

FMCG

No respite from margin pressures

We expect our FMCG universe to report a healthy sales growth of 20.1% YoY in Q2FY12, led by a mix of volumes and price hikes. Operating margins, however, will likely decline 120bps, as input cost pressures intensify on both YoY and QoQ basis. We estimate adjusted PAT to grow 10.6% YoY (the lowest PAT growth YoY in the past 10 quarters). Our top picks are ITC, HUL and UNSP among large-caps, and Marico and Britannia within mid-caps.

Overall, both absolute and relative FMCG valuations have reached near peak levels, leaving limited scope for further outperformance. We advise booking profits as risk-reward seems negative from the current levels. We recommend large-cap FMCGs over mid-caps at present. We also expect discretionary spends to be affected to some extent going forward.

- ❖ **Sales to grow 20.1% YoY in Q2FY12:** We expect sales to grow 20.1% YoY for our FMCG universe in Q2FY12, led by Bajaj Corp, Asian Paints, Marico and Nestle, which would see strong organic growth. Dabur, United Breweries and United Spirits are likely to post strong growth from inorganic growth. Marico, Asian Paints and Bajaj Corp will likely grow on strong price rise; most of the other companies are likely to see strong volume growth. We expect large-caps, HUL and ITC to report strong topline growth of 15% YoY and 18% YoY respectively.
- ❖ **Operating margins to decline 120bps YoY:** Operating margin for our FMCG universe is likely to dip 120bps YoY, allowing for an EBITDA growth of 13% YoY. Most of the companies are likely to report a contraction in operating margins, led by a gross margin decline, as input commodity costs have inched up. Emami, Bajaj Corp, Dabur, Jyothy Labs, GCPL and Colgate will likely witness the highest margin decline YoY, while some companies such as Britannia and GSK Consumer should witness an EBITDA margin expansion YoY.
- ❖ **Key factors to watch for:** 1) Any sign of consumer spending slowdown, given rising inflation and slowing GDP growth, and impact on discretionary spending thereof, 2) pricing action/strategy in highly competitive categories such as Shampoos, Biscuits and detergents, 3) A&P spending trend post weak Q1FY12 spending, 4) gross margin pressure QoQ and 5) product mix shifts across categories.
- ❖ **Prefer large-caps over mid-caps:** We believe consensus earnings expectations are high for FMCG and negative surprises are likely in the next few quarters, driven more by margin disappointments. We expect relatively weak festive season demand YoY in the next 3–4 months, which could hit margins due to negative operating leverage for discretionary companies. Weaker rupee and reasonably elevated raw material prices continue to pose a risk to gross margins. A&P spends are unlikely to dip meaningfully from the current levels to cushion the impact of gross margin pressure.
- ❖ **Absolute/relative FMCG valuations near peak; stocks could react negatively on downgrade:** We continue to prefer large-caps over mid-caps in staples given the large-caps' relative value and better earnings visibility. We prefer staples (FMCG) over discretionary (paints, retail, durables) on expected spending slowdown.

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Recommendation snapshot

Company	CMP	Target	Rating
Asian Paints	3,031	3,350	Buy
Bajaj Corporation	100	130	Buy
Britannia Industries	451	500	Buy
Colgate India	996	850	Sell
Dabur India	100	115	Buy
Emami	397	450	Sell
Godrej Consumer	402	450	Hold
GSK Consumer	2,403	2,350	Sell
Hindustan Unilever	322	365	Buy
ITC	194	225	Buy
Jyothy Labs	151	155	Sell
Marico Ltd.	144	170	Buy
Nestle India	4,200	3,650	Sell
Radico Khaitan	123	175	Buy
United Breweries	355	425	Sell
United Spirits	779	1,350	Buy

Stock price performance

Company	1m	3m	6m
Asian Paints	(7.4)	(6.5)	18.1
Bajaj Corporation	(16.6)	(15.2)	(2.2)
Britannia Industries	(6.0)	(6.8)	23.3
Colgate India	(0.8)	(1.6)	16.0
Dabur India	(7.2)	(12.3)	2.5
Emami	(11.3)	(18.9)	(2.9)
Godrej Consumer	(6.0)	(8.2)	7.2
GSK Consumer	1.2	(2.3)	6.7
Hindustan Unilever	0.6	(3.3)	16.9
ITC	(4.3)	(0.8)	6.3
Jyothy Labs	(14.2)	(29.2)	(31.1)
Marico Ltd.	(7.6)	(5.3)	3.8
Nestle India	(5.8)	(1.9)	14.0
Radico Khaitan	(4.3)	(3.8)	(7.6)
United Breweries	(16.3)	(31.4)	(26.2)
United Spirits	(12.8)	(25.3)	(29.3)



