

21 August 2024

## FMCG

Sensex: 80,905

Nifty: 24,770

*Summer sales up but Q1 dragged by the elections; H2 to be better*

**Summer spike, but elections hurt.** The scorching summer boosted demand for seasonal products (Glucon-D, prickly heat talc, cooling products, certain beverages, etc.). Emami, Zydus Wellness, Varun Beverages were prime beneficiaries of seasonal (summer) sales. The searing heat and elections in Q1, however, curtailed sales of certain products, especially alcoholic beverages, owing to supply-chain woes and restrictions imposed during this period.

Per media, Nielsen-tracked FMCG volumes were the lowest in five quarters (3.8% in Q1, 6.5% in Q4). In fact, rural volume growth at 5.2% exceeded urban volume growth of just 2.8% (for the second quarter in a row). FMCG revenue overall grew just 4% (6.3% in H2 FY24, 10.6% in H1 FY24), per Nielsen. We expect good revenue growth ahead, aided by an upswing in rural demand and return of pricing.

**Management commentaries point to a better H2.** Management commentaries project better revenue, aided by rural demand recovering, distribution expanding and pricing growth returning in H2. In discretionaries, alcobevs are likely to gain from the premiumisation trend with double-digit growth in the Prestige & Above category; paint companies expect double-digit FY25 growth, with 2% price hikes in Q2.

**Price increase, mix to aid gross margins.** Prices of most commodities (barring milk, soda ash, mentha oil) rose y/y (three-month average). Crude oil and derivatives, key inputs for several FMCG products and their packaging rose 10-11% y/y but q/q fell 4%. Coffee prices surged 35%, while titanium dioxide dipped 11%. We expect price hikes to offset high input costs, which should aid FY25 gross margins (though with modest gains vs. a 230bp y/y gain in FY24).

**Valuations.** FMCG stocks have run up 20-25% in the last four months, aided by a brighter outlook and the government's thrust on the rural/social sectors. With H2 demand outlook better, we expect healthy mid- to long-term returns for FMCG stocks. For the companies we cover, we estimate an 11% earnings CAGR over FY24-26, boosted by gross-margin gains and recovery in demand.

While valuations have risen, we see potential for our preferred picks: **HUL (TP: Rs3,130), Dabur (Rs720), Godrej Consumer (Rs1,670) and Emami (Rs930). United Breweries (Rs2,350)** is our pick in consumer discretionary.

**Ajay Thakur**  
Research Analyst

## Preferred picks - Valuation matrix

Particulars	Reco	M. Cap	CMP	TP	EPS (Rs)		P/E (x)		RoE (%)	Div. yield, %
		(Rs bn)	(Rs)	(Rs)	FY25e	FY26e	FY25e	FY26e	FY24	
HUL	Buy	6,430	2,744	3,130	46.6	52.2	58.9	52.6	20.1	1.5
Godrej Consumer	Buy	1,411	1,404	1,670	23.0	27.8	61.1	50.6	15.2	0.3
Dabur	Buy	1,097	621	720	11.5	13.0	54.0	47.8	18.7	0.9
United Breweries	Buy	516	1,990	2,350	24.1	31.3	82.7	63.5	9.8	0.5
Emami	Buy	351	803	930	19.4	22.1	41.4	36.3	29.3	1

Source: Bloomberg, Anand Rathi Research

Prices as on 19<sup>th</sup> August 2024

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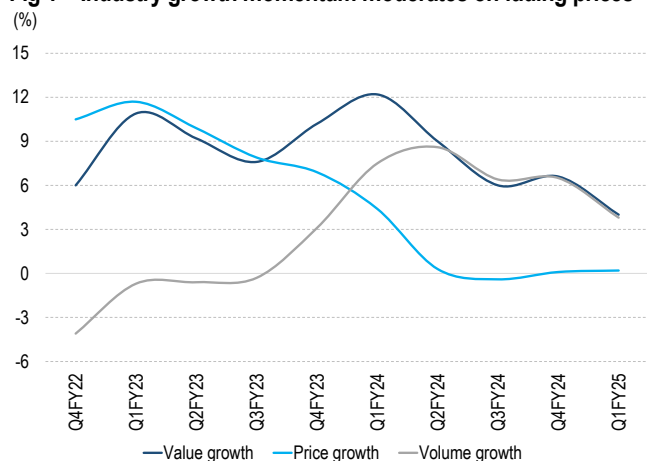
## Revenue analysis

### Mixed bag: Summer sales up; Q1 dragged by the elections

The scorching summer led to healthy demand for seasonal products (Glucon-D, prickly-heat talc, cooling products, certain beverages, etc.) as Emami, Zydus Wellness, Varun Beverages, etc., were prime beneficiaries of seasonal (summer) sales. However, the searing heat and elections in Q1 curbed sales of certain products (especially alcobevs) due to supply-chain woes and restrictions during this period.

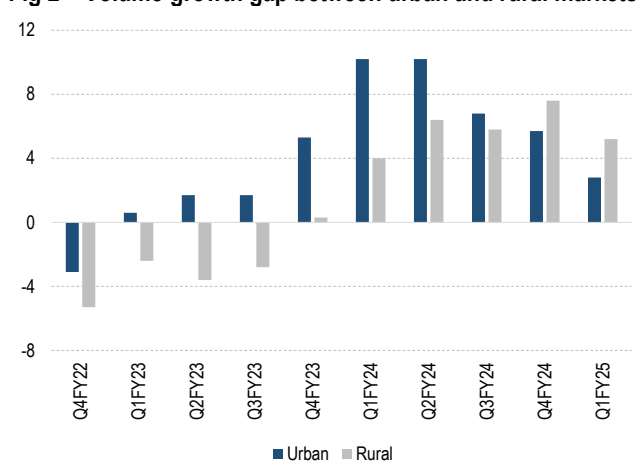
Per media, Nielsen-tracked FMCG volume was the lowest in five quarters at just 3.8% in Q1 (6.5% in Q4). In fact, rural volume growth at 5.2% exceeded urban volume growth which was just 2.8% (for the second quarter in a row). FMCG revenue overall grew just 4% (6.3% in H2 FY24, 10.6% in H1 FY24), per Nielsen. We expect revenue growth to improve ahead, aided by an uptick in rural demand and the return of pricing.

**Fig 1 – Industry growth momentum moderates on fading prices**



Source: Media reports, Nielsen, Anand Rathi Research

**Fig 2 – Volume-growth gap between urban and rural markets**



Source: Media reports, Nielsen, Anand Rathi Research

### Monsoon tracking well, could swell demand

Per the IMD, the above-average monsoon (106% of the long-term average, LPA) is expected this year. In fact, the monsoon reached Kerala early on 30<sup>th</sup> May vs 1<sup>st</sup> Jun normally and covered much of south India. So far, it is well on track and 3% higher than the LPA for the whole country. Its spatial distribution also seems to be good, with over 28 states and UTs having received normal and above rains, In eight states and UTs (mostly the NE and NW) rainfall has been deficient. Given that the shortfall is in the well-irrigated states of Punjab and Haryana, it is unlikely to hamper crop prospects. Thus, we hope of a much better *kharif* crop and, consequently, higher rural income.

