Sharekhan by BNP PARIBAS

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Stock Update | Result Update

Emami Ltd

Weak Q2; promising outlook for H2

Consumer Goods	Sharekhan code: EMAMILTD

Reco/View: Buy	↔	CMP: **Rs. 464**	Price Target: **Rs. 550**	↔

↑ 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 29.24

Updated Oct 08, 2022

Medium Risk

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

Source: Morningstar

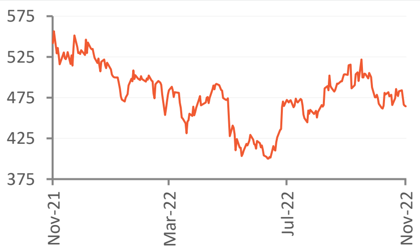
Company details

Market cap:	Rs. 20,483 cr
52-week high/low:	Rs. 575 / 394
NSE volume: (No of shares)	2.8 lakh
BSE code:	531162
NSE code:	EMAMILTD
Free float: (No of shares)	20.2 cr

Shareholding (%)

Promoters	54.3
FII	11.6
DII	27.0
Others	7.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.0	1.5	8.6	-14.3
Relative to Sensex	-10.2	-2.4	-8.5	-17.4

Sharekhan Research, Bloomberg

Summary

- Emami's Q2FY2023 operating performance was below our as well street's expectation, affected by high base in pain management and healthcare segment, slowdown in the hair oil category, and higher input cost inflation. Revenue grew by 3% to Rs. 813.8 crore, while operating profit decreased by 30% y-o-y.
- Demand for winter products has picked up and management expects good recovery in Q3 sales. Raw-material prices have corrected substantially, which will help OPM to be higher in H2. Management targets 27% EBIDTA margin for FY2023.
- Management is eyeing double-digit growth in the medium term through improved growth in hair oil and skincare category, new recruitments through bridge packs in key categories, and expansion in distribution network (especially in rural markets). Better monsoon season could lead to revival in rural demand.
- The stock is currently trading at 25.7x/20.8x its FY2023/FY2024E earnings. We maintain Buy with an unchanged PT of Rs. 550.

In Q2FY2023, Emami's revenue grew by 3% to Rs. 813.8 crore with domestic business growing by 1%, while the international business grew by 17% during the same period. Helios Lifestyle consolidation led to Rs. 24 crore incremental revenue. Net sales grew by 8%, excluding pain management, healthcare range, and Helios revenue. Hair oil and male grooming products registered moderate growth due to demand slowdown, while pain management and healthcare range of products witnessed double-digit decline in sales due to high Covid base affecting the overall domestic growth during the quarter. Gross margin decreased by 214 BPS y-o-y to 66.6%. This along with higher ad spends (stood at 17.4% as a percentage to sales) led to a sharp decline in OPM to 24% from 35.1% in Q2FY2022. Operating profit decreased by 30% y-o-y to Rs. 195.4 crore. However, a lower incidence of tax led to a 14% decline in adjusted PAT to Rs. 197.4 crore. In H1FY2023, consolidated revenue grew by ~10% to Rs. 1,592 crore. Operating profit decreased by 18% to Rs. 368.7 crore and PAT decreased by ~10% to Rs. 323.7 crore.

Key positives

- Urban market grew by 2x ahead of the rural market; modern trade (salience of 8.7%) and e-commerce (salience of 7.8%) grew by 28% and 55%, respectively.
- Boroplus range sales grew by 17%, which led to pick-up in demand prior to the winter season.
- Gross margin improved sequentially by 403 BPS to 66.6%.

Key negatives

- Healthcare products and pain management products registered a decline of 16% and 13%, respectively, on high Covid base.
- Consolidated OPM stood lower at 24% in Q2FY2023 vs. 35.1% in Q2FY2022.

