another quarter or two. In the medium term, the focus will be largely on heavy media spends to gain more share and drive revenue growth. In Africa, the focus is to simplify the business by rationalising SKUs, improving governance and improving the operating structure, which will help to improve profitability in the coming years.
- Management has maintained its guidance of achieving double-digit revenue growth in FY023 with low single digit volume growth. With focused strategies in key markets, volume growth trajectory will improve in the coming years and will drive overall revenue growth.
- Decline in prices of key inputs (including palm oil and packaging material) would help in margin improvement in Q3. The company will pass on some benefits to consumers to improve sales volume. Management expects to maintain OPM on y-o-y basis at ~20%. Company aims OPM to stay at 20-22% in the medium term.

Revision in estimates – We have broadly maintained our earnings estimates for FY2023 and FY2024. The management has maintained its guidance of low double-digit revenue growth and expects to maintain OPM on y-o-y basis.

Our Call

View – Maintain Buy with an unchanged PT of Rs. 959: A change in the top management and revamped strategies focuses on growth levers such as increase in penetration, cross-pollination, simplifying business in key markets and increase in distribution to drive double-digit revenue growth in the medium term. Company targets consistent improvement in OPM through premiumisation and operating efficiencies in the medium to long run. The stock is currently trading at discount valuations of 42.9x/36.7x its FY2023/24E earnings. We maintain our Buy on the stock with an unchanged PT of Rs. 959.

Key Risks

A sustained slowdown in demand in key markets or inflation in raw-material prices would act as a key risk to our earnings estimates in the medium to long term.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	11,029	12,277	13,609	15,237
OPM (%)	22.2	20.3	20.1	20.8
Adjusted PAT	1,765	1,793	2,024	2,369
Adjusted EPS (Rs.)	17.3	17.5	19.8	23.2
P/E (x)	49.2	48.5	42.9	36.7
P/B (x)	9.2	7.5	6.8	6.1
EV/EBITDA (x)	36.3	35.5	31.8	27.5
RoNW (%)	20.4	17.1	16.6	17.5
RoCE (%)	18.3	17.3	17.9	19.3

Source: Company; Sharekhan estimates

Soft Q1 - Revenue grew by 8% y-o-y; OPM declined by 407 bps y-o-y

GCPL's consolidated revenues grew by 8% y-o-y to Rs. 3,125 crore registering a three-year CAGR of 10% driven by 12% y-o-y growth in India business (three-year CAGR at 12%), 12% y-o-y CC growth in Africa (three-year CAGR at 11%), 15% y-o-y CC growth in Latin America (three-year CAGR at 28%), while Indonesia decreased by 12% y-o-y in CC terms (three-year CAGR at -2%). Volumes declined by 5% (India business volumes declined by 6%). The homecare segment's revenue declined by 4% y-o-y (two-year CAGR at 8%), while the personal care segment continued its strong momentum, growing by 25% y-o-y (two-year CAGR at 21%). Higher palm oil & packaging cost led to 558 bps y-o-y decline in the gross margin to 46.6%. OPM decreased by 407 bps y-o-y to 17.0%. OPM of India and Indonesia business registered a decline of 380 bps and 810 bps y-o-y, respectively. Operating profit decreased by 12.8% y-o-y to Rs. 532.6 crore due to 36.8% y-o-y increase in advertisement expenses, while employee expenses declined by 10.6% y-o-y. Adjusted PAT decreased by 16.5% y-o-y to Rs. 347 crore. Reported PAT stood at Rs. 344.9 crore.

India business performance driven by continued growth momentum in Personal Care

India business delivered price-led y-o-y growth of 12% to Rs. 1,814 crore, with two/three-year CAGR at 16%/12% driven by continued growth momentum in personal care, while home-care reported yet another quarter of weak performance. India business sales volume declined by 6% y-o-y in Q1. However, two-year CAGR for volume growth stood at 4%. The company gained market share in ~90% of the categories. EBITDA margins declined by 380 bps y-o-y to 22.5% due to ~660 bps y-o-y decline in gross margins (due to higher commodity inflation) and a rise in advertisement spends by ~140 bps to drive category development, which was mitigated by reducing controllable costs by ~450 bps (employee benefit expenses reduced by ~230 bps and other expenses by ~230 bps).