Fig 1 - RCML FMCG Universe: Q2FY12 preview

Company	CMP	Target	Reco	Sales (Rs mn)			EBITDA margin (%)		PAT (Rs mn)		
	(Rs)	(Rs)		Q2FY12E	Q2FY11	YoY (%)	Q2FY12E	Q2FY11	Q2FY12E	Q2FY11	YoY (%)
Asian Paints	3,031	3,350	Buy	22,997	18,108	27.0	16.5	18.3	2,511	2,147	17.0
Bajaj Corp	100	130	Buy	1,040	812	28.0	24.0	28.4	272	202	35.0
Britannia	451	500	Buy	13,028	10,948	19.0	6.0	4.8	520	328	58.3
Colgate	996	850	Sell	6,290	5,518	14.0	17.6	20.3	968	1,003	(3.5)
Dabur	100	115	Buy	12,451	9,728	28.0	17.8	20.9	1,675	1,604	4.5
Emami	397	450	Sell	3,269	2,724	20.0	15.5	21.1	460	535	(14.0)
GCPL	402	450	Hold	11,338	9,528	19.0	15.0	17.7	1,198	1,304	(8.1)
GSK Consumer	2,403	2,350	Sell	7,228	6,126	18.0	15.0	15.5	899	786	14.5
HUL	322	365	Buy	53,830	46,809	15.0	12.2	13.8	5,453	5,338	2.1
ITC	194	225	Buy	59,722	50,612	18.0	35.0	35.3	14,598	12,468	17.1
Jyothy Labs	151	155	Sell	1,448	1,448	-	8.0	10.8	62	154	(59.7)
Marico	144	170	Buy	9,812	7,788	26.0	10.8	12.7	706	716	(1.3)
Nestle	4,200	3,650	Sell	19,975	16,373	22.0	19.3	19.8	2,496	2,186	14.2
Radico Khaitan	123	175	Buy	2,663	2,219	20.0	14.3	14.3	198	188	5.3
United Breweries	355	425	Sell	7,256	5,669	28.0	8.5	9.0	265	219	20.9
United Spirits	779	1,350	Buy	17,334	13,542	28.0	15.5	16.2	909	830	9.5
Aggregate	-	-	-	249,682	207,950	20.1	19.1	20.3	33,191	30,007	10.6

Source: RCML Research

Fig 2 - Sector valuation snapshot: HPC and Foods

Company	MCap	Dividend Yield (%)	Sales Growth (%)			EPS CAGR		EBITDA Margin (%)		ROE (%)		P/E (x)		EV/EBITDA (x)	
	(Rs mn)		FY12E	FY13E	FY11-13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Asian Paints	290,582	1.2	22.5	15.4	16.7	15.4	16.2	38.4	37.6	30.9	25.3	20.3	16.8		
Bajaj Corp	14,684	1.9	22.5	17.9	18.7	29.1	29.1	29.0	27.1	12.0	10.5	10.3	8.7		
Britannia	53,854	2.5	18.8	19.3	47.2	6.4	6.7	63.4	66.3	23.6	18.5	16.8	13.6		
Colgate	135,449	2.2	13.9	13.3	11.4	19.6	20.4	102.2	95.8	31.0	27.1	26.1	22.3		
Dabur	174,173	1.4	26.1	15.0	16.0	18.5	18.5	42.6	39.0	25.7	22.0	19.0	16.5		
Emami	60,139	0.9	21.8	18.8	16.7	19.3	19.4	35.1	30.4	21.5	19.3	19.8	16.5		
GCPL	130,083	1.4	23.6	15.8	10.2	16.7	16.7	27.3	26.7	24.4	20.6	19.1	16.5		
GSK Consumer	101,061	1.8	18.8	15.9	17.3	15.7	15.6	32.2	34.7	28.2	24.5	21.2	18.4		
HUL	695,613	2.3	14.5	14.3	16.9	12.6	12.9	84.9	81.9	28.0	23.9	24.3	20.6		
ITC	1,508,747	2.8	17.2	14.4	20.4	35.0	34.5	36.4	39.2	24.1	20.8	16.2	14.4		
Jyothy Labs	12,155	3.3	74.1	24.8	(9.8)	8.8	9.9	5.5	9.0	35.5	21.7	18.4	13.2		
Marico	88,720	0.7	27.1	17.0	25.6	12.4	13.8	31.7	32.9	26.7	19.9	19.1	14.7		
Nestle	404,947	1.1	20.4	18.6	16.9	20.0	20.3	114.0	93.0	42.5	36.2	26.7	22.2		
Aggregate	3,670,206		19.1	15.5			20.4	20.5		27.0	23.0	19.3	16.6		