**Fig 3 – Rainfall distribution across the states**

Sr. No.	States	1 <sup>st</sup> Jun to 19 <sup>th</sup> Aug 2024			Cat.
		Actual	Normal	% Dep.	
<b>East &amp; North-east India</b>					
1	Arunachal Pradesh	985.6	1,189.7	-17	N
2	Assam	975.9	1,066.3	-8	N
3	Meghalaya	1957.6	1,976.6	-1	N
4	Nagaland	542.7	733.4	-26	D
5	Manipur	515.7	751.1	-31	D
6	Mizoram	833.2	1,105.3	-25	D
7	Tripura	1,003.1	1,013.7	-1	N
8	Sikkim	1,548.0	1,169.4	32	E
9	West Bengal	883.7	924.0	-4	N
10	Jharkhand	599.5	700.5	-14	N
11	Bihar	516.5	675.0	-23	D
<b>North-west India</b>					
1	Uttar Pradesh	461.0	513.7	-10	N
2	Uttarakhand	826.3	859.3	-4	N
3	Haryana	245.6	299.9	-18	N
4	Chandigarh (UT)	435.7	626.8	-30	D
5	Delhi	435.3	375.2	16	N
6	Punjab	208.1	318.2	-35	D
7	Himachal Pradesh	424.5	535.4	-21	D
8	Jammu & Kashmir (UT)	283.7	394.1	-28	D
	Ladakh (UT)	22.3	15.7	42	E
9	Rajasthan	472.5	321.4	47	E
<b>Central India</b>					
1	Odisha	700.3	786.5	-11	N
2	Madhya Pradesh	730.3	663.7	10	N
3	Gujarat	537.2	522.3	3	N
4	Dadra & Nagar Haveli and Daman & Diu (UT)	1842.9	1,665.7	11	N
5	Goa	3490.4	2,490.5	40	E
6	Maharashtra	876.3	716.0	22	E
7	Chhattisgarh	845.3	794.9	6	N
<b>South Peninsula</b>					
1	Andaman & Nicobar Islands (UT)	1,062.2	1,038.7	2	N
2	Andhra Pradesh	409.3	311.2	32	E
3	Telangana	550.0	493.4	11	N
4	Tamil Nadu	316.3	171.7	84	LE
5	Puducherry (UT)	388.7	234.4	66	LE
6	Karnataka	747.6	600.5	25	E
7	Kerala	1,414.5	1,616.3	-12	N
8	Lakshadweep (UT)	1,037.6	757.1	37	E
<b>The country as a whole</b>		<b>632.5</b>	<b>611.8</b>	<b>3%</b>	

Source: IMD, Anand Rathi research

**Fig 4 – Rainfall distribution categorisation**

Category	1 <sup>st</sup> Jun to 19 <sup>th</sup> Aug 2024	
	No. of States	
Large excess	2	
Excess	8	
Normal	18	
Deficient	8	
Large deficient	0	

Source: IMD, Anand Rathii research

### Reported revenue growth slowed to just 3.6%

Our analysis of 11 FMCG companies (excl. ITC) shows that Q1 revenue grew just 3.6%, down sharply from ~6% in H1 FY24 and ~13% in FY23, but better than 2.7% in H2 FY24. Most FMCG companies' management commentaries, though, are optimistic about better revenue trajectories, aided by rural demand recovery, distribution expansion and/or product launches.

We expect gradual revenue recovery to 7.2% in FY25 for the FMCG companies we cover, from volume growth. In discretionary, Q1 revenue was flat for three paint companies but grew 8% for alcobev companies. We expect 4.7% revenue growth in FY25 for paints and 11% for alcobevs.

**Fig 5 – Volume growth to revive ahead**

(%)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	3	3	5	2	5	5	3	2	2	2	4
ITC (cigarettes)	-12	16	18	4	15	11	10	7	-2	2	2
Dabur	15	10	1	6	-3	0	3	3	4	4	5
GCP	10	4	1	10	3	11	12	11	8	12	10
Marico	7	7	3	3	4	5	3	3	2	3	4
Britannia	11	3	2	3	3	2	0	1	6	6	8
Emami	9	11	2	2	-4	2	3	5	-2	6	9
Bajaj Cons.	10	-1	4	6	-4	-1	3	4	8	7	-7
<b>Discretionary</b>											
United Spirits (P&A)	-8	24	23	12	13	12	11	13	13	4	5
United Breweries	-39	33	31	4	4	3	-12	7	8	11	5
Radico Khaitan (P&A)	-8	25	20	20	14	18	28	22	20	14	14
Asian Paints	13	31	14	9	0	10	9	6	12	10	7
Berger Paints	NA	20	16	12	7	11	13	11	9	14	12

Source: Companies, Anand Rathii Research

Fig 6 – Revenue growth improves for staples in Q1, but discretionaries dragged by election and summer heat

(%)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	18	12	16	2	16	11	7	4	0	0	2
Colgate	7	5	2	7	1	4	11	6	8	10	13
Nestle	8	10	10	11	14	21	15	10	8	9	3
ITC	0	24	17	2	2	6	-8	3	2	1	7
Dabur	10	14	6	9	3	6	11	7	7	5	7
GCP	11	11	8	7	9	10	10	8	6	4	-3
Marico	10	18	3	-1	3	4	-3	-1	-2	2	7
Britannia	13	8	15	3	17	13	8	1	1	1	6
Emami	8	11	7	5	1	9	7	6	1	7	10
Bajaj Consumer	8	-5	12	2	0	14	8	1	4	-4	-9
Jyothy Labs	12	15	13	11	16	13	15	13	11	7	8
Zydus Wellness	6	8	12	12	7	11	1	2	-3	10	20
<b>Discretionary</b>											
United Spirits	-13	19	9	7	-6	-1	10	-1	8	11	3
United Breweries	-35	38	28	8	2	3	-7	13	13	21	9
Radico Khaitan	0	19	10	31	-4	5	26	23	34	15	6
Asian Paints	7	34	19	3	1	11	7	0	5	-1	-2
Berger Paints	7	29	21	6	6	12	10	4	7	3	2
Kansai Nerolac	-4	26	18	3	1	14	7	2	6	4	-1

Source: Companies, Anand Rathi Research

\*Note: Positive changes of 10% or more in green

## Gross margin analysis

### Gross-margin gains ease in Q1; >200bp rise for 8 companies

Falling input prices led to Q1 gross-margin gains for the FMCG companies we cover. Of these (barring ITC), 11 gained ~200bps y/y on aggregate (~300bps in Q4; ~380bps in Q3). In discretionaries, paint companies reported just 45bp y/y gross-margin gains (200bps in Q4; 550bps y/y in Q3). Alcobeys saw on aggregate a 30bp y/y gross-margin decline, with higher grain prices driving the increase in ENA costs, though partly offset by lower glass costs. The drop in barley costs helped breweries' margins. Some rise in input costs was seen; however, most companies have talked of price hikes in H2, which would counter-balance the higher cost. We, thus, expect a modest expansion in the FY25 gross margin (vs. a hefty 230bp rise in FY24).

