

Revival around the corner for FMCG Industry

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FMCG sector, the fourth largest constituent of Indian economy, which contributes around 2.2% to country's GDP, has a market size of about Rs 130,000 crore. Unlike the US market for FMCG, which is mainly dominated by a handful of global players, the Indian FMCG sector is highly fragmented with almost half the market accounted by unbranded, unpackaged home made products.

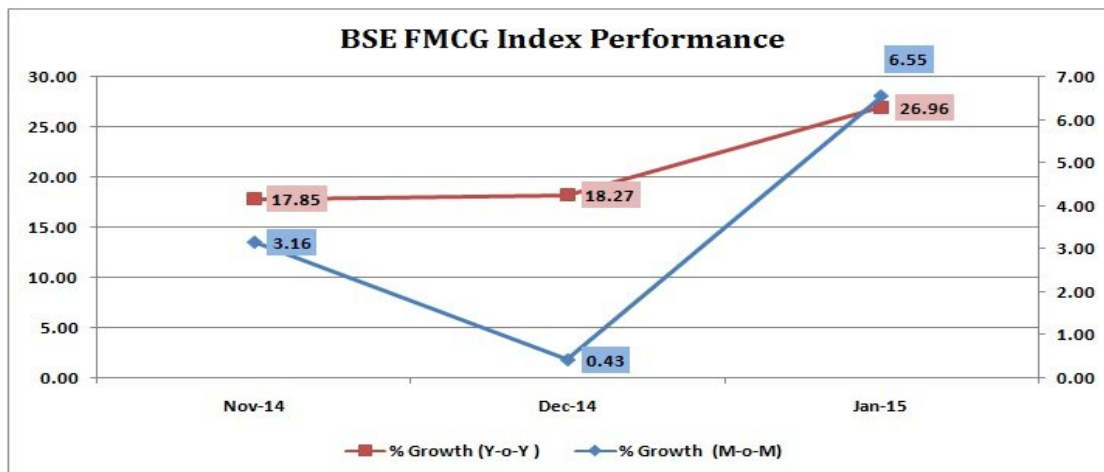
The sector is characterized by a well-established distribution network spread across nearly six million retail outlets (including two million in 5,160 towns and four million in 627,000 villages), low penetration levels, increasing consumption, high brand awareness, intense competition between the organized and unorganized segments, and a strong MNC presence.

The large share of fast moving consumer goods (FMCG) in total individual spending along with the large population base is another factor that makes India one of the largest FMCG markets. Even on an international scale, total consumer expenditure on food in India at \$120 billion is amongst the largest in the emerging markets, next only to China.

However, the Indian FMCG sector is highly fragmented, volume driven and characterized by low margins. Sluggish volumes and soft demand has been the story of the fast moving consumer goods (FMCG) sector so far in the financial year. However, with declining inflation and improving consumer sentiment, growth seems to be picking up for the sector.

Performance of FMCG Index

FMCG companies have been facing many challenges in the recent quarters mainly due to a drop in rural demand, pressure on sales volumes, moderating margins and stiff competition. Though the quarter gone by also turned out to be a disappointing one, the index staged a healthy performance past three months. A major reason for the upbeat performance is the fact that brokerages have upgraded future earnings estimates for these companies on expectations that the sharp fall in oil prices would boost growth. Besides, with increased fund flows in the Indian market, there is a lot of money scouting for safer havens. The index which registered M-o-M growth of 6.55% in January has surged over 25% on Y-o-Y basis.



Financial Performance: December earnings of most of the FMCG companies were disappointing mainly on account of slack consumer demand. Most of the FMCG companies disappointed the street with its December earnings as consumers continued to hold back on their small and discretionary spends. Company.