Source: RCML Research

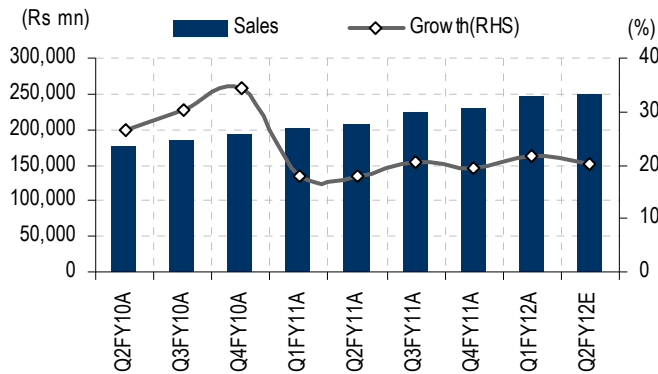
Fig 3 - Sector valuation snapshot: Alcoholic Beverages

Company	MCap (Rs mn)	Dividend Yield (%)	Sales Growth (%)		EPS CAGR FY11-13E	EBITDA Margin (%)		ROE (%)		P/E (x)		EV/EBITDA (x)	
			FY12E	FY13E		FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Radico Khaitan	16,283	1.1	17.5	21.2	18.0	13.7	14.7	13.6	16.8	17.4	12.5	12.9	9.9
United Breweries	90,338	0.5	46.3	20.8	47.1	12.3	13.5	19.1	22.2	37.9	25.4	19.6	14.8
United Spirits	101,837	0.4	18.2	17.2	25.8	15.6	16.4	11.2	13.8	19.8	14.4	12.3	10.0
Aggregate	208,458	-	25.1	18.6		14.5	15.4			25.0	17.7	14.1	11.2