Fig 7 – Gross-margin trend

(%)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	52.9	50.9	47.6	51.9	47.5	48.7	49.9	52.7	51.5	51.9	51.4
Colgate	68.0	67.3	65.7	67.7	65.9	66.9	68.4	68.8	72.2	69.3	70.6
Nestle	57.5	57.0	55.1	56.8	54.9	53.8	54.8	56.5	58.6	56.8	57.6
ITC	56.1	53.4	56.3	57.4	58.9	58.6	59.5	57.3	58.4	59.9	57.7
Dabur	49.9	48.2	45.6	47.8	45.5	45.8	46.6	48.3	48.6	48.6	47.8
GCP	55.3	50.5	49.7	55.1	51.1	52.9	53.7	54.9	55.9	55.9	55.9
Marico	47.0	42.9	45.2	50.8	44.9	47.4	50.0	50.5	51.3	51.6	52.3
Britannia	41.9	38.0	41.2	43.4	43.7	44.9	41.9	42.9	43.9	44.9	43.4
Emami	67.7	66.3	64.7	67.6	65.9	63.1	65.4	70.1	68.8	65.8	67.7
Bajaj Consumer	64.2	58.1	56.1	57.4	53.9	54.7	55.4	55.1	54.0	55.5	56.1
Jyothy Labs	47.1	41.6	42.3	44.5	43.1	45.7	47.9	49.2	49.8	49.5	51.3
Zydus Wellness	54.7	51.2	49.2	51.1	43.9	50.8	52.6	45.2	48.1	54.6	55.6
<b>Discretionary</b>											
United Spirits	45.2	45.5	42.9	46.6	40.9	45.6	54.1	43.5	43.7	45.7	52.7
United Breweries	52.2	49.9	43.1	42.7	42.0	38.8	40.6	44.7	44.2	41.9	43.2
Radico Khaitan	50.3	45.0	41.8	42.5	41.8	40.6	43.6	44.1	41.8	41.0	41.5
Asian Paints	44.3	37.1	38.7	43.4	38.6	42.5	42.9	43.4	43.6	43.7	42.5
Berger Paints	43.3	38.0	36.3	40.7	34.7	39.8	39.8	41.1	41.1	40.7	39.9
Kansai Nerolac	38.0	30.5	30.2	35.2	30.2	31.6	35.3	35.7	36.2	34.8	37.0

Source: Companies, Anand Rath Research

Fig 8 – Gross-margin changes

(bps)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	-125	-195	-332	430	-426	-84	256	692	401	316	154
Colgate	276	-69	-163	203	-73	4	211	502	631	244	222
Nestle	-27	-46	-194	170	-217	-472	93	371	374	299	283
ITC	-646	-265	283	113	756	544	850	33	-44	130	-175
Dabur	1	-171	-257	217	-283	-163	74	295	310	279	119
GCP	-170	-479	-85	544	48	343	715	702	474	304	211
Marico	-185	-410	235	560	123	294	494	685	634	417	227
Britannia	167	-392	313	224	574	688	506	396	21	-3	0
Emami	74	-146	-155	287	-153	59	241	345	291	265	226
Bajaj cons.	-370	-611	-199	130	-212	-231	-4	249	7	83	64
Jyothy labs	66	-550	70	220	206	425	800	957	666	378	342
Zydus Wellness	-118	-354	-204	262	-440	-3	-168	186	424	382	304
<b>Discretionary</b>											
United Spirits	-90	31	-266	375	-432	129	765	403	281	14	-140
United Breweries	58	-229	-680	-38	-811	-1011	-385	-198	213	314	245
Radico Khaitan	204	-530	-316	66	-373	-215	4	259	3	42	-207
Asian Paints	61	-717	154	470	182	379	523	764	504	121	-40
Berger paints	178	-522	-173	439	-198	93	407	582	638	83	5
Kansai Nerolac	-14	-750	-30	500	-115	359	539	707	598	319	169

Source: Companies, Anand Rath Research

\*Note: Positive changes of more than 150bps in green

Prices of most commodities, barring milk, soda ash and mentha oil rose y/y (three-month average). Crude oil and its derivatives, key inputs for several FMCG products and their packaging grew 10-11% y/y but q/q fell 4% (three-month average prices). Coffee prices surged 35%, while titanium dioxide dipped 11%.

In the last 3/6 months, prices of caustic soda, barley, tea and coffee have risen. This has implications chiefly for HUL, Tata Consumer and United Breweries. With that, we anticipate a steady input price environment to persist due to a lack of major demand-supply mismatch/disruption. Further, with price rises (as indicated by most companies), we expect gross margin trajectories to endure for most of the companies we cover, aided by a better mix (alcoholic beverages, Emami, Zydus Wellness, etc.).

**Fig 9 – Major input materials and their price changes**

Inputs	Units	Price / Index	Change (%)					Companies impacted
			1-mth	3-mth	6-mth	1-yr	2-yr	
Wheat	Rs / quintal	2,655.0	3.9	11.8	4.3	9.9	11.6	ITC, Britannia, Nestle, Adani Wilmar
Palm oil	\$ / lb.	3,866.5	(2.3)	(0.3)	(2.9)	2.1	(9.2)	Godrej Cons., HUL, Britannia, Prataap Snks, Bikaji
Soda ash	Rs / 50kg	1,715.0	(0.6)	(0.6)	(7.3)	(18.7)	(40.3)	HUL, Jyothy Labs
Sugar	Rs / quintal	3,950.0	3.1	(1.0)	3.9	6.8	11.3	Britannia, ITC, Nestle, HUL, Zydus Wellness
TiO2	Rs / kg	340.0	(1.2)	(1.4)	(1.4)	(9.3)	(13.9)	Paints companies
Caustic soda	Rs / 50kg	2,225.0	2.3	0.0	11.8	5.2	(33.6)	All FMCG
Mentha oil	Rs / kg	1,007.6	3.9	(1.0)	1.6	(4.3)	(9.8)	Emami, Colgate
Poly-propelene	Rs /tonne	990.0	(2.9)	(1.0)	1.0	4.2	0.0	All FMCG
Milk powder	Index	168.8	(0.1)	(0.7)	(1.2)	(2.7)	4.5	Nestle, Zydus Wellness, HUL, Britannia
Barley	Rs / quintal	2,255.0	(2.0)	8.7	24.9	17.4	(28.4)	United Breweries, HUL
Crude oil	\$ / bbl.	80.8	(3.5)	(3.0)	(3.2)	(3.2)	(12.5)	All FMCG
Tea	Rs / kg	265.0	12.8	20.5	20.5	8.2	(15.9)	Tata Consumer, HUL
Coffee	\$ / lb.	239.9	(1.7)	19.2	26.7	60.7	6.4	Nestle, HUL, Tata Consumer
LAB	\$ /tonne	1,750.0	0.6	2.9	2.3	4.5	0.0	HUL, Jyothy Labs
HDPE	\$ / tonne	1,010.0	(2.9)	(2.9)	(1.0)	(1.9)	(2.9)	All FMCG

