Q3FY2008 FMCG earnings preview

Festive demand and seasonality to drive earnings growth

Industry

- With economic growth on a fast track and rising disposable incomes with Indian consumers, the fast moving consumer goods (FMCG) companies are on a firm footing. The third quarter being demarcated by festivals tends to drive the volume growth for the sector. Increasing consumerism, changing lifestyles, advent of organised retail and product innovations by companies also augurs well for the sector.
- Prices of key raw materials—palm oil, edible oils and sugars—continue to be on an up trend. The FMCG companies have so far been able to pass on the rise in input prices to consumers. This reflects their pricing power despite toughening competition. Increased competition, new products launches by companies such as ITC, Marico and Hidustan Unilever Ltd (HUL) and higher ad-spend during the festive season in general is likely to push up the advertisement expenditure for the sector as a whole.
- We expect the quarter to register strong volumes and overall sales growth for most companies. While HUL's improved performance would be driven by the strong growth of its personal products segment, ITC and Marico's growth is expected to be inclusive with all their segments performing well. We believe the FMCG sector is in a sweet spot with increasing spending power of the Indian consumer. We thereby maintain our positive stance on the sector.

HUL

We expect HUL's revenues to grow by 13.6% year on year (yoy) in Q4CY2007 primarily on account of better performance of the home and personal care (HPC) segment. HUL's overall growth for the past quarters has been dampened by a mid single-digit growth in the revenues of the personal care segment. However, we expect the segment to register a double-digit growth for the quarter due to a low base effect (Q4CY2006 revenues grew only by 2.5%) and an early onset of winter that augurs well for sales of its skin care products. The performance of the personal care segment (specially the margins) was affected in Q3CY2007 because of a seven-week closure of its Assam factory that manufactures ~30% of its personal products. With the operations being normal now the performance is expected to be better in Q4. Palm oil prices have remained strong, however, the company has successfully passed on the cost escalation to the consumers. We expect HUL's adjusted net profit to grow by a robust 17.9% yoy to Rs569.8 crore with improved performance of the high-margin personal care segment.

ITC

For Q3FY2008, we expect ITC to register a 13.7% year-on-year (y-o-y) growth in its revenues. We expect the y-o-y dip in cigarette sales volumes to taper down below 3% against a decline of 3-4% in Q2FY2008, as consumers slowly take the price rise in their stride (20%+ price hike in April 2007). Thus we believe cigarette volume growth to recover to the normal rate of 5-7% in FY2009. Q3FY2008 performance was affected by a one-off loss in agri-business due to ban on exports and duty-free import of certain commodities allowed by the government. This had impacted the overall margins for the company. We expect the agri-business performance to achieve normal standards in Q4. To overcome the adverse implications of the appreciating

Quarterly estimates

Company	Net sales			Adjusted PAT			Reported PAT		
	Q3FY08	Q3FY07	% chg	Q3FY08	Q3FY07	% chg	Q3FY08	Q3FY07	% chg
HUL*	3585.1	3156.1	13.6	569.8	483.4	17.9	569.8	511.2	11.5
ITC	3599.3	3165.6	13.7	818.1	717.4	14.0	818.1	717.4	14.0
Marico	503.3	409.2	23.0	43.9	27.7	58.3	43.9	28.4	54.4
ICI India	269.0	224.2	20.0	33.1	23.5	40.9	33.1	225.3	-85.3
Indian Hotels	506.1	409.8	23.5	114.5	88.0	30.1	114.5	88.0	30.1

*December ending company

rupee ITC switched to rupee billing from September 2007. This would have a positive impact on the performance of the hotel segment, which would also benefit from the fact that the third quarter is traditionally a good quarter for the segment. The non-cigarettes FMCG business is expected to maintain its strong growth momentum with *Bingo* and *Sunfeast* making inroads into consumer's hearts. ITC is further expanding the portfolio of health products by launching *Sunfeast Benne Vita* flaxseed biscuits and pasta. Further with *Fiama De Wills* and *Superia* range of shampoos and soaps, ITC is well positioned to challenge the incumbents. We believe these new products may lead to increase in advertisement spend for the quarter. Overall we expect the net profit to increase by 14% yoy.

Marico

We expect the net revenues of Marico to grow by 23% yoy to Rs503.3 crore. Strong growth in volumes across its products—*Parachute*, hair oils and *Saffola* is expected to continue. For the quarter copra prices were substantially lower yoy, however the prices of edible oils have increased substantially during FY2008. Thus we expect the operating profit margin to improve by 57 basis points yoy to 14.04%. To combat the increase in raw material cost Marico raised prices across *Saffola* brands by an average of 10% in Q3. During the quarter Marico launched *Parachute Star* range for kids in select metros and also extended *Saffola* range to *Saffola* diabetes management product. We expect the ad spend to be up this quarter as indicated by the company. The international business performance is expected to be robust aided by *Fiancee* and *Haircode*. Overall we expect the adjusted net profit to grow by 58.3%, which would be one of the highest in the industry.

ICI India

ICI India is expected to report a 20% y-o-y growth in revenues to Rs269 crore. We expect a 20.7% y-o-y jump in sales of the paints business to Rs232 crore. This robust sales growth, over and above the normal y-o-y growth, is attributed to the *Diwali* sales. Diwali in FY2008 fell in Q3 as against Q2 in FY2007. We expect the chemicals business to grow by 15.5% yoy to Rs36.8 crore. ICI sold its advanced refinish business in March 2007, so the y-o-y numbers are not exactly comparable. With crude prices on a high, we expect the raw material costs to be up yoy, however a weaker dollar would help negate the increase in raw material costs to a certain extent. We expect the operating profit margin to be at 14.2% against 15.6% in Q3FY2007. Thus the operating profit is expected to grow by 9.1% yoy to Rs38.2 crore. However aided by a higher other income, the adjusted net profit is expected to grow by 40.9% to Rs33.1 crore.

IHCL

For the third quarter of FY2008, we expect Indian Hotels Company Ltd (IHCL) to report a top line growth of 23.5% at Rs506.1 crore and a bottom line growth of 30.1%. We expect strong growth in average room rate (ARR) as occupancy rates pick up in Q3. Shift to rupee tariffs (from September 2007) would also protect ARR realisations. Thus we expect the operating profit to be up 32% yoy. We expect the interest cost to be substantially up resulting in the net profit to grow at 30.1% yoy to Rs114.5 crore.

The author doesn't hold any investment in any of the companies mentioned in the article.