Source: RCML Research

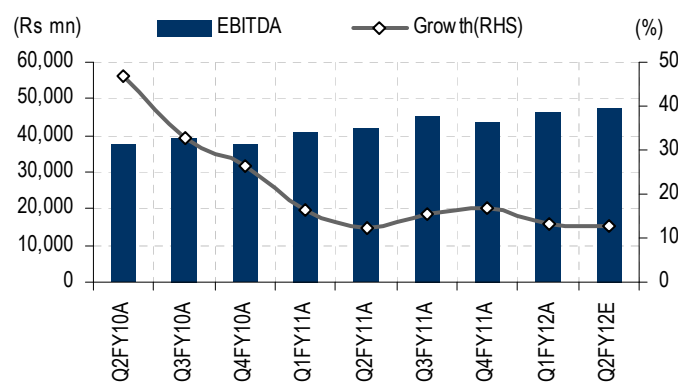
Quarterly trends

Fig 4 - RCML FMCG universe: Sales growth trend



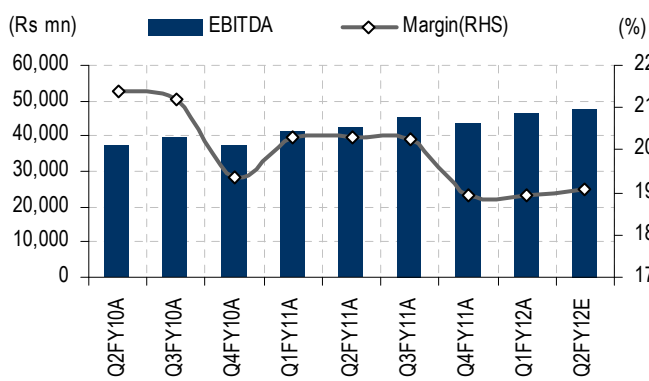
Source: RCML Research

Fig 5 - RCML FMCG universe: EBITDA growth trend



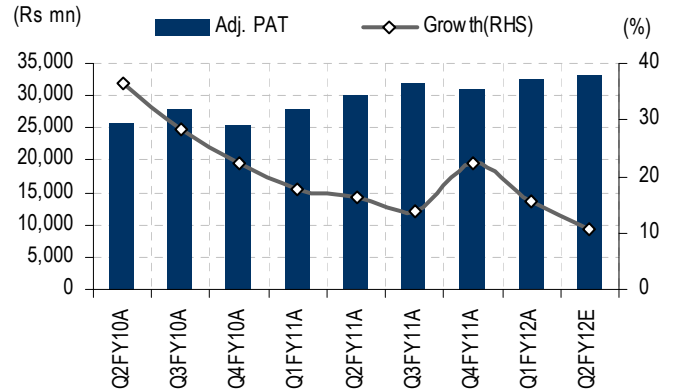
Source: RCML Research

Fig 6 - RCML FMCG universe: EBITDA margin trend



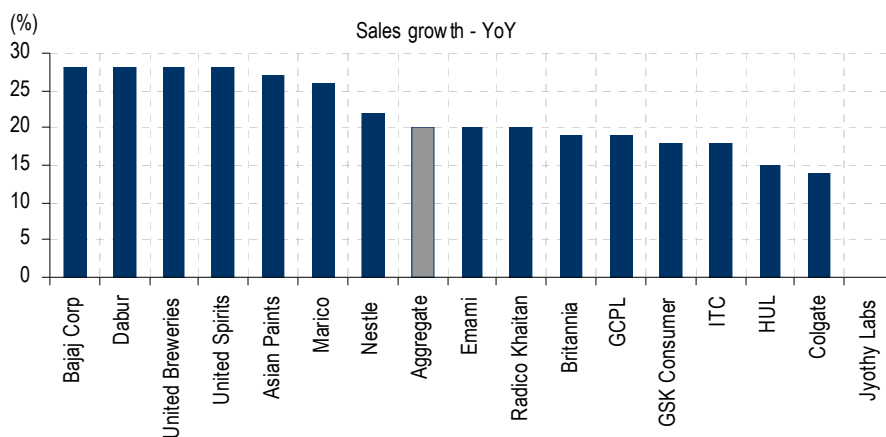
Source: RCML Research

Fig 7 - RCML FMCG universe: Adjusted PAT growth trend



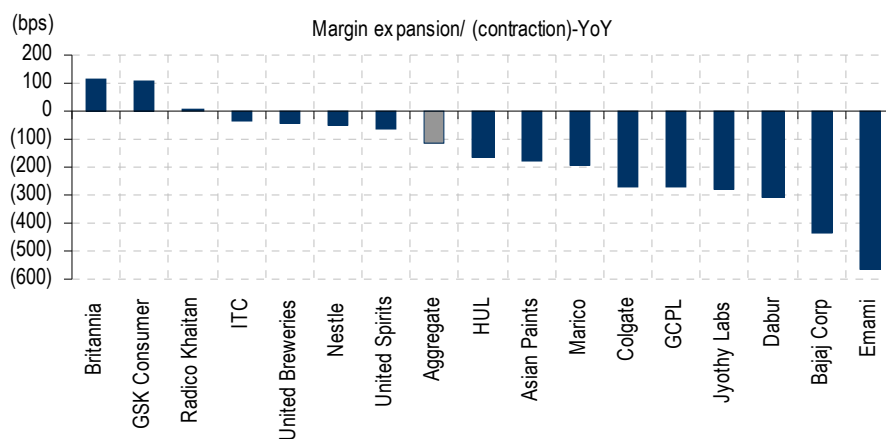
Source: RCML Research

Fig 8 - RCML FMCG universe: Sales growth in Q2FY12E (YoY)



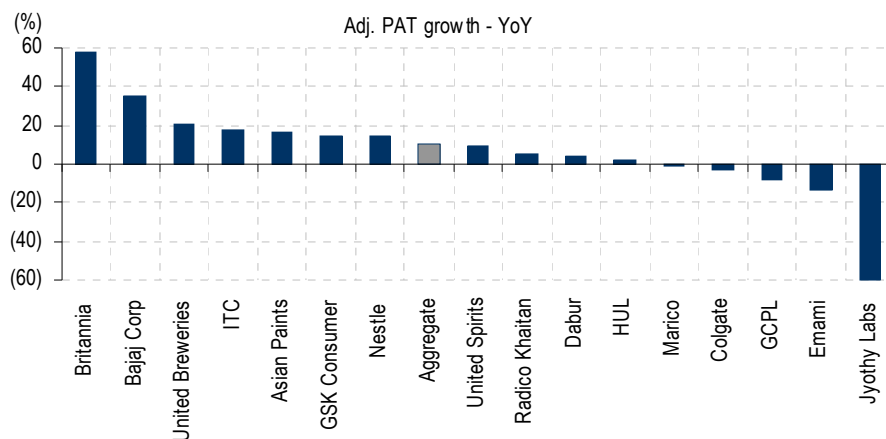
Source: RCML Research

Fig 9 - RCML FMCG universe: EBITDA margin change in Q2FY12E (YoY)