Company	Net Sales	Net Sales (Y-o-Y growth %)	Operating Profit Margin	PAT	PAT (Y-o-Y growth %)
ITC	8800.22	2.05	10.09	2635.00	10.47
Hindustan Unilever	7579.18	7.69	6	1252.17	17.87
Dabur India	1498.31	11.89	17.98	216.87	18.41

Tobacco major, ITC missed street expectations on top-line as well as bottom-line front in the third quarter, due to a significant decline in cigarette sales in volume terms. India's biggest cigarette maker's net profit grew 10.47% year-on-year to Rs 2,635 crore for the December quarter, while its net sales rose by 2.05% Rs 8,800.22 crore compared with the same period a year ago, but sequentially down by 1.45%

Meanwhile, Hindustan Unilever (HUL) posted a third-quarter earnings performance that was below expectations and although the country's largest consumer goods company indicated it has seen a modest volume recovery in some categories over the past few weeks. The company's net profit rose 17.87% year-on-year to Rs 1,252.17 crore, boosted by income from sale of property. However, after adjusting for this exceptional item, net profit was up 2.1% to Rs 955 crore. The FMCG major also disappointed on volume growth front, which stood at 3 percent, much lower compared to forecast of 5-6 percent and 4 percent in Q3FY14.

However, Dabur India matched street expectations with the third quarter consolidated net profit rising 16.4 percent year-on-year to Rs 282.8 crore and its standalone net profit rising by 18.41% at Rs 216.87 crore for the quarter ended December 31, 2014.

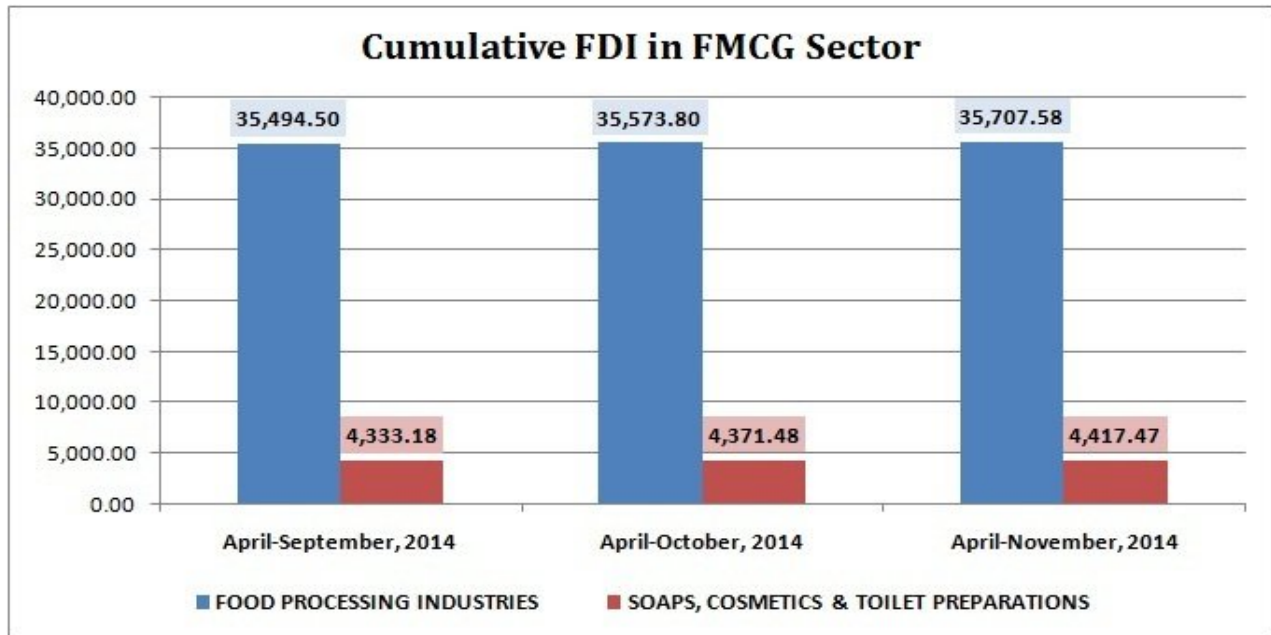
Positives for the Sector:

Receding Crude Oil Prices: Most of the FMCG companies have a fairly decent proportion of their cost structure in terms of base due to crude oil, whether it is paraffin oil or whether it is something which goes into detergents or the packaging material which are plastics. Hence, a slide in global crude oil prices is a big positive for FMCG sector since this is likely to improve their profit-margins.