Weak Q1 for Home Care segment; revenues drop 4% y-o-y

Home Care revenues declined by 4% y-o-y with a two-year CAGR of 8% to Rs. 663 crore. GCPL delivered a soft performance in household insecticides led by a high base and relatively muted season. The company's non-mosquito portfolio continued to deliver strong growth momentum. The company continued to deepen penetration and gain market share and has put in place various category development initiatives to drive sustainable growth. Air Fresheners saw strong performance, led by an uptick in the category coupled with market share gains. Two-year CAGR of air fresheners is in double digits. GCPL's category development initiative around driving relevance for Aer Power Pocket and premiumisation through Aer Matic ('If bathrooms/ rooms could talk') is receiving encouraging consumer response.

Strong 25% y-o-y growth in Personal care (price led for soaps; volume led for hair colour)

Personal care segment grew by 25% y-o-y with a 2-year CAGR of 21% to Rs. 1,088 crore. As per the management, soaps delivered price-led growth during the quarter while growth in hair colour was largely volume-led. GCPL continued to gain market share and deepen penetration led by category development initiatives. Magic powder-to-liquid handwash continued to gain market share by volume, backed by digital communication and distribution expansion. In Q1FY2023, the company strengthened its value-for-money and green proposition with the launch of the affordable and sustainable ready-to-mix Magic Bodywash priced at Rs. 45. Hair Colour witnessed strong growth driven by category uptick with a two-year CAGR in double digits. Godrej Expert Rich Crème continued to perform well and gain market share, backed by strong marketing campaigns. Furthermore, the initial response to Godrej Expert Rich Crème's at Rs. 15 is encouraging. Within the personal care category, GCPL aims to improve market share for soaps portfolio while in case of the hair colour portfolio the focus will be on category development and improving penetration in the long run.

India business performance

Category	Sales (Rs. crore)	y-o-y growth	2-year CAGR
Homecare	663	-4%	8%
Personal care	1,088	25%	21%
Unbranded and Exports	63	-6%	19%
Total Net Sales	1,814	12%	16%
Branded Volume Growth	-	-6%	4%

Source: Company; Sharekhan Research

Weak Q1 for Indonesia; AUM and Latin America continued to grow in double-digits

Indonesia business revenue down by 12% y-o-y

Indonesia business delivered a weak performance with a sales decline of 12% y-o-y in CC terms (three-year CAGR of -2%) to Rs. 376 crore. Sales excluding Hygiene (Saniter) saw a y-o-y decline of 4% in CC terms. GCPL continued to reduce stocks with channel partners, resulting in nearly flat growth on sell-outs. The company's EBITDA margins, contracted by 810 bps y-o-y to 15.3% due to higher commodity inflation, upfront marketing investments, high hygiene comparator, and scale deleverage.

Africa, US and Middle East (AUM) business reported 12% y-o-y growth

AUM regions delivered y-o-y double-digit sales growth of 12% in CC terms (3-year CAGR of 11%) to Rs. 779 crore driven by strong sales growth momentum in Southern Africa. In terms of categories, dry hair category grew in mid-single digit, while the FMCG category grew in double digits. EBITDA margins for the regions decreased by 160 bps y-o-y to 8.3%. GCPL continues to introduce marketing initiatives to drive sustainable growth and has increased investments across both dry hair and FMCG categories.

Latin America and SAARC y-o-y revenue growth at 15%

Latin America and SAARC region posted CC revenue growth of 15% y-o-y and 28% on a three-year CAGR basis to Rs. 151 crore. EBITDA margins for the region sharply declined from 13.6% in Q1FY2022 to 1.4% in Q1FY2023.

International business performance

Particulars	Q1FY23	Q1FY22	y-o-y (%)
Revenue (Rs. Crore)			
Indonesia	377	411	-8.4
AUM	779	694	12.2
Latin America & SAARC	151	159	-5.0
EBITDA Margins (%)			**bps**
Indonesia	15.3	23.4	-810
AUM	8.3	9.9	-160
Latin America & SAARC	1.4	13.6	-