Management Commentary

- Rural demand is expected to revive if monsoons are normal and covers pan India providing relief to the agri economy. The months of October and early November saw good pickup for winter products. Further, the high base of healthcare range and pain management products will reduce in the coming quarters. Thus, management is confident of good growth in the domestic market in Q3FY2023.
- Management is eyeing double-digit growth in the medium term through improved growth in hair oil and skincare category, new recruitments through bridge packs in key categories, expansion in distribution network (especially in rural markets), and sustained strong growth in key channels such as modern trade/e-commerce.
- Under project Khoj, the company has enhanced its presence in the rural market to 32,000 villages in FY2022. The company is planning to add 10,000-11,000 villages and rural presence is expected to increase to 42,000 villages by the end of FY2023. The company will add another 8,000 villages and expects 50,000 village presence by FY2024.
- New product launches contribute around 1.5% to revenue and the company expects it to increase to 3% over the next two to three years.
- Gross margins have corrected from their peak and management expects gross margins to improve in H2FY2023. Advertisement spends are expected to be 17-18% in FY2023. The company is expecting improvement in H2FY2023 and end the fiscal with OPM of 27% (equal to pre-Covid levels).
- The company expects tax rate to be around 10% for FY2023/FY2024 as it is getting MAT credit.

Revision in estimates – We have reduced our earnings estimates for FY2023 and FY2024 to factor in higher ad spends with the company indicating ad spends as a percentage to sales at 17-18%. We have also introduced FY2025 earnings estimates through this note.

Our Call

View: Maintain Buy with an unchanged PT of Rs. 550 – Emami has a strong brand portfolio and its sustained focus on new product launches, distribution expansion, and scale-up on emerging channels will help to improve its growth prospects in the medium term. Acquisition of Dermicool provides lot of synergistic benefits and scope for margin improvement in the long run. Further, the company is focusing on scaling up the D2C platform to improve the revenue stream in the medium to long term. The stock is currently trading at 25.7x and 20.8x its FY2023E and FY2024E earnings, respectively. We maintain our Buy recommendation with an unchanged price target (PT) of Rs. 550.

Key Risks

Emami's product portfolio is seasonal in nature. Hence, any weather vagaries or supply disruption due to frequent lockdowns would affect performance in the near to medium term.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenues	2,881	3,192	3,552	4,111	4,790
OPM (%)	30.7	29.8	27.2	28.1	28.6
Adjusted PAT	673	761	796	982	1,172
% YoY growth	28.0	13.0	4.6	23.4	19.3
Adjusted EPS (Rs.)	15.1	16.9	18.0	22.3	26.6
P/E (x)	30.8	27.4	25.7	20.8	17.5
P/B (x)	11.7	9.9	8.7	7.3	5.9
EV/EBITDA (x)	22.8	21.2	20.5	16.8	13.7
RoNW (%)	37.5	39.6	35.9	38.0	37.3
RoCE (%)	42.4	44.4	39.5	43.3	42.3

Source: Company; Sharekhan estimates

Weak operating performance in Q2

Emami's revenue grew marginally by 3.2% y-o-y to Rs. 814 crore, slightly lower than our and average street expectation of Rs. 845 crore and Rs. 849 crore, respectively. Domestic business revenue stood flat, while international business revenues grew by 17%. Recently acquired Helios lifestyle added 3.5% to consolidated revenue. Excluding paint management and healthcare (high base) and Helios, revenue growth stood at 8%. Gross margin declined by 214 bps y-o-y to 66.6% and OPM declined from 35.1% to 24% due to high input cost inflation. OPM came in lower than our and average street expectation of 28.4-29%. Operating profit declined by 30% y-o-y to Rs. 195 crore. However higher other income and lower incidence of tax arrested the steep decline in adjusted PAT to Rs. 197.4 crore, higher than our and average street expectation of Rs. 178 crore-179 crore. Reported PAT stood at Rs. 180 crore (down by 2.5% y-o-y).

Key brands witnessed muted performance in Q2FY2023

In Q2FY2023, Navratna range, male grooming range, and Kesh King range registered sales decline of 5%, 2%, and 10%, respectively, due to muted demand environment (especially in the rural market). On the other hand, pain management range and healthcare range or products witnessed double-digit decline in revenue due to the high Covid base.