Source: Bloomberg, Anand Rathi research

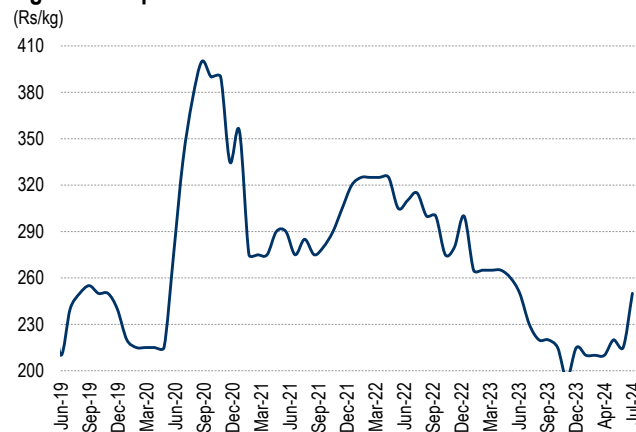
## Raw material price trend

**Fig 10 – Sugar prices up 11% in the last two year**



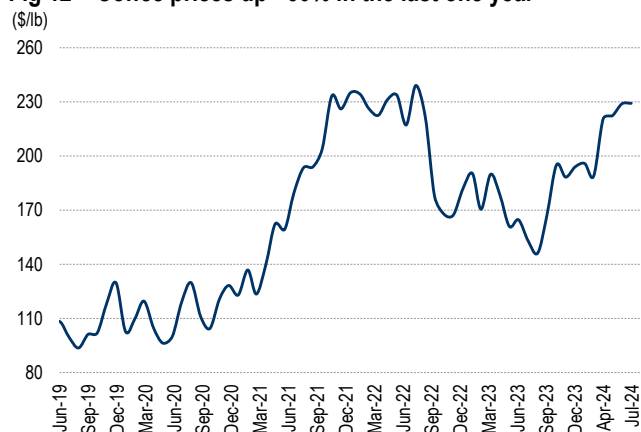
Source: Bloomberg, Anand Rathi Research

**Fig 11 – Tea prices rises but still favourable**



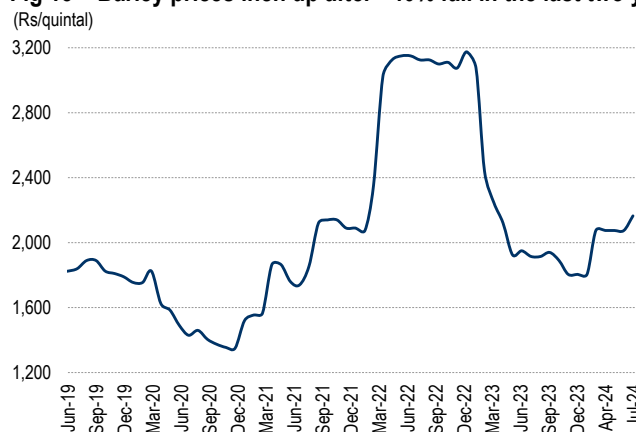
Source: Bloomberg, Anand Rathi Research

**Fig 12 – Coffee prices up ~60% in the last one year**



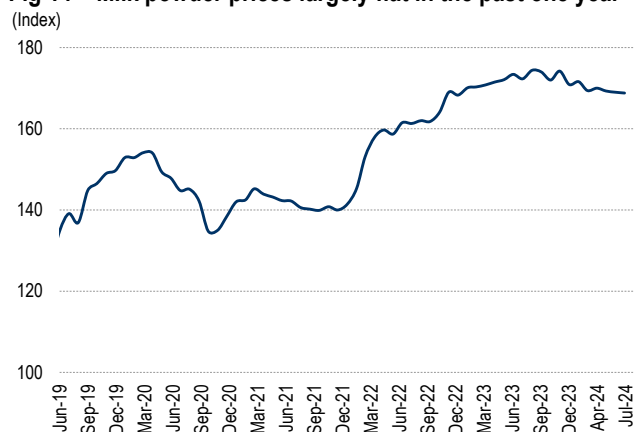
Source: Bloomberg, Anand Rathi Research

**Fig 13 – Barley prices inch up after ~40% fall in the last two yr**



Source: Bloomberg, Anand Rathi Research

**Fig 14 – Milk powder prices largely flat in the past one year**



Source: Bloomberg, Anand Rathi Research

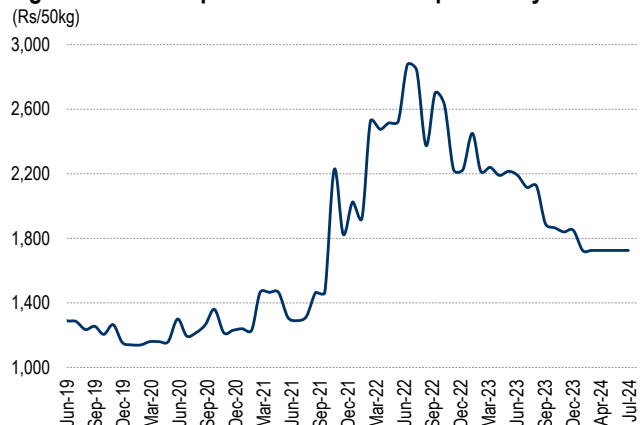
**Fig 15 – Wheat prices up >10% in the past two years**