Source: RCML Research

Fig 10 - RCML FMCG universe: Adjusted PAT growth in Q2FY12E YoY



Source: RCML Research

Companies

Fig 11 - Asian Paints

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	22,997	18,108	27.0	
EBITDA	3,795	3,315	14.5	Consol. revenue growth to be strong on account of low base in Q2FY11 (impacted due to erratic monsoons)
EBITDA margin (%)	16.5	18.3	(180bps)	Margin contraction to stem from decline in gross margins as crude oil and titanium dioxide prices rise YoY
Adj. PAT	2,511	2,147	17.0	
Adj. PAT margin (%)	10.9	11.9	(95bps)	

Source: RCML Research

Fig 12 - Bajaj Corp

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	1,040	812	28.0	
EBITDA	250	231	8.3	Sales growth YoY to be strong on the back of 10% price increase
EBITDA margin (%)	24.0	28.4	(440bps)	Big drop in EBITDA margin due to high input prices (LLP)
Adj. PAT	272	202	35.0	Higher other income YoY to offset EBITDA margin decline
Adj. PAT margin (%)	26.2	24.8	135bps	

Source: RCML Research

Fig 13 - Britannia

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	13,028	10,948	19.0	
EBITDA	782	529	47.8	Strong sales growth momentum to continue despite high base
EBITDA margin (%)	6.0	4.8	120bps	EBITDA margin to improve YoY, led by improvement in gross margins (on account of lower sugar and wheat prices)
Adj. PAT	520	328	58.3	
Adj. PAT margin (%)	4.0	3.0	100bps	

Source: RCML Research

Fig 14 - Colgate

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	6,290	5,518	14.0	
EBITDA	1,107	1,122	(1.3)	Net sales growth to be largely volume-led
EBITDA margin (%)	17.6	20.3	(270bps)	Margin pressure likely on account of higher material costs and A&P expenses
Adj. PAT	968	1,003	(3.5)	
Adj. PAT margin (%)	15.4	18.2	(280bps)	

Source: RCML Research

Fig 15 - Dabur

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	12,451	9,728	28.0	
EBITDA	2,216	2,028	9.3	Namaste consolidation to lead to higher revenue growth; expect organic revenue growth of ~15%
EBITDA margin (%)	17.8	20.9	(310bps)	Operating margins to decline due to pressure on gross margins and lower margins of Namaste
Adj. PAT	1,675	1,604	4.5	Interest costs of acquisition to impact PAT growth
Adj. PAT margin (%)	13.5	16.5	(300bps)	

Source: RCML Research

Fig 16 - Emami

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	3,269	2,724	20.0	
EBITDA	507	575	(12.0)	Volume growth to be lower this quarter
EBITDA margin (%)	15.5	21.1	(560bps)	EBITDA Margins to be impacted by RM cost pressures, leading to a decline in EBITDA and adj. PAT
Adj. PAT	460	535	(14.0)	
Adj. PAT margin (%)	14.1	19.6	(555bps)	

Source: RCML Research

Fig 17 - GCPL

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	11,338	9,528	19.0	
EBITDA	1,701	1,690	0.6	19% YoY sales growth which would be organic in nature, with no more consolidation-led growth seen in the current quarter
EBITDA margin (%)	15.0	17.7	(275bps)	Margins in the domestic soaps business could be under pressure on account of higher palm oil price inventory
Adj. PAT	1,198	1,304	(8.1)	Higher interest costs to impact PAT growth
Adj. PAT margin (%)	10.6	13.7	(310bps)	

Source: RCML Research

Fig 18 - GSK Consumer

(Rs mn)	Q3CY11E	Q3CY10A	Change %	Comments
Net Sales	7,228	6,126	18.0	
EBITDA	1,084	951	14.1	
EBITDA margin (%)	15.0	15.5	(50bps)	Sales growth at 18% YoY, 12-13% volume growth
Adj. PAT	899	786	14.5	The company is likely to largely maintain margins on a YoY basis.
Adj. PAT margin (%)	12.4	12.8	(40bps)	

