Consumer Goods

Modest demand recovery in Q2, earnings growth wane

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Sector Report | **Quarterly Preview** | **October 2, 2024** | **NIFTY 50: 25,797**

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Hope for demand recovery with steady-to-improving margin is largely baked in sector valuations. The demand trend saw a minor uptick in Q2, while earnings growth slowed as margin benefits are in the base. Key outliers for Q2: a) excess rains and floods, b) weak demand for summer products, c) increased trade promotion, d) inflationary setting in food categories, e) trade pipeline corrections, and f) regional disruption in Kolkata, Manipur, and Kerala in India, as well as in Bangladesh. YoY, overall Q2 sector revenue growth is likely to see expansion sequentially, except Dabur, Emami, and Honasa Consumer. Earnings growth momentum is likely to wane as gross margin benefits are in the base; focus has been on topline recovery. We roll over our target price to Sep-26E from Jun-26E EPS and revise up our multiple for Colgate (to 55x), Bikaji (65x), and HUL (62x), factoring in the enhanced execution. We continue to favor HUL, Honasa, Emami, and Marico; avoid Colgate, on expensive valuations.

Moderate expansion in growth to sustain; commentary for 2H recovery is key

Q2FY25 demand setting saw a minor uptick, wherein coverage companies are likely to see ~6% revenue growth (improvement from Q1FY25 growth of ~5%). HUL and Britannia, which have effected price cuts in low-unit packs, would continue to log negative price growth. We see double-digit organic growth sustaining for Colgate, Bikaji, and Honasa. For Honasa, reported sales likely to be flat, given increased sales return to restore general trade channel hygiene. For Dabur, we see 5% consol. Q2 sales decline.

Earnings growth momentum to slow down, as margin benefits are in the base

Gross margin (GM) expansion for our coverage companies is likely to reduce from Q2FY25E. Surge in prices of raw materials like palm oil, cocoa, coffee, tea, and milk would pressurize margin. GM compression is expected for ITC (inflationary leaf tobacco), HUL (from inflationary RM), GCPL, Marico and Honasa (driven by inventory returns). OPM for ITC, Dabur, Marico, and Honasa would contract, while Bikaji, GCPL, and Colgate would see >100bps YoY expansion. Earnings growth is likely to be in double digits for Britannia, GCPL, Colgate, and Bikaji, whereas Dabur and Honasa are likely to see earnings decline.

Valuations remain elevated; we favor players with enhanced execution

FMCG sector's forward valuation P/E of 60x is now at a premium of 150% to the Sensex. The market has been quick to price in demand recovery ahead; hence we prefer players with better execution. Hence, HUL tops our list of favorites; we upgrade its valuation to 62x (15% premium to the historical average forward P/E) from 58x. Honasa is also an execution play, given that Q2 would see corrective action in general trade; we retain our positive outlook and BUY. Emami is next on our preference list; we see a muted Q2, but our Q3 and medium-term outlook remains firm on better seasonality. We have recently turned positive on Marico, where we see improved execution aiding double-digit growth.

Q2FY25 growth (YoY) estimates

(%)	Sales	EBITDA	Earnings
ITC	8	2	1
HUL	4	5	6
NEST	7	7	8
BRIT	8	8	11
GCPL	0	6	11
DABUR	-5	-17	-17
MRCO	8	7	8
CLGT	13	17	17
HMN	5	7	8
HONASA	1	-112	-100
Bikaji	17	26	24

Source: Emkay Research

Rating, Target Price and Valuation

	Rating	CMP (Rs/sh)	TP (Rs/sh)	Upside (%)	P/E (x) FY26E	P/E (x) FY27E	EV/EBITDA (x) FY26E	EV/EBITDA (x) FY27E
Britannia Industries	ADD	6,446	6,750	5	55.9	49.5	39.4	34.6
Colgate-Palmolive	REDUCE	3,820	3,275	(14)	60.0	54.3	41.7	37.8
Dabur India	ADD	619	650	5	48.6	42.0	35.5	30.4
Emami	BUY	754	950	26	37.2	33.1	27.3	23.9
Godrej Consumer Products	ADD	1,388	1,450	4	52.6	46.8	36.6	32.9
Hindustan Unilever	BUY	2,924	3,400	16	56.2	50.5	39.6	35.7
Honasa Consumer	BUY	455	600	32	61.1	45.1	43.9	31.6
ITC	ADD	516	520	1	28.1	25.6	21.1	18.7
Marico	ADD	694	775	12	47.4	42.4	34.4	30.9
Nestlé India	ADD	2,707	2,800	3	68.6	62.0	45.9	40.8

Source: Company, Emkay Research

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