Source: Bloomberg, Anand Rathi Research

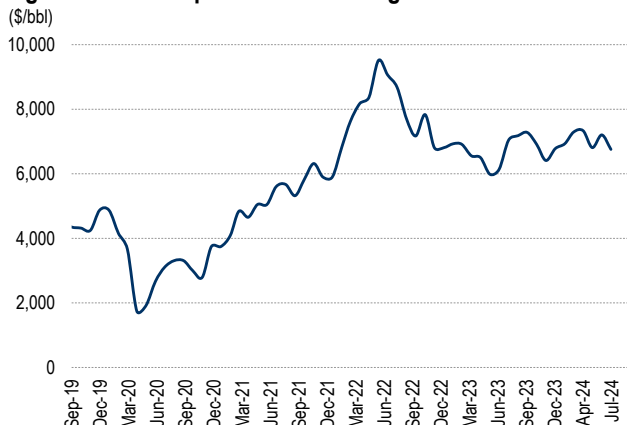


**Fig 16 – Soda ash prices fell ~20% in the past one year**



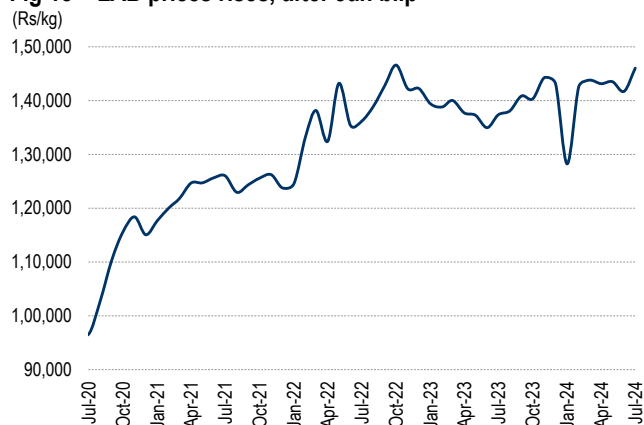
Source: Bloomberg, Anand Rathi Research

**Fig 17 – Crude oil prices remain benign**



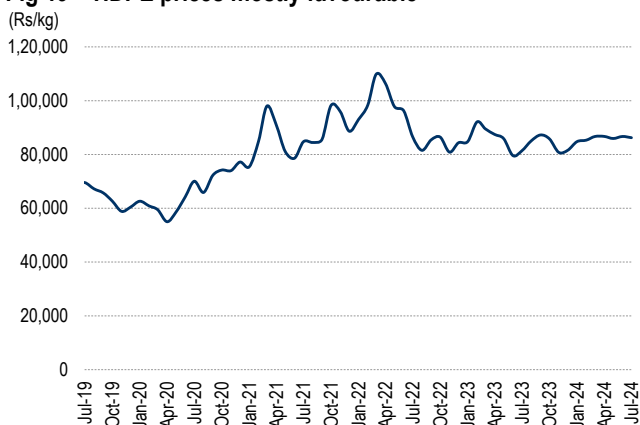
Source: Bloomberg, Anand Rathi Research

**Fig 18 – LAB prices rises, after Jan blip**



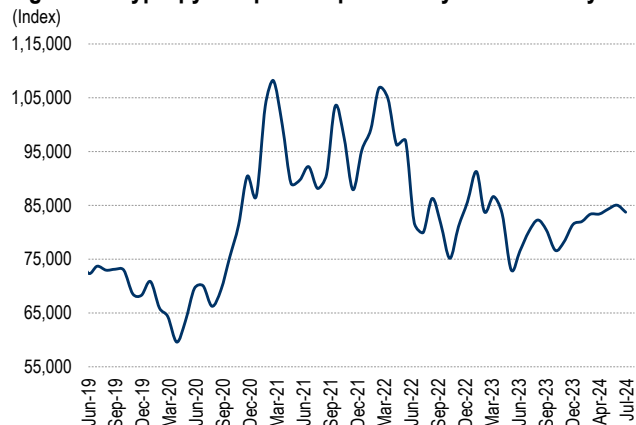
Source: Bloomberg, Anand Rathi Research

**Fig 19 – HDPE prices mostly favourable**



Source: Bloomberg, Anand Rathi Research

**Fig 20 – Polypropylene prices up modestly in the last 1-yr**



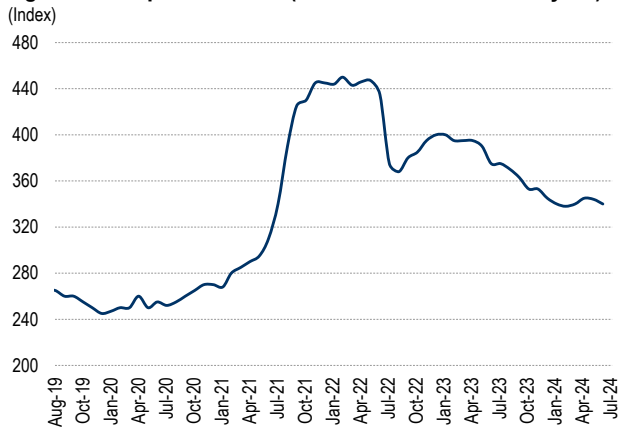
Source: Bloomberg, Anand Rathi Research

**Fig 21 – Palm oil prices rangebound**



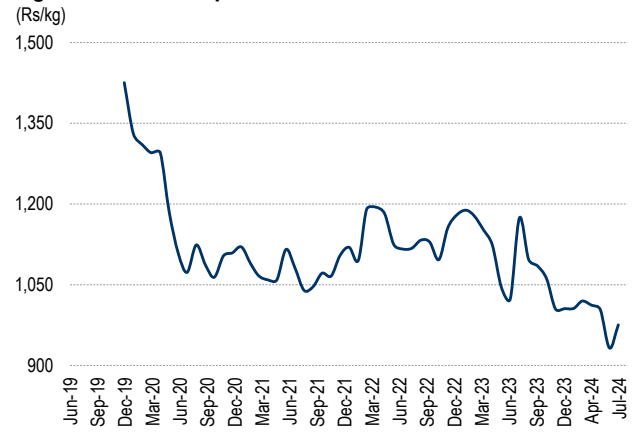
Source: Bloomberg, Anand Rathi Research

**Fig 22 – TiO2 prices soften (down 9% in the last one year)**



Source: Bloomberg, Anand Rath Research

**Fig 23 – Mentha oil prices still favourable**



Source: Bloomberg, Anand Rath Research

## EBITDA margin analysis

### A&SP spend surged in FY24 on keener competition

A&SP spends rose 12% y/y (or 80bps) for eight FMCG companies in Q1. This increase came after a 24% rise in FY24, owing to more competition (small companies turned relentless due to the sharp fall in input costs) and launches. We expect A&SP spends (as % of net sales) to be high, but growth is likely to be modest ahead as gross-margin gains are expected to ease in FY25.