Results (Consolidated) Rs cr

Particulars	Q2FY23	Q2FY22	y-o-y (%)	Q1FY23	q-o-q (%)
Net revenue	**813.8**	**788.8**	**3.2**	**778.3**	**4.6**
Raw materials	271.6	246.4	10.2	291.1	-6.7
Employee costs	93.5	82.1	13.9	88.8	5.3
Ad promotions	141.5	105.3	34.3	136.3	3.8
Other expenses	111.9	77.9	43.6	88.8	25.9
Total expenditure	618.4	511.7	20.9	605.0	2.2
Operating profit	**195.4**	**277.2**	**-29.5**	**173.3**	**12.7**
Other income	42.0	37.6	11.6	6.3	563.3
Finance costs	1.8	0.8	125.6	2.5	-29.3
Depreciation	24.5	23.6	3.6	24.2	1.3
Profit before tax	**211.1**	**290.4**	**-27.3**	**153.0**	**38.0**
Tax	11.5	56.3	-79.5	28.9	-60.1
Adjusted PAT	199.6	234.1	-14.7	124.1	60.9
Minority interest	-2.2	-3.8	-	-4.4	-
Adjusted PAT after MI	**197.4**	**230.2**	**-14.2**	**119.7**	**64.9**
Extra-ordinary items	17.5	45.6	-61.6	47.6	-63.3
Reported PAT	180.0	184.6	-2.5	72.1	149.8
Adjusted EPS (Rs.)	4.5	5.2	-12.3	2.8	60.9
			bps		**bps**
GPM (%)	66.6	68.8	-214	62.6	403
OPM (%)	24.0	35.1	-1113	22.3	174
NPM (%)	25.9	36.8	-	19.7	629
Tax rate (%)	22.1	23.4	-129	9.3	-

Source: Company, Sharekhan Research

Category/Brand-wise performance

Key brands/category	y-o-y growth (%)	H1FY2023
Healthcare range	-16	-20
Pain Management range	-13	-21
Navratna range	-5	-15
Kesh King range	-10	3
Boroplus range	17	14
Male Grooming range	2	16
7 Oils in One	45	45

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – H2FY2023 to be relatively better compared to H1

Consumer goods companies would start seeing the benefit of correction in key input prices from Q3FY2023. The recent sharp correction in some key input prices helped companies to pass on benefits to the customer in the form of price cuts in highly penetrated categories (such as soaps). This along with a good monsoon season in most parts of the country (except for some parts in the North and East) will lead to decent recovery in sales volumes in the coming quarters. A decline in commodity prices has also helped inflationary pressures to ease out, thus boosting consumer sentiments. Hence, some tailwinds are building up for the sector to improve its growth in the coming quarters. Overall, we expect H2FY2023 to be much better compared to H1FY2023 with expected recovery in sales volumes. OPM is also expected to improve from Q3FY2023. Low penetration 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 several opportunities for achieving sustainable growth in the medium to long run.

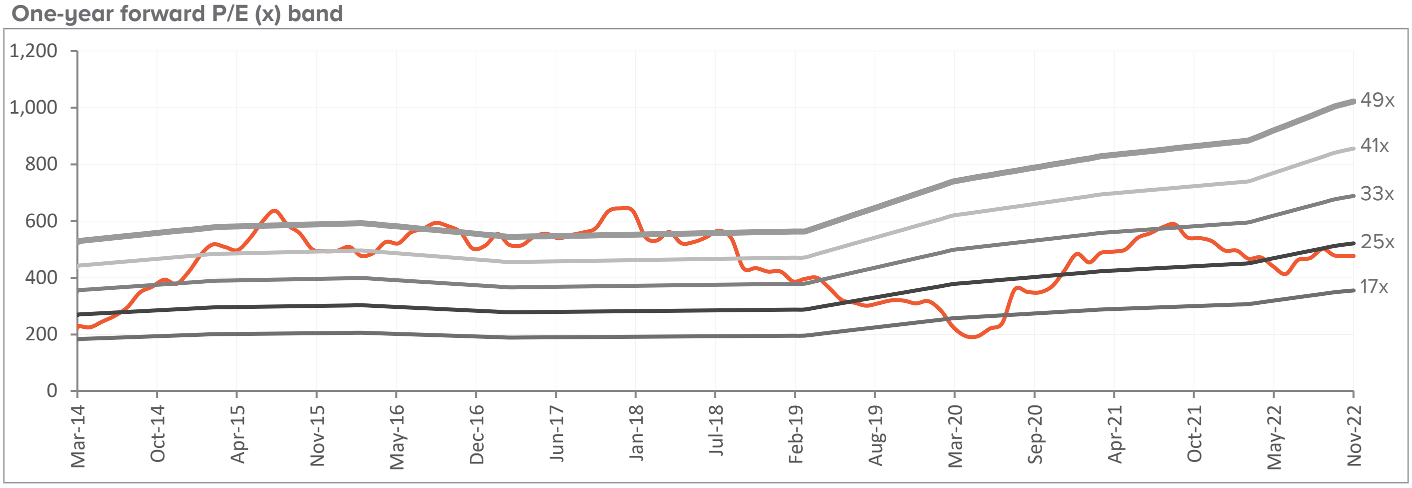
■ Company Outlook – Eyeing double-digit growth in the medium term