Source: RCML Research

Fig 19 - HUL

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	53,830	46,809	15.0	
EBITDA	6,567	6,469	1.5	Expect 8-9% volume and ~5-6% positive price hike impact YoY
EBITDA margin (%)	12.2	13.8	(160bps)	Operating margins to decline 160bps YoY on account of gross margin pressures
Adj. PAT	5,453	5,338	2.1	EBITDA and PAT to grow ~2% YoY each
Adj. PAT margin (%)	10.1	11.4	(130bps)	

Source: RCML Research

Fig 20 - ITC

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	59,722	50,612	18.0	
EBITDA	20,903	17,889	16.8	
EBITDA margin (%)	35.0	35.3	(35bps)	Expect cigarette revenues to grow ~16-17% (~7-8% volume)
Adj. PAT	14,598	12,468	17.1	EBITDA and adj. PAT growth to broadly mirror revenue growth
Adj. PAT margin (%)	24.4	24.6	(20bps)	

Source: RCML Research

Fig 21 - Jyothy Labs

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	1,448	1,448	-	
EBITDA	116	156	(25.7)	
EBITDA margin (%)	8.0	10.8	(275bps)	Sales likely to remain flat YoY as the company continues to be impacted by discontinuation of sales to super stockists
Adj. PAT	62	154	(59.7)	Henkel consolidation will not happen in the quarter
Adj. PAT margin (%)	4.3	10.7	(635bps)	

Source: RCML Research

Fig 22 - Marico

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	9,812	7,788	26.0	
EBITDA	1,060	993	6.8	
EBITDA margin (%)	10.8	12.7	(195bps)	Parachute (32% pricing and 7-8% volume growth) to drive strong domestic topline growth. MENA disruptions to hit international business
Adj. PAT	706	716	(1.3)	Operating margins to be hit by the rise in <i>copra</i> prices due to staggered price hike implementation
Adj. PAT margin (%)	7.2	9.2	(200bps)	

Source: RCML Research

Fig 23 - Nestle

(Rs mn)	Q3CY11E	Q3CY10A	Change %	Comments
Net Sales	19,975	16,373	22.0	
EBITDA	3,855	3,237	19.1	
EBITDA margin (%)	19.3	19.8	(50bps)	Net sales growth to be aided by a healthy mix of price (~7-8% YoY) and volume growth (~13-14% YoY)
Adj. PAT	2,496	2,186	14.2	Margins to decline 50 bps YoY, leading to 19% YoY EBITDA growth. However, higher interest costs will likely impact PAT growth
Adj. PAT margin (%)	12.5	13.3	(85bps)	

Source: RCML Research

Fig 24 - Radico Khaitan

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	2,663	2,219	20.0	
EBITDA	381	316	20.3	
EBITDA margin (%)	14.3	14.3	-	Sales growth to remain strong at 20%, largely IMFL volume led
Adj. PAT	198	188	5.3	Margins to largely remain stable YoY; higher interest costs to impact PAT growth
Adj. PAT margin (%)	7.5	8.5	(100bps)	

Source: RCML Research

Fig 25 - United Breweries

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	7,256	5,669	28.0	
EBITDA	617	508	21.5	
EBITDA margin (%)	8.5	9.0	(45bps)	Strong sales growth aided by consolidation of MAPL, ABDL, Empee Breweries and Chennai Breweries. Organic growth of ~15% YoY
Adj. PAT	265	219	20.9	Margins down 45bps YoY due to higher barley and packaging costs
Adj. PAT margin (%)	3.6	3.9	(20bps)	

Source: RCML Research

Fig 26 - United Spirits

(Rs mn)	Q2FY12E	Q2FY11A	Change %	Comments
Net Sales	17,334	13,542	28.0	
EBITDA	2,687	2,191	22.6	Strong sales growth (~20% organic growth), driven by robust volume growth of ~13-14% YoY; Balaji Distilleries' consolidation to add 7% to sales growth
EBITDA margin (%)	15.5	16.2	(70 bps)	Margins to decline YoY due to gross margin decline (higher ENA and glass costs)
Adj. PAT	909	830	9.5	and consolidation of lower-margin Balaji Distilleries
Adj. PAT margin (%)	5.2	6.1	(90 bps)	

Source: RCML Research

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Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
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