Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Godrej Consumer Products Ltd

Broadening portfolio and distribution to drive Africa growth

Stock Update | Company Update

Consumer Goods	Sharekhan code: GODREJCP
Reco/View: Buy ↔	CMP: Rs. 885 / Price Target: Rs. 1,000 ↑

↑ 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	Neutral	↔	Neutral
RQ	Positive	↔	Positive
RV	Positive	↔	Positive

ESG Disclosure Score NEW

ESG RISK RATING 26.88

Updated July 08, 2022

Medium Risk

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

Source: Morningstar

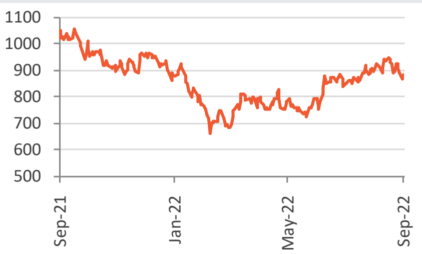
Company details

Market cap:	Rs. 90,463 cr
52-week high/low:	Rs. 1,102 / 660
NSE volume: (No of shares)	15.1 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	-2.6	16.8	21.6	-16.0
Relative to Sensex	-0.2	10.0	25.1	-10.9

Sharekhan Research, Bloomberg

Summary

- Godrej Consumer Products Limited (GCPL) is strengthening its last-mile distribution, simplifying portfolio with SKU rationalisation, focusing on relevant launches in key categories, investing in consumer awareness, and accelerating wet Hair/FMCG growth, which will drive consistent double-digit growth for Africa business.
- Africa business's margins are expected to scale-up from earlier levels of 10-12%, driven by efficiencies at production and procurement level, reduction in fix costs, and better mix in the coming years.
- Correction in crude prices, freight rates, and palm oil prices (corrected by 60% from April 2022 high) will provide good support to GCPL's overall OPM going ahead.
- The stock is currently trading at 44.7x and 38.2x its FY2023E and FY2024E earnings, respectively. We maintain Buy with a revised PT of Rs. 1,000.

We attended the investor conference call arranged by Godrej Consumer Products Limited (GCPL) to get a clearer perspective on the growth prospects of Africa business from Mr. Dharnesh Gordhon (Business Head – Godrej Africa, Middle East, and USA [GUAM]). On-ground execution through relevant route-to-market strategy, enhancing distribution, new product launches based on consumer insights and preferences were key focus areas of Mr. Gordhon when he was inducted to lead the Africa business. Revenue of GUAM (Africa) business grew by 22% in FY2022 and EBIDTA margin stood almost flat. Mr. Gordon is focusing on broadening of portfolio and investment in communication to consumers to drive consistent double-digit growth in the coming years. Sweating of assets, operating efficiencies, and strong procurement strategy will help OPM of Africa business to consistently improve.

- **Africa business to maintain double-digit growth; OPM to gradually improve:** Africa business's revenues grew by 22% y-o-y to Rs. 3,046 crore and OPM stood at 10% in FY2022. Strong growth can be attributed to 22% growth in West Arica (contributes 30-35% to Africa business's revenue) and 17% growth in South Africa region (20-25% of Africa business). On the category front, dry hair and wait hair category registered strong double-digit growth, while household insecticide business is growing in strong double digits. Raw-material inflation and currency headwinds impacted EBIDTA margin (or else OPM would have been higher by 500 bps). The company is focusing on strengthening last-mile distribution, simplifying portfolio with SKU rationalisation, relevant launches in key categories, investing in consumer awareness, and accelerating wet hair/ FMCG growth, which will drive consistent double-digit growth for Africa business. The company targets OPM to consistently improve with efficiencies and better mix.
- **Household insecticide and wet hair to be key growth pillars for Africa:** West Africa market (including Nigeria) saw strong consumer acceptance to GCPL's home insecticides (HI) products due to differentiated product offerings, which aided strong share gains in the last nine months. Launch of GoodKnight power shots got strong response and repeated purchases and it is focusing on launching liquid vaporiser under the brand, Good Knight Flash. In the next two months, the company will be launching HI products in Ghana. In other markets, such as Middle East, Hit portfolio is growing stronger. GCPL is the No. 2 player in the HI market in UAE. Wet hair portfolio has bigger opportunity in Africa. The ability to serve consumer needs for hair care through moisturising, scalp treatment, shampooing, and other hair care products will help drive growth for the wet hair care category.
- **Correction in palm oil prices augurs well for overall margins:** GCPL's OPM in Q1FY2023 was down by >400 bps y-o-y to 17%, affected by the sharp increase in palm oil, crude oil, and freight prices. Palm oil prices have corrected by >60% since their high of April 2022. Further, crude oil and freight prices corrected from their high due to lower demand. Recent correction in commodity prices augurs well for the company to improve its OPM in the quarters ahead. The company will pass on some benefits to consumers to improve sales volume. The company targets OPM to remain at 20-22% in the medium term

Our Call

View – Maintain Buy with a revised PT of Rs. 1,000: Change in top management coupled with revamped strategies focuses on growth levers such as higher penetration, cross-pollination, simplifying business in key markets, and increased distribution to drive double-digit revenue growth in the medium term. The company targets consistent improvement in OPM through the route of premiumisation and operating efficiencies in key geographies such as India, Africa, and Indonesia. The stock is currently trading at discount valuations of 44.7x/38.2x its FY2023/FY2024E earnings. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,000.