Source: Company; Sharekhan Research

Key conference call highlights

- **Strong revenue growth with margin expansion expected in Africa:** In Africa, GCPL's focus is on simplifying the business by rationalising the SKUs, improving governance and simplifying the operating structure. Margins of the Africa business is currently affected by governance issues and complex operating structure. Margin is expected to improve to 15-16% by FY2025 (currently at ~8%) driven by favourable sales mix, improved governance and a simplified operating structure. The management has guided that Africa business is expected to grow in double-digits in the near to medium term.
- **Indonesia to recover in a quarter or two:** In Indonesia, the base of sanitor will reduce by Q3 and with improvement in the macro environment, the growth is expected to comeback in Indonesia in another quarter or two gradually and is expected to grow in the single digit in the near term. In the medium term large focus will be on spending heavily on media spends to gain market share and drive revenue growth. It will aid double-digit growth.
- **Double-digit revenue growth expected in India:** GCPL targets double-digit revenue growth in India backed by blockbuster innovation and category development. The management has stated that focus will be on further democratising the category by making it more affordable to the consumers and spending on improving market positioning of key products in India. The company's launch of Magic powder-to-liquid handwash and ready-to-mix Magic Bodywash are a step forward in the same direction of making handwash and bodywash affordable for masses as powder handwash/bodywash is made available at 1x price of soap as against liquid handwash/bodywash, which are priced at 1.3x of soaps.

- **Strategies in place to drive growth in HI:** The household insecticide category delivered poor performance in Q1 on y-o-y basis with 3-year CAGR close to double-digits. The company has undertaken various initiatives to drive sustainable growth for the category including increased marketing spends on HI for category awareness, change in market positioning of GoodKnight as brand for a good night sleep, trial of products to drive penetration and making products more affordable to attract upgrades from coils and illegal incense sticks.
- **Region-wise distribution strategies:** The company has differentiated distribution strategies for different regions. In India, since the company's focus is largely on category development, GCPL aims to leverage the existing distribution network to improve penetration. However, in Indonesia and Africa the company's focus will be on improving the distribution network to drive growth in the medium to long term.
- **Media spends to remain high:** The management has indicated that since the company is focusing on category development, the company's media spends will remain high with major focus on creating awareness about underpenetrated categories. Media investments will depend on return that the company earns on spends. The management also stated that though media spends are expected to be higher, margins will be maintained on y-o-y basis through cost saving initiatives.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Total revenue	**3,125.0**	**2,894.5**	**8.0**	**2,915.8**	**7.2**
Raw material cost	1,669.2	1,384.7	20.5	1,473.4	13.3
Employee cost	259.7	290.4	-10.6	273.3	-5.0
Advertisement & Publicity	201.4	147.2	36.8	185.1	8.8
Other expenses	462.1	461.1	0.2	461.3	0.2
Total operating expenses	2,592.4	2,283.4	13.5	2,393.0	8.3
Operating profit	**532.6**	**611.1**	**-12.8**	**522.8**	**1.9**
Other income	27.5	20.9	31.7	23.8	15.8
Forex gain / (loss)	-11.8	-11.1	6.0	-34.9	-66.1
Interest expense	35.1	27.3	28.5	32.8	6.9
Depreciation	57.1	50.9	12.2	54.0	5.6
Profit before tax	**456.2**	**542.7**	**-15.9**	**424.9**	**7.4**
Tax	109.3	127.2	-14.1	60.9	79.4
Adjusted PAT (before MI)	**347.0**	**415.5**	**-16.5**	**364.0**	**-4.7**
Minority interest (MI)	-0.3	-0.3	0.0	0.1	-
Extraordinary item	-1.8	-1.6	18.1	-0.8	-
Reported PAT	**344.9**	**413.7**	**-16.6**	**363.3**	**-5.1**
EPS (Rs.)	3.4	4.1	-16.5	3.6	-4.7
			bps		**bps**
GPM (%)	46.6	52.2	-558	49.5	-288
OPM (%)	17.0	21.1	-407	17.9	-89
NPM (%)	11.1	14.4	-325	12.5	-138
Tax rate (%)	23.9	23.4	50	14.3	962

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Deflating commodity prices augurs well; good monsoon key for rural demand

High consumer inflation and slowdown in the rural demand will keep pressure on the sales volume in the near term. However, a normal monsoon, cool-off in the commodity prices and improved consumer sentiments will help volume growth to recover in H2FY2023. Consumer good companies' margins are expected to be lower y-o-y in Q1FY2023 with raw material prices remaining high during most of the quarter. However, the scenario has changed in last 15-20 days with commodity prices cooling from its high providing some breather for consumer goods companies. The companies are expected to see margins expand from H2FY2023. Overall, we expect H2FY2023 to be much better compared to H1FY2023 with an expected recovery in the volume growth and likely expansion in the margins in Q3/Q4 FY2023. Low penetration in key categories (especially in rural India), lower per capita consumption compared to other countries, a large shift to branded products, and emergence of new channels such as e-Commerce/D2C provide a number of opportunities for achieving sustainable growth in the medium to long run.