Fig 24 – Trend in A&SP spends

(%)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	10.3	9.2	8.3	10.7	7.9	8.7	9.8	11.3	10.5	10.7	10.7
Colgate	13.0	12.7	12.2	12.5	13.2	10.6	13.7	14.0	14.6	11.3	13.3
Dabur	8.3	7.2	5.6	6.8	5.9	5.7	6.5	6.8	7.5	6.5	7.0
GCP	9.0	8.1	9.0	11.1	7.7	7.0	9.3	10.2	12.9	8.9	9.9
Marico	8.7	8.4	8.7	9.9	8.9	9.4	8.6	10.8	10.2	9.9	9.1
Emami	15.9	16.1	16.6	18.5	15.6	15.5	18.4	17.9	16.6	20.2	20.3
Jyothy Labs	6.5	7.4	7.2	7.6	6.8	7.5	7.3	7.8	9.0	9.1	8.3
Zydus Wellness	12.3	11.7	11.5	12.8	10.7	9.3	14.9	11.5	12.3	12.0	14.8
<b>Discretionary</b>											
United Spirits	7.1	7.2	8.7	9.3	10.0	13.7	5.5	8.4	11.0	11.8	6.3

Source: Companies, Anand Rathi Research

Fig 25 – A&SP spend changes

(bps)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	-178	-108	-92	240	-127	-92	47	420	261	201	94
Colgate	-83	-30	-50	30	137	-70	8	260	148	75	-40
Dabur	83	-110	-165	125	-216	-31	96	168	161	86	52
GCP	154	-90	90	210	74	67	285	179	523	188	64
Marico	-124	-33	33	120	-36	-7	78	229	125	55	52
Emami	-185	20	50	190	-69	-395	77	47	104	471	188
Jyothy Labs	-68	85	-17	40	-37	30	-21	149	213	161	96
Zydus Wellness	-84	-62	-20	140	-305	-79	106	-51	160	270	-9
<b>Discretionary</b>											
United Spirits	-62	8	153	57	-14	841	-30	294	93	-184	82

Source: Companies, Anand Rathi Research

\*Note: Positive changes of 150bps or more in green

Q1 EBITDA margin for 11 FMCG companies (excl. ITC) grew 100bps, despite the 200bp gross-margin gain. Gross-margin gains were partly offset by higher brand spends and other expenses. The discretionary segment saw 210bp margin declines for six companies, largely driven by a 420bp fall in Asian Paints' EBITDA margin. United Breweries, Radico Khaitan and Kansai Nerolac posted margin gains.

We expect EBITDA margins to rise 50bps in FY25 for six FMCG companies. Within discretionaries, alcobev companies are likely to see 160bp EBITDA margin expansion, aided by premiumisation and lower input costs (glass). EBITDA margins of paint companies are likely to decline 70bps in FY25 on rising input costs and A&SP spends (to tackle competition).

Fig 26 – EBITDA margin trend

(%)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	24.7	24.5	23.4	23.7	23.2	23.3	23.2	24.2	23.3	23.1	23.5
Colgate	31.2	30.7	29.6	31.0	28.0	33.5	31.6	32.8	33.6	35.7	34.0
Nestle	24.0	24.4	22.2	23.8	22.9	22.7	22.7	24.3	23.8	25.6	23.1
ITC	34.1	33.5	36.3	37.4	38.4	37.9	39.5	36.5	36.5	37.2	37.0
Dabur	20.9	20.7	18.7	19.4	20.0	15.3	19.3	20.6	20.5	16.6	19.6
GCPL	21.8	19.6	18.3	21.0	20.2	20.0	18.6	19.5	25.7	23.0	21.7
Marico	19.7	17.6	18.5	21.0	18.5	17.5	23.2	20.1	21.2	19.4	23.7
Britannia	19.1	15.6	17.4	18.9	19.5	19.9	17.2	19.7	19.3	19.4	17.7
Emami	30.7	29.9	25.3	26.5	29.9	23.9	23.0	27.0	31.6	23.7	23.9
Bajaj Cons.	26.2	19.8	17.6	19.4	14.1	16.7	17.2	17.7	15.6	14.5	14.9
Jyothy Labs	16.5	11.3	12.7	14.8	13.8	14.7	17.1	18.5	17.5	16.4	18.0
Zyduz Wellness	18.4	17.0	15.0	13.2	6.8	20.3	16.6	3.8	3.1	20.7	18.5
<b>Discretionary</b>											
United Spirits	12.9	16.4	13.2	17.7	13.4	9.4	26.7	16.3	16.2	12.7	25.8
United Breweries	9.0	11.9	8.2	8.6	4.8	3.0	9.8	9.8	8.0	6.7	11.5
Radico Khaitan	17.0	13.8	11.2	12.3	12.2	9.5	12.5	13.1	12.3	11.4	13.1
Asian Paints	22.4	16.5	18.2	21.4	18.7	21.2	23.1	20.2	22.6	19.4	18.9
Berger paints	17.4	15.2	14.1	16.6	13.0	15.1	18.4	17.1	16.7	13.9	16.9
Kansai Nerolac	17.0	10.2	10.8	13.2	11.0	9.5	16.1	14.6	13.2	10.8	16.3

Source: Companies, Anand Rath Research

Fig 27 – EBITDA margin changes

(bps)	FY21	FY22	FY23	FY24	Q3 FY23	Q4 FY23	Q1 FY24	Q2 FY24	Q3 FY24	Q4 FY24	Q1 FY25
<b>Staples</b>											
HUL	-5	-20	-110	30	-124	-80	49	129	8	-19	26
Colgate	463	-48	-111	140	-174	46	516	337	557	226	238
Nestle	33	44	-222	160	-29	-307	252	230	95	293	49
ITC	-478	-63	276	114	619	423	682	15	-181	-70	-245
Dabur	35	-25	-200	70	-129	-271	6	51	48	128	24
GCP	18	-220	-135	275	-4	399	197	357	552	296	311
Marico	-35	-213	94	246	56	153	253	272	272	186	51
Britannia	321	-353	179	153	438	442	365	343	-19	-56	56
Emami	470	-84	-452	117	-520	256	60	301	166	-23	88
Bajaj Cons.	220	-640	-220	180	-905	-277	-259	311	244	-224	-281
Jyothy Labs	150	-520	144	210	232	422	705	609	374	163	90
Zyduz Wellness	205	-145	-205	-171	-154	-184	-467	3	-363	45	187
<b>Discretionary</b>											
United Spirits	-335	345	-320	429	-422	-762	1135	125	282	259	-92
United Breweries	-447	295	-372	38	-623	-1226	-111	-330	323	366	172
Radico Khaitan	167	-315	-260	110	-350	-31	31	127	8	187	58
Asian Paints	177	-586	164	322	57	293	502	573	393	-185	-422
Berger Paints	73	-221	-112	250	-239	-75	371	349	368	-117	-148
Kansai Nerolac	119	-680	60	240	-142	363	298	375	224	128	19

Source: Companies, Anand Rath Research

\*Note: Positive changes of 150bps and more in green

## Management commentaries

### HUL

- Seeing early signs of rural demand recovery, though rural growth still lagging urban growth on a two-year basis.
- Retained most of its 200bp market-share gain from the inflation period. Though slight dip in market share, this was anticipated as the company navigates the inflation-deflation cycle.
- Introduced Stratos technology in Lux and Lifebuoy soaps, reducing use of palm oil by up to 25%, enhancing price competitiveness without compromising quality. Stratos is a patented technology that reformulates soaps with enhanced skin benefits by reducing non-functional TFM and incorporating active ingredients.
- Aims to maintain current EBITDA margins by expanding gross margins through better pricing, net productivity steps and continued investments in brands and capabilities.