Emami maintained its thrust on achieving double-digit revenue growth in the medium term, led by product launches (1.5% of revenue), distribution expansion (especially in rural markets), market share gains in categories such as premium hair oil, launch of bridge-gap packs to add more customers, and growing strongly on alternate channels such as e-commerce/modern trade. Management believes raw-material prices have reached their peak and expects input prices to moderate from current levels. The company has undertaken price increase of 4-5% to mitigate raw-material inflation and is unlikely to take any significant price increase in the coming months. Gross margins are likely to expand in H2FY2023. Overall, the company expects to maintain OPM in FY2023.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 550

Emami has a strong brand portfolio and its sustained focus on new product launches, distribution expansion, and scale-up on emerging channels will help to improve its growth prospects in the medium term. Acquisition of Dermicool provides lot of synergistic benefits and scope for margin improvement in the long run. Further, the company is focusing on scaling up the D2C platform to improve the revenue stream in the medium to long term. The stock is currently trading at 25.7x and 20.8x its FY2023E and FY2024E earnings, respectively. We maintain our Buy recommendation with an unchanged price target (PT) of Rs. 550.

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
Dabur	53.5	48.2	37.9	43.3	40.0	31.6	26.3	26.8	31.4
Marico	51.4	45.0	38.2	37.8	32.3	28.2	41.4	47.5	52.6
Emami	27.4	25.7	20.8	21.2	20.5	16.8	44.4	39.5	43.3

Source: Company; Sharekhan Research

About company

Emami is one of the leading FMCG companies that manufactures and markets personal care and healthcare products. With over 300 diverse products, the company's portfolio includes brands such as *Navratna, Boroplus, Fair & Handsome*, and *Zandu*. With the acquisition of *Kesh King*, the company has forayed into the ayurvedic haircare segment. Emami has a wide distribution reach in over 4.5 million retail outlets though ~3,250 distributors. The company has a strong international presence in over 60 countries in GCC, Europe, Africa, CIS countries, and SAARC.

Investment theme

Emami has a strong brand portfolio, largely catering to low-penetrated categories in the domestic market. However, most of these are prone to seasonal vagaries, affecting growth in the domestic business. The company has taken various initiatives for key categories to improve its growth prospects. Ayurvedic hair oil brands, *Kesh King* and *7-in-one oil*, have seen a revival in performance. Strong demand for the Zandu healthcare portfolio is seen, driven by heightened demand for health and hygiene products. The company has appointed a separate sales head, international business head, and healthcare segment head recently, which give us an indication that management is now getting its focus back on improving the growth prospects of its consumer business.

Key Risks

- Slowdown in domestic consumption demand (especially in the rural market) would result in muted numbers for Emami in the near to medium term.
- Emami's product portfolio is prone to seasonal vagaries and, hence, remains a key risk to the category's performance.

Additional Data

Key management personnel

R. S. Agarwal	Chairman
Sushil K. Goenka	Managing Director
N. H. Bhansali	CEO-Finance, Strategy and Business Development and CFO
A. K. Joshi	Company Secretary & Compliance Officer & Vice President (Legal)

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	DSP investment managers Pvt Ltd	5.34
2	Mirae Asset Global Investments	4.32
3	HDFC AMC	2.97
4	L & T Mutual Fund Trustee Ltd/India	2.20
5	Aves Trading and Finance	2.10
6	HDFC Life Insurance Co Ltd	1.96
7	Aditya Birla Sun Life AMC	1.86
8	Kotak Mahindra AMC	1.77
9	Franklin Resources Inc	1.58
10	Invesco Ltd	1.49

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

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