Key Risks

Sustained slowdown in demand in key markets or inflation in raw-material prices would act as 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)	51.3	50.5	44.7	38.2
P/B (x)	9.6	7.8	7.1	6.3
EV/EBITDA (x)	37.8	37.0	33.1	28.6
RoNW (%)	20.4	17.1	16.6	17.5
RoCE (%)	18.3	17.3	17.9	19.3

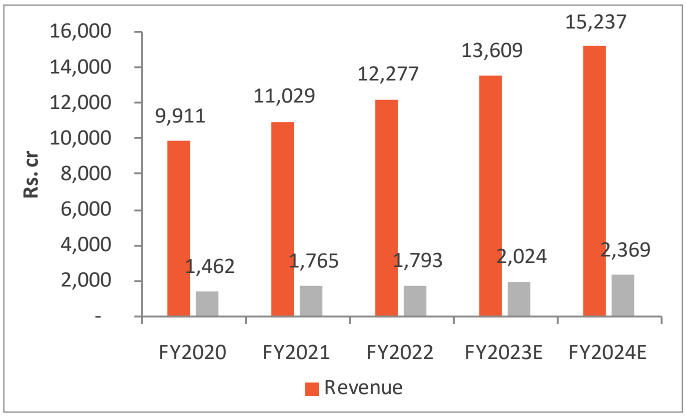
Source: Company; Sharekhan estimates

GCPL GAUM Business Performance and Strategy Concall Highlights

- **GUAM business focuses on strengthening base in West Africa:** Out of the total GUAM market, US contributes 20-25% of revenue, contribution of Nigeria and Dhana's is at 30-35%, South Africa contributes 25-30%, while Kenya and other smaller markets contribute the remaining share. In terms of categories, dry hair comprises 55% of the revenue and remaining 45% is consists of FMCG.
- **Focus on effective distribution and broadening of the portfolio:** Improved outlet coverage (increased by 2.5x over FY2020) has led to higher availability of the company's products to consumers. The next phase after improvement in coverage is widening of the portfolio. In Africa business, hair extension business is a large part, whereas contribution of the FMCG portfolio is very minute. Going ahead, GCPL aims to increase FMCG business in Africa as well.
- **Margin trend difficult to predict:** Margins are impacted by multiple factors such as increased commodity prices and higher volatility in currencies. GCPL plans to be more efficient through higher capacity utilization of existing capacities rather than adding new capacities and aims to benefit from internal efficiencies through reduction in fixed and operational costs.
- **Strong double-digit growth across categories in Africa:** Both the wet hair and dry hair portfolios reported strong double-digit growth in the past 18 months in Africa region. The FMCG portfolio has also registered robust growth and has grown at a much faster rate than dry hair during the period.
- **Key priorities for wet and dry hair categories:** For the wet hair portfolio, the company aims to build a portfolio of wide products, which addresses the various needs of the consumers and to improve the availability of its products to consumers. In case of hair extension, various changes have taken place with respect to consumer preferences and challenges from consumers. GCPL has focused on improving the sourcing of raw materials, enhancing the manufacturing and coming up with new styles that suit consumer preferences.
- **Good Knight on strong growth momentum:** Good Knight brand has grown very well in the last couple of quarters and is widely accepted by consumers. With a differentiated product offering by the Good Knight brand and by creating awareness about category development, the brand has witnessed strong market share gains.
- **Household insecticide and wet hair to be key growth pillars for Africa:** West Africa market (including Nigeria) saw strong consumer acceptance to GCPL's HI products due to differentiated product offerings, which aided strong share gains in the last nine months. Launch of Good Knight power shots got strong response and repeated purchases and it is focusing on launching liquid vaporiser under the brand Good Knight Flash. In the next two months, the company will be launching HI products in Ghana. In other markets, such as Middle East, Hit portfolio is growing stronger. GCPL is the No. 2 player in the HI market in UAE. Wet hair portfolio has bigger opportunity in Africa. Ability to serve consumer needs for hair care through moisturising, scalp treatment, shampooing, and other hair care products will help drive growth for the wet hair care category.
- **Focus on simplifying the portfolio:** GCPL is focused on simplifying its portfolio and improve availability through SKU rationalisation. The company tried to provide value preposition in some of the key categories to gain strong acceptance in key brands. Each cluster (excluding US) has 2,000 SKUs across brands. In Kenya, SKUs have been reduced to half and will be further reduced in the coming years.