### Dabur

- FMCG gradually improved in rural areas in the past two quarters, despite challenges (extreme heat, high food prices). Rural demand consistently outpaced urban demand; rural recovery seen in the last three quarters.
- Volumes grew q/q to 5.2%, with significant expansion in distribution, adding 50,000 stores, 21,000 villages and 3,300 *yodhas* in Q1.
- Did well in hair oils (20% growth in coconut oils, a 100bp market-share gain in perfumed hair oils) despite mounting competition from Bajaj Consumer in hair oils. Maintained Real Juice's market share; launched PET bottles to regain coconut-water share; saw a 30% surge in Dabur Glucose alongside positive feedback for newly launched Hajmola.
- Deflationary environment expected to aid gross margins in Q2, with some inflation anticipated in H2; committed to brand investments.

### Godrej Consumer

- India's organic volume grew 8% (on a high, 10%, base), driving 6% revenue growth due to negative pricing. Growth was achieved despite trade scheme cuts on soaps and an unusually hot summer for household insecticides.
- Expects to return to pricing from the next quarter, with 2-3% price hikes on average in FY25. A large part of the price hike will be in soaps.
- Announced formation of Godrej Pet Care (GPC), a GCP subsidiary. Pet foods already a Rs50bn category with decades of growth (in late teens) ahead.
- Slight loss in domestic margins in Q1. Expects EBITDA margins to hold at the current level, with minor fluctuations ( $\pm 150$ bps).

## Zydus Wellness

- Better macroeconomic indicators and controlled inflation set to boost the company's brand, with demand momentum outpacing urban growth and narrowing consumption gap across categories.
- Highest sales with 20% y/y growth, driven by 17.1% higher volumes, a 41.8% increase in personal care, and 15% rise in food & nutrition, boosted by seasonal products (Glucon-D, Nycil) due to a harsh and prolonged summer.
- Aiming at 17-18% EBITDA margins ahead, led by a better gross margin and operating leverage.
- Has repaid debt and de-levered its balance sheet in Q1.

## Marico

- Gradually, demand improving with rural growth ahead of that of urban. Good urban growth, particularly in premium categories; rural markets recovering.
- Brand maintained its premium, gained 100bp market share; mid-teen growth in flanker brands (Nihar Coconut Oil, Oil of Malabar), bringing composite coconut oil portfolio's volume market share to a record 64% on a MAT basis. Parachute volumes expected to gradually rise to mid-single digits from Q2 to Q4.
- Steadily reducing concentration risk in Bangladesh by diversifying its portfolio to products (shampoo, baby care), away from coconut oil.
- No margin expansion expected this year. Aims to maintain margins at FY24 levels despite mild inflation.

## Emami

- Rural demand gradually improved, especially in the north (more market-share gains) and the east; steady performance in the south and expansion in modern trade in the west.
- Despite the scorching summer boosting demand for seasonal products, discretionary consumption hindered by rising food prices and low consumer confidence.
- Sound profitability with 8.7% volume growth and 10% value growth, driven by strong performances of summer portfolio and brands (Navratna, Dermicool, The Man Company). Challenges seen in pain management and certain grooming ranges, being addressed through strategic initiatives.
- Expects 5-6% volume growth, 1-2% value growth.
- Hopes to expand gross/EBITDA margins for the year despite higher advertising expenses; FY25 EBITDA margin expected at 26-27%. The gross margin expanded and would continue for the full year.

## Britannia

- FMCG industry is poised for consumption-led growth in FY25, thanks to the better monsoon, modest inflation and falling unemployment.
- Rural employment is at an all-time high; hence, rural better than urban.

- Focus on driving revenue growth in FMCG, even if it has to retain margins at 16% instead of aiming at 18%, while striving for optimal margins.
- H2 revenue growth will hinge on how it navigates price drops, which drove double-digit volume growth. Present context suggests the base would constrict revenue, with volumes closely aligned with revenue.

## **Tata Consumer**

- Scorching summer in many parts of the country curtailed demand, especially of hot beverages (the company has primarily a tea business in India and in out-of-home categories).
- Gross margin expected to rise and return to the previously stated figure, which will be significantly accretive for the current portfolio.
- EBITDA margin to be accretive for acquired business, with a significant rise in capital foods due to a full quarter of integration.
- The company is confident of delivering the normative growth, with its Jun performance almost normal and returning to expected levels ahead.

## **Discretionaries**

### **Asian Paints**

- Challenging Q1 due to heat and elections, with weaker demand in Apr and May. Recovery in Jun, however, highlighted green shoots in rural demand, especially in tier-3/-4 towns, which grew faster than tier-1/-2 cities. Expects to maintain 5-6% volume-value gap guidance in FY25.
- Expects double-digit volume growth in FY25; retained 18-20% PBDIT margin guidance.
- Not bruised by larger entities (competition). Enjoys pricing premium.

### **Berger Paints**

- Despite elections, inclement weather and slowdown in key markets, double-digit volume growth, and highest market-share gain in a quarter. In Q1, Indigo Paints and Berger Paints gained market share, while Asian Paints lost some.
- Strong growth seen in waterproofing, construction chemicals and wood coatings, while the industrial segment, after a slow start in Apr and May, recovered in June, suggesting positive momentum ahead.
- Competition (Birla Opus). Initial hype has somewhat dipped, with fear largely dissipating. Performance and repeat cycles for Birla Opus are keys to watch. Maintained operating profit guidance of 15-17%, with a 17.2% margin in Q1; Expects better operating and gross margins in Q2.

### **Kansai Nerolac**

- Though lagging urban growth, rural uptick seen. In Q1 strong demand for automotive coatings, subdued demand in decorative coatings due to the heat, labour shortage and elections. Performance coatings improved in Jun.

- Birla Opus took several measures, but will take time to connect with customers, dealers, painters. Not seen much market push for extra grammage (as Birla Opus is offering).
- Aims to maintain EBITDA margin at FY24 level and attain high single-digit volume growth for the year. Expects H2 (marriage season from Jul, and festival sales) to be better.
- GDP growth high, but consumption growth lower. High-single digit volume growth still possible.

## United Spirits

- Premiumisation ladder intact but below company aspiration and that experienced FY21 to FY23. Soft consumption growth in latter half of FY24 with the overhang of persistently high food prices. Some green shoots, however, emerging in rural demand recovery, with normal monsoon, which may drive consumption.
- Launched a first-of-its-kind, 375ml pack in hipster format for Royal Challenge American tribe in key markets (UP, Telangana, Assam).
- Expects to expand margins, with normal EBITDA margin of ~16.5%.
- Firmly committed to delivering on growth guidance for full fiscal. Expects double-digit growth in P&A, the first half being less than double digits, the second half more than double digits.