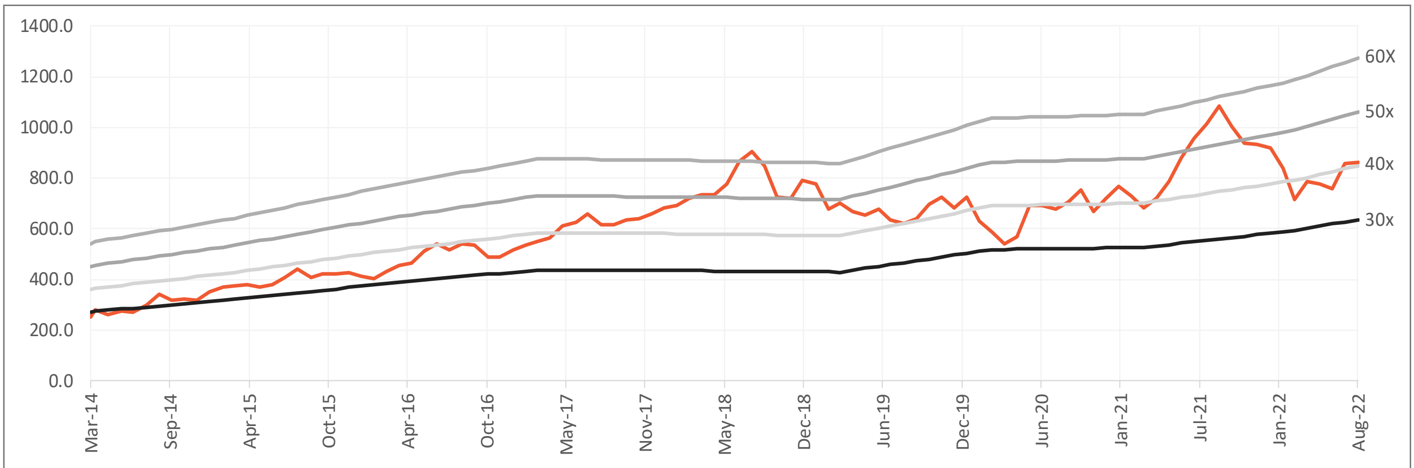
■ Company Outlook – Change in leadership likely to drive consistent growth in long run

Under the leadership of Mr. Sudhir Sitapati, the company will focus on achieving consistent double-digit revenue growth in the medium term. Improved penetration of household insecticides (HI) in rural markets, sustained double-digit growth in the Africa business and a recovery in Indonesia business are key medium-term revenue growth drivers. Decline in key input prices (including palm oil and packaging material) would help in margin improvement in Q3FY23. The company will pass on some benefits to consumer to improve sales volumes. Management expects to maintain OPM at ~20% y-o-y and aims to sustain it at 20-22% in the medium term.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 959

A change in the top management and revamped strategies focuses on growth levers such as increase in penetration, cross-pollination, simplifying business in key markets and increase in distribution to drive double-digit revenue growth in the medium term. Company targets consistent improvement in OPM through premiumisation and operating efficiencies in the medium to long run. The stock is currently trading at discount valuations of 42.9x/36.7x its FY2023/24E earnings. We maintain our Buy on the stock with an unchanged PT of Rs. 959.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Hindustan Unilever	69.8	61.3	50.9	48.9	42.9	35.8	24.1	27.1	31.8
Dabur India	55.5	48.9	39.1	45.0	40.5	32.6	26.3	27.3	31.4
Godrej Consumer Products	48.5	42.9	36.7	35.5	31.8	27.5	17.3	17.9	19.3

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. Under the new leadership, the immediate focus of the company is to fill the gaps to achieve sustainable double-digit revenue growth in the medium term. Increase in penetration, cross-pollination, simplifying business in key markets and increase in distribution are some of the key growth drivers in the medium term. Premiumisation, better revenue mix and operating efficiencies would to drive margins in long run.

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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	First State Investments ICVC	2.76
2	Temasek Holdings Pte Ltd	2.06
3	Vanguard Group Inc	1.35
4	James Place Asia Unit Trust	1.18
5	Mitsubishi UFJ Financial Group Inc	1.15
6	BlackRock Inc	1.08
7	Republic of Singapore	1.05
8	Republic of Singapore	1.05
9	EuroPacific Growth Fund	1.01
10	Kotak Mahindra AMC	0.8

Source: Bloomberg

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

Sharekhan

by BNP PARIBAS

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