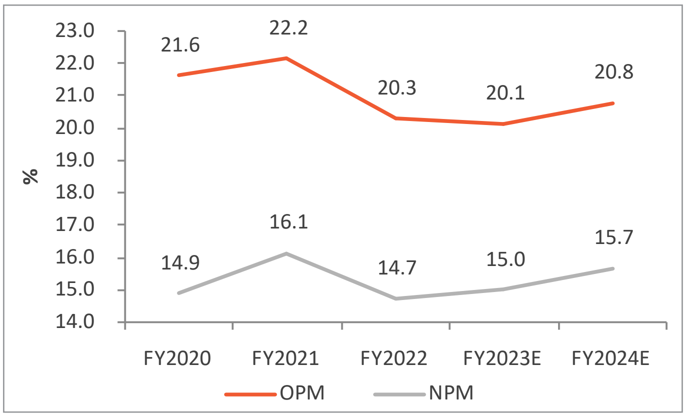
Financials in charts

Steady growth in revenue and PAT



Source: Company, Sharekhan Research

Margins to improve from current levels

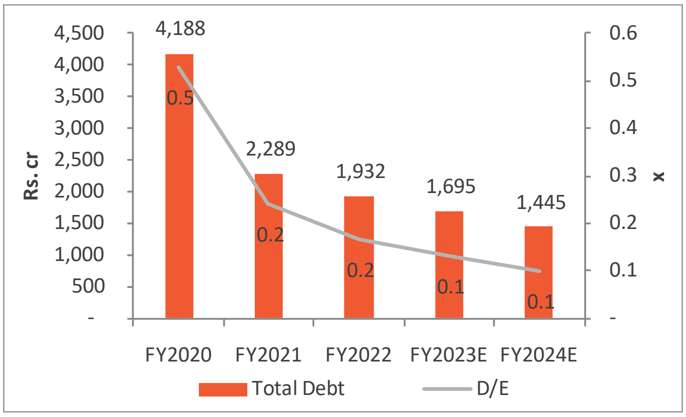


Source: Company, Sharekhan Research

Return ratios to rise going ahead

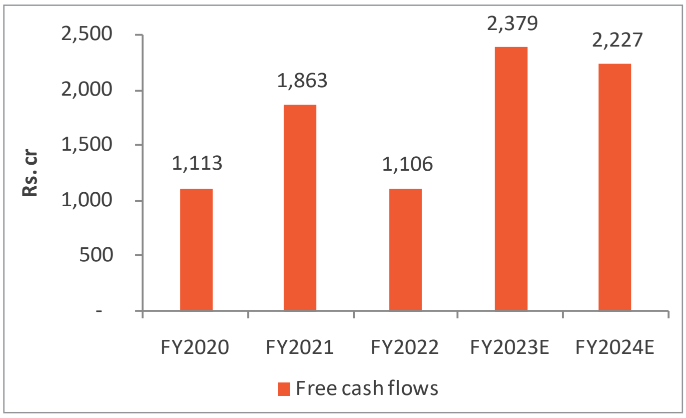
Source: Company, Sharekhan Research

Improvement in debt position



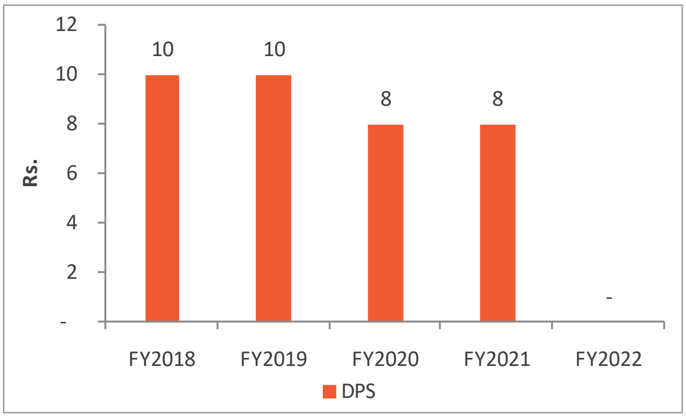
Source: Company, Sharekhan Research

Significant free cash flow generation



Source: Company, Sharekhan Research

Trend in dividend per share



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Deflating commodity prices augur well; Good monsoon key for rural demand

High consumer inflation and slowdown in rural demand will keep pressure on sales volume in the near term. However, a normal monsoon season, cool-off in the commodity prices, and improved consumer sentiments will help volume growth to recover in H2FY2023. Consumer goods companies' margins are expected lower y-o-y in Q1FY2023, with raw-material prices remaining high during most of the quarter. However, the scenario has changed in the past two months with commodity prices cooling from their high, providing some breather for consumer goods companies. Companies are expected to see margin expansion from H2FY2023. Overall, we expect H2FY2023 to be much better compared with H1FY2023, with the expected recovery in volume growth and likely expansion in margins in Q3/Q4 FY2023. Low penetration levels in key categories (especially in rural India), lower per capita consumption compared with 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 term.