Oil Prices have been hovering near multi year low majorly on worries of glut caused primarily by an unexpected high production of US share crude. The prices have slid by 55% from \$112/bbl in June 2014 to \$50/bbl mainly due to significant increase in supply with US crude oil production at a 25 year high due to shale oil boom; demand slowdown in Europe, Japan and China; decision of Saudi Arabia to protect market share rather than act as wing producer of oil and also due to cut in speculative positions; shift from unwinding of bullish bets in commodity

exchanges to panic selling. However, oil prices could marginally recover over the next 1-2 years with slower production growth and demand recovery.

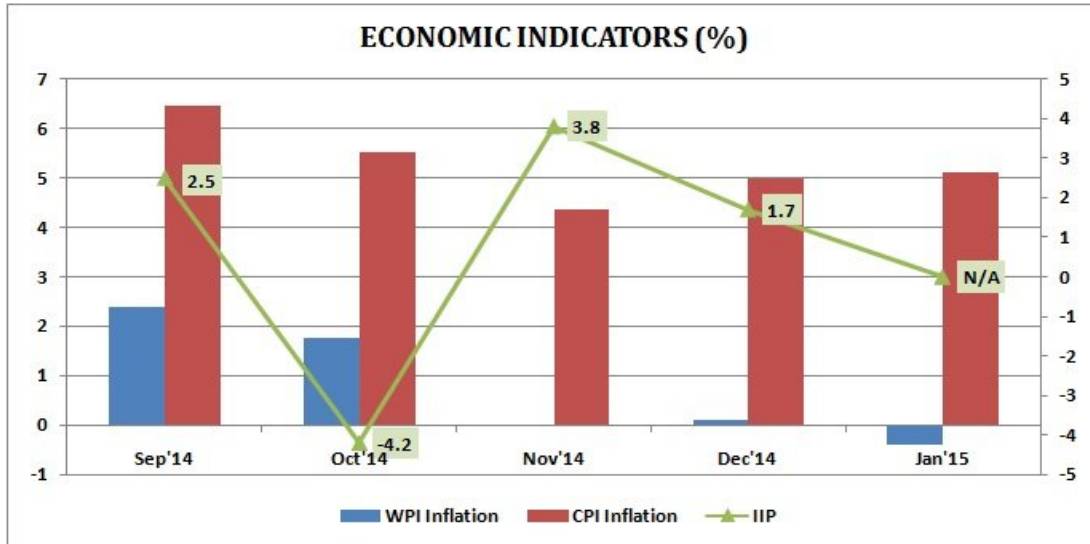
FDI in FMCG Sector: There has been slow, but gradual growth of FDI in FMCG Industry, which presently accounts for over 3% of the nation's total FDI inflows in April 2000-November 2014. Cumulative FDI inflows into India from April 2000 to November 2014 in the food processing sector stood at Rs 35,707.58 crore, accounting for 2.58% of overall FDI inflows while that in the soaps, cosmetics and toiletries stood at Rs 4417.47 crore, accounting for 0.36%.



Uptick in Economic Performance: Growth in FMCG majorly depends upon the performance of the economy, since pickup in economic growth leads to better consumption, which in turn helps consumer goods companies to perform better. Notably, the Indian economy witnessed a strong recovery in the fiscal year ended March 31, 2014 (FY 2014). Based on a new series of national accounts with revision in base year from 2004-05 to 2011-12, India's gross domestic product (GDP) expanded 6.9% in FY 2014 compared with 5.1% expansion in FY 2013. Based on the previous data, the GDP grew 4.7% in FY 2014, from 4.5% expansion in FY 2013. The dramatic revision could shake up the way the current trajectory of India's economy is perceived both at home and abroad.