## United Breweries

- Despite election-led challenges, a great quarter. Being the largest with significant shares in some states, election-related constraints hit the company disproportionately. Without elections, domestic volumes could have been ~8-9%.
- Election-related production and supply issues led to a 10% market-share loss in Telangana and declines in Rajasthan and Odisha in Apr and May. By Jun, though, began recouping market share, volumes in the premium range rising 44% domestically, despite election-related restrictions.
- Aspires to expand EBIT margins 400-500bps in 3-4 years.
- Working on driving category growth to ~15-18% (now 7-8%). Adding to category growth, while raising proportion of the premium category in its portfolio is a key focus area; also, capturing premium market share.

## Radico Khaitan

- Q1 started on a positive note; on track to deliver on strategic roadmap. Despite external challenges (lower consumption growth, concerns about continuously high food-grain prices, volatile commodity prices), delivered strong P&A growth (14% y/y by volume).
- Q1 saw a 175bp y/y pricing impact. On average, prices to rise 150-160bps in the year. Some southern states contemplating price change.
- Plans to continue to expand margins.
- Guided to 4-5% Regular category growth maintained its 15%+ P&A category growth guidance.



## Valuations

FMCG stocks have run up 20-25% in the last four months, aided by the brighter outlook and government thrust on rural/social sectors. However, with a better demand outlook for H2 (aided by normal monsoon), we expect healthy mid- to long-term returns from n FMCG stocks.

We expect an upswing in FMCG companies' revenue, more so from Q2, led by rural demand recovering and the return of pricing. Also, discretionaries in the P&A/Premium portfolios should continue to do well. Margins are likely to improve for staples and discretionaries, aided by price rises. Competition, though, is expected to be stiff in staples and discretionaries, on relentless efforts by smaller companies in FMCG and paint/beer companies. For the companies we cover, we estimate an 11% earnings CAGR over FY24-26, aided by margin gains and demand recovering.

While valuations have risen, we see potential for our preferred picks: **HUL (TP: Rs3,130)**, **Dabur (Rs720)**, **Godrej Consumer (Rs1,670)**, **Emami (Rs930)**. **United Breweries (Rs2,350)** is our pick in consumer discretionary.

**Fig 28 – Earnings growth for the companies we cover**

	Revenue (Rs m)				EBITDA margins (%)			PAT (Rs m)			
	FY24	FY25e	FY26e	2-yr CAGR	FY24	FY25e	FY26e	FY24	FY25e	FY26e	2-yr CAGR
<b>Staples</b>											
HUL	618,960	651,661	710,550	7.1	23.7	23.8	24.3	102,750	109,441	122,641	9.3
GCPL	140,961	155,174	172,313	10.6	21.0	22.6	23.3	19,163	23,471	28,383	21.7
Dabur	124,040	134,975	147,769	9.1	19.3	20.1	20.5	18,432	20,367	23,020	11.8
Marico	96,531	107,621	119,054	11.1	20.6	20.9	21.3	14,811	16,342	18,510	11.8
Emami	35,781	39,875	43,986	10.9	26.5	27.3	28.1	7,301	8,468	9,655	15.0
Zydu Wellness	23,279	25,229	28,133	9.9	13.2	16.3	17.9	2,812	3,889	3,953	18.6
<b>Discretionary</b>											
Asian Paints	354,947	369,509	398,331	5.9	21.4	20.1	20.5	53,272	51,880	56,561	3.0
Berger Paints	111,989	119,824	128,691	7.2	16.6	16.5	16.9	11,267	12,196	13,803	10.7
Kansai Nerolac	78,014	81,436	88,195	6.3	13.2	14.1	14.4	5,242	7,536	8,573	27.9
United Spirits	113,210	122,112	135,131	9.3	17.7	18.4	19.4	14,260	15,371	18,411	13.6
United Breweries	81,227	90,475	100,165	11.0	8.6	11.2	12.7	4,109	6,364	8,287	42.0
Radico Khaitan	41,185	48,954	53,399	13.9	12.2	14.4	15.5	2,557	3,921	5,007	39.9

Source: Bloomberg, Anand Rathi Research

Fig 29 – Valuation parameters for the companies we cover

	CMP	M. Cap	EV	EPS (Rs)			PE (x)			EV / EBITDA (x)		
	Rs / sh	Rs bn	Rs bn	FY24	FY25e	FY26e	FY24	FY25e	FY26e	FY24	FY25e	FY26e
<b>Staples</b>												
HUL	2,744	6,430	6,326	43.7	46.6	52.2	62.8	58.9	52.6	43.1	40.8	36.7
GCPL	1,404	1,411	1,421	18.7	23.0	27.8	74.9	61.1	50.6	48.1	40.5	35.4
Dabur	621	1,097	1,091	10.4	11.5	13.0	59.7	54.0	47.8	45.5	40.3	36.1
Marico	669	859	855	11.5	12.7	14.3	58.3	52.8	46.6	42.9	37.9	33.7
Emami	803	351	348	16.7	19.4	22.1	48.0	41.4	36.3	36.7	32.0	28.2
Zydus Wellness	2,207	144	144	44.2	61.2	62.1	49.9	36.1	35.5	46.7	35.1	28.6
<b>Discretionary</b>												
Asian Paints	3,076	2,972	2,961	55.5	54.1	59.0	55.4	56.9	52.2	39.0	39.9	36.2
Berger Paints	563	661	663	9.7	10.5	11.8	58.2	53.8	47.5	35.6	33.4	30.5
Kansai Nerolac	295	239	227	6.5	9.3	10.6	45.6	31.7	27.9	22.0	19.8	17.8
United Spirits	1,404	918	906	19.6	21.2	25.3	71.5	66.3	55.4	53.1	42.0	42.5
United Breweries	1,990	516	515	15.5	24.1	31.3	128.1	82.7	63.5	73.9	50.8	40.3
Radico Khaitan	1,699	229	236	19.2	29.4	37.5	88.6	57.8	45.3	47.0	33.6	28.6

Source: Bloomberg, Anand Rathi Research

Prices as on 19<sup>th</sup> August 2024

## Appendix

### Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

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	Buy	Hold	Sell
Large Caps (Top 100 companies)	>15%	0-15%	<0%
Mid Caps (101st-250th company)	>20%	0-20%	<0%
Small Caps (251st company onwards)	>25%	0-25%	<0%

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Compliance officer-Deepak Kedia, email id - deepakkedia@rathi.com, Contact no. +91 22 6281 7000.

Grievance officer-Madhu Jain-email id -grievance@rathi.com, Contact no. +91 22 6281 7191

ARSSBL registered address: Express Zone, A Wing, 9th Floor, Western Express Highway, Diagonally Opposite Oberoi Mall, Malad (E), Mumbai – 400097.

Tel No: +91 22 6281 7000 | Fax No: +91 22 4001 3770 | CIN: U67120MH1991PLC064106.