

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.

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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

Eyes on the market
Emkay Connect: Assessing demand setting in East India
Consumer Goods | SECTOR REPORT | September 17, 2024 | NIFTY 50: 25,384

We hosted a group of investors for Emkay Connect – our East India trip covering major listed consumer companies (across segments), unlisted players, sector experts, and supply chain partners. Consumption pickup in FMCG segments is clearly visible with large incumbents focusing on growth. We continue to see sector valuations reflecting the improved demand setting ahead and better execution aiding faster earnings. We remain selective and continue to favor HUL, Dabur, Emami, and Honasa.

Top-10 takeaways from our corporate connect and ground checks are: (i) ahead of time winter trade leading to help Dabur report better growth in Q2; (ii) quick formalization of supply chain partners in leading to better growth for not only large players, but also for fast-scaling regional players like Amrapuram (South), (iii) sustained healthy in beauty care for Himalaya and strong offers for The Dharma Co.; (iv) in beverages, Campa would look to disrupt the market as long-term agreement comes up for renewal in late-2025; (v) e-commerce has been a fast growing channel, where adoption has been healthy in urban centers; accordingly, (vi) of media budget to rise digital; (vii) in pantries, (viii) have not made many inroads given limited offering and lack of brand appeal; (ix) Alcohol continues to see premiumization; price hikes offsetted recently in West Bengal; (x) in cigarettes, Marboro does have visible volume uptick in urban centers, where e-commerce offers it a head playing field and youth off take has been good; (xi) leaf tobacco inflation to have a bearing on margins for cigarette; supply chain sees price hikes undertaken to only protect margin being absorbed, but any excess pricing should have a bearing on volume; and (xii) renewed thrust on hygiene seen across companies where players are upbet on faster demand recovery.

Consumer adoption of convenience fast paced; premium segment doing well. Consumption of revenue in East for most consumer companies has been low, given slower consumer evolution and a price sensitive consumer base. Unlike other parts of the country, unorganized segmentation has been high, which we see as a factor of relatively limited substitution. The setting post-Covid seems to be shifting quickly toward formalization, where consumer is seeking convenience and concentration of organized players has been high.

Rural threat phosessed, urban thrust enhanced, focus on execution. Rural is poised for growth recovery when FMCG companies have taken action. Enhanced focus is on urban, where select channels continue to see consumer adoption, leading to faster growth. Thrust on product superiority in solving premiumization. Trade expects innovation intensity to expand with players focusing on brand investments. Our connect with media planner suggests ~40% of industry spend is now on the digital medium.

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Rating, Target Price and Valuation

	Rating	CMP (Rs/sh)	TP (Rs/sh)	Upside (%)	P/E (x)		EV/EBITDA (x)	
					FY26E	FY27E	FY26E	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