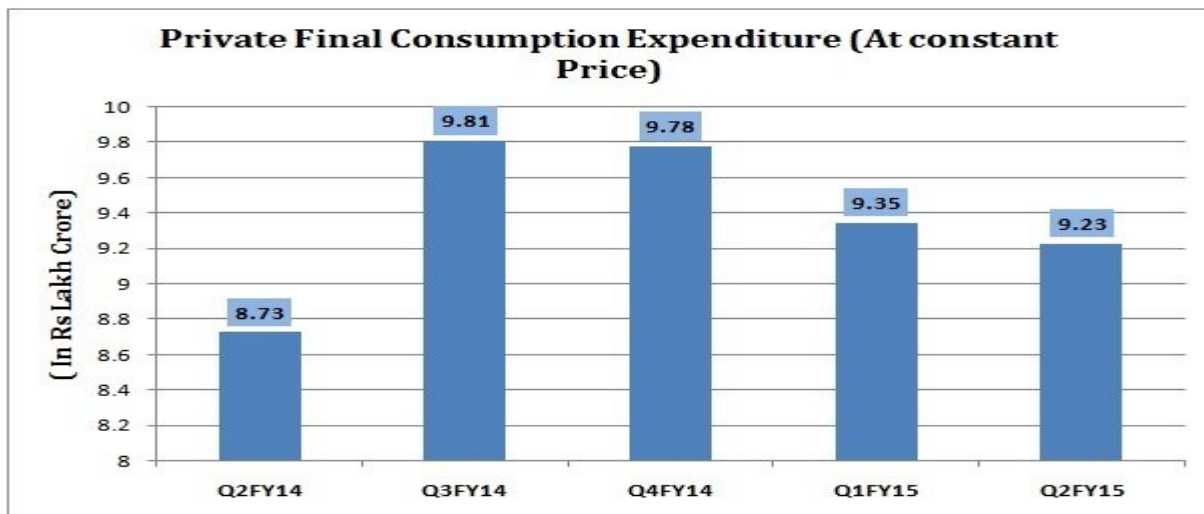
Further, the RBI surprised financial markets by announcing a cut in its main lending rate viz. the repo rate by 25 basis points in an unscheduled monetary policy review in mid of January, citing easing of inflationary pressures in the economy. The annual rate of inflation based on the combined consumer price indices (CPI) for urban and rural India although rose to 5.11% in January. Meanwhile, for the first time since late 2009, the annual rate of inflation, based on monthly wholesale price index (WPI) came below 0 at -0.39% in January, as compared to 0.11% in December on the back of sharp correction in oil prices.

However, index for industrial output (IIP) for the month of November after hitting a five-month high of 3.8% at 169.8, higher than street's expectation of figure of over 2% and further grew by 1.7% for the month of December. The growth rate though slowed down, but was much in line with expectation.



Negatives for the Sector:

Receding household consumption spending: Despite inflation gradually receding, spending on discretionary items has been on declining trajectory, mainly because of cautious approach of consumers for spending on discretionary items. Private final consumption expenditure (PFCE), the major component of which is household final consumption, which stood at Rs 9.23 lakh crore for Q2FY15, is not only lower on sequential basis (Rs 9.35 lakh crore in Q1FY15), but also lower on Y-o-Y basis (Rs 9.81 lakh crore in Q2FY14)



Subdued Volume Growth: Most of the FMCG companies continue to deliver a low midterm revenue growth on account of no change in the demand environment. FMCG volumes have been adversely impacted as discretionary consumer spending took a beating owing to lower economic growth along with high inflation.

Lower consumption also has limited new product launches, especially in the premium segments; leading to players adjusting their product mix by launching new products that were easy on the wallet. Spends on advertising and promotions also increased as players battled to attract customers, which again is negative for the sector.

Higher ad Spends: The FMCG segment, considered as the mainstay for ad spends and accounted for a third of spends in 2014. Further, if reports are to be believed India's advertising expenditure is expected to touch Rs 49,000 crore, which translates into 12.6% growth for calendar year 2015 and with this the share of contribution from FMCG players also is expected to rise, thereby weighing on top -line of these companies.