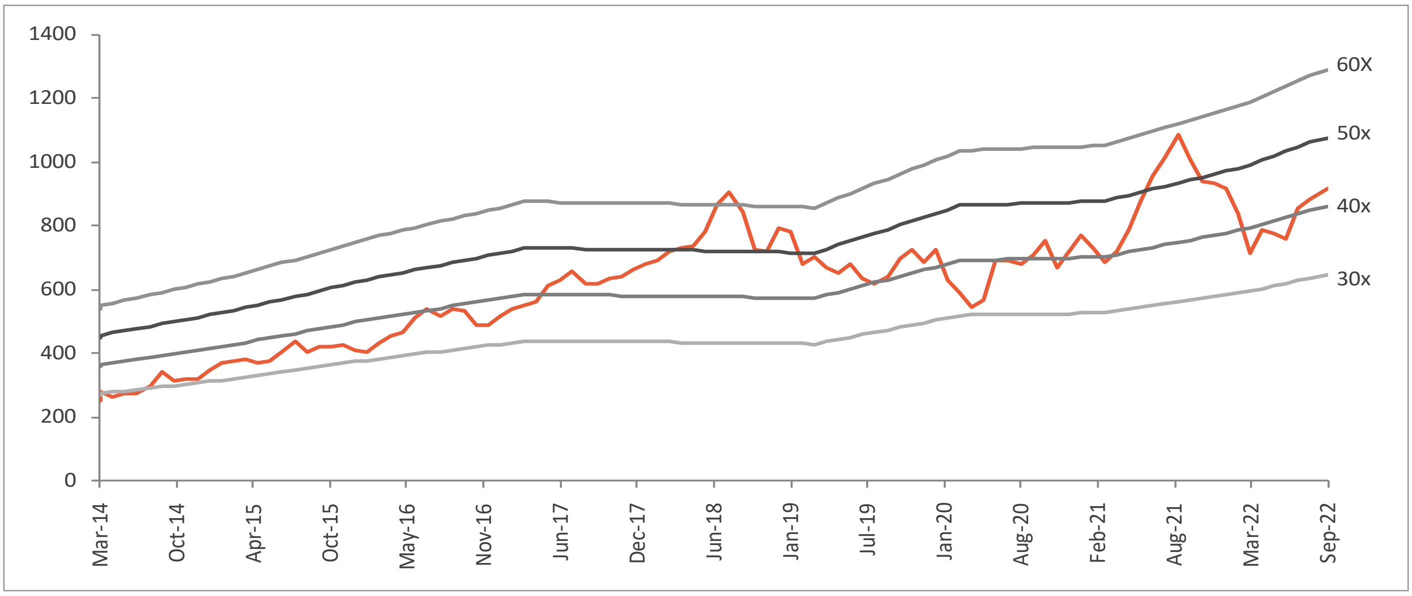
■ Company outlook - Change in leadership likely to drive consistent growth in the long run

Under the new leadership of Mr. Sudhir Sitapati, the company will focus on achieving consistent double-digit revenue growth in the medium term. Improved penetration of HI in rural markets, sustained double-digit growth in Africa business, and recovery in Indonesia business are key medium-term revenue growth drivers for the company. The decline in key input prices (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 a y-o-y basis at around 20%. Management targets OPM to remain at 20-22% in the medium term.

■ Valuation - Maintain Buy with a revised PT of Rs. 1,000

Change in top management coupled with revamped strategies focuses on growth levers such as higher penetration, cross-pollination, simplifying business in key markets, and increased distribution to drive double-digit revenue growth in the medium term. The company targets consistent improvement in OPM through the route of premiumisation and operating efficiencies in key geographies such as India, Africa, and Indonesia. The stock is currently trading at discount valuations of 44.7x/38.2x its FY2023/FY2024E earnings. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,000.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Hindustan Unilever	71.7	63.0	52.2	50.2	44.1	36.8	24.1	27.1	31.8
Dabur India	54.6	48.1	38.4	44.2	39.8	32.0	26.3	27.3	31.4
Godrej Consumer Products	50.5	44.7	38.2	37.0	33.1	28.6	17.3	17.9	19.3

Source: Company; Sharekhan Research

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. Increased penetration, cross-pollination, simplifying business in key markets, and increased distribution are some of the key growth drivers in the medium term. Premiumisation, better revenue mix, and operating efficiencies would to drive margins in the 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 and 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	2.76
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 (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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