Intense Competition: Competitive pressure has become intense across categories in the sector. While the pressure is relatively low in household products, it has become intense in the personal care segment. Among the pan-India players, HUL with its strong distribution network continues to be dominant in terms of rural sales. Apart from HUL, big companies like ITC, Dabur and Emami have increased their reach and supplies to the rural areas. Thus, with higher competition, many regional players have to keep their prices lower to woo the customers to buy their product, which in turn hits their margins and also stunts their opportunity of expansion.

Outlook:

Sluggish volumes and soft demand has been the story of the fast moving consumer goods (FMCG) sector so far in the financial year, however revival is around the corner for FMCG segment on account of improving consumer sentiment, which is mainly driven by better performance of the economy, especially ebbing inflation. Positive economic environment, low inflation and development initiatives led by the new government mainly are instrumental in the uptick of any sector, including consumer goods. Additionally, fall in global crude oil prices also is a boon for the sector since most of FMCG companies have fairly decent proportion of their cost structure based on crude oil be it paraffin oil, detergent inputs or packaging material. However, this impact is expected to be visible only in Q1FY16 on account of high inventory stocks and subdued volumes

Companies Financial Data In Industry

Company Name	CMP	MCAP (Rs Crore)	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Procter & Gamble Hygiene & Health Care Ltd.	7053.90	22897.48	355.16	0.39	99.46	70.93
JL Morison (India) Ltd.	1626.25	221.99	586.97	0.06	62.45	26.04
Colgate-Palmolive (India) Ltd.	1914.55	26036.50	63.81	1.41	38.80	49.34
Gillette India Ltd.	4050.55	13198.81	214.08	0.37	24.48	165.44
Hindustan Unilever Ltd.	907.20	196248.35	30.36	1.43	19.27	47.07
Emami Ltd.	1024.90	23261.91	50.18	0.68	19.05	53.79
Godrej Consumer Products Ltd.	1168.05	39765.60	99.09	0.45	18.61	62.78
ITC Ltd.	389.55	311635.98	42.10	1.54	11.91	32.72
Bajaj Corp Ltd.	443.35	6539.41	43.45	1.47	10.66	41.60
Muller & Phipps (India) Ltd.	89.00	5.56	-75.50	0.00	10.29	8.65
Marico Ltd.	353.30	22787.21	36.76	0.99	9.02	39.18
Jyothy Laboratories Ltd.	300.50	5439.76	54.79	1.00	7.93	37.87
Dabur India Ltd.	266.70	46846.17	12.81	0.66	4.20	63.51
Pee Cee Cosma Sope Ltd.	53.00	14.03	55.94	2.26	3.66	14.47
Paramount Cosmetics (India) Ltd.	44.95	21.82	48.10	1.33	3.33	13.49
Opal Luxury Time Products Ltd.	105.00	35.27	84.34	0.00	1.44	72.90
Ambica Agarbathies & Aroma Industries Ltd.	4.74	8.14	20.11	0.00	0.62	7.69
MFL India Ltd.	6.86	24.72	9.51	0.00	0.20	34.81
Marico Kaya Enterprises Ltd.	1459.50	1882.33	230.69	0.00	0.04	0.00
Gujarat Meditech Ltd.	6.37	2.62	10.56	0.00	0.00	0.00
Safal Herbs Ltd.	34.05	340.50	0.88	0.00	0.00	0.00
Synergy Cosmetics (Exim) Ltd.	0.82	0.93	9.13	0.00	-0.02	0.00
Ador Multiproducts Ltd.	15.84	4.34	9.93	0.00	-5.04	0.00
GKB Ophthalmics Ltd.	50.40	20.93	35.02	0.00	-7.04	0.00
JHS Svendgaard Laboratories Ltd.	6.27	15.11	18.70	0.00	-11.95	0.00

Sorted with TTM EPS (High to Low)

Source – Ace Equity

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