Q4FY2007 FMCG earnings preview

Volume growth and improved pricing power to drive the revenue growth

Key points

- Backed by a pick-up in rural demand, the fast moving consumer goods (FMCG) sector has seen the volume growth getting better every quarter. The revenue growth for the current quarter is likely to be driven by volume growth as well as improved pricing power.
- Rising input prices is a concern for the industry. Palm oil prices have increased by around 20% in the last three months but LAB prices continue to remain steady. Price increases as well as cost savings would help the companies to maintain their margins.
- We expect the profit of Hindustan Lever Ltd (HLL), the market leader in the segment, to grow by 18.8% year on year (yoy) backed by a strong growth in the home and personal care (HPC) segment and price increases in key products. We expect the margin to improve from 11.8% in Q1CY2006 to 12.8% in Q1CY2007, which would be primarily due to the price hikes taken in many of its products as well as improved product mix.
- ITC's profits are expected to grow by a strong 24% yoy. We expect the growth to be broad-based with the magnitude of losses in the non-FMCG business coming down. The imposition of the value-added tax (VAT) is having a dampening effect but we believe any decline is a good opportunity to buy.
- The long-term potential of this sector appears favourable with higher disposable incomes and increased spending. We believe with strong free cash flows, high return on capital employed (RoCE) and sustainable growth the sector still looks attractive.

HLL

We expect the profits of the market leader in the segment, HLL, to grow by 18.8% yoy backed by a strong growth in the HPC segment and price increases in key products. We expect a double-digit growth in the soap & detergent segment as well as in the personal product segment.

We expect the margin to improve from 11.8% in Q1CY2006 to 12.8% in Q1CY2007; the improvement would be primarily due to the price hikes taken in many of its products. We also expect the margins in the soap & detergent segment to get slightly affected by the strong palm oil prices.

HLL has raised the price of *Surf Excel Blue* (750gm) by 5% from Rs60 to Rs63. The company has also increased the price of *Surf Excel Quick Wash* (1kg) from Rs112 to Rs116—a clear 3.6% increase. Price increases have been effected in *Fair & Lovely* (including the Rs5 sachet), small packs of toothpastes, *Pond's* Talcum Powder, *Wheel* and *Rin* (nil) laundry bars, and premium brands such as *Pears* and *Lakme*.

Recently, HLL launched its Chinese range under the *Knorr* brand and has big plans for its food category for the current year.

(Rs cr)	Net sales			PAT		
	Q4FY07	Q4FY06	% chg	Q4FY07	Q4FY06	% chg
HLL	3,077.0	2798.0	10.0	349.1	293.9	18.8

*Extraordinary income of Rs148 crore excluded

ITC

ITC's profits are expected to grow by a strong 24% yoy. We expect the growth to be broad-based with the magnitude of losses in the non-FMCG business coming down.

The implementation of a 12.5% VAT would result in lower growth or no growth in the cigarette volumes. The company has effected a 10-25% price hike across segments. We believe the stock would continue to underperform till clarity emerges on how the subsequent price hikes would affect the company's volumes. But looking at the rising disposable income and addictive nature of cigarette consumption, we believe the volumes will not fall drastically and any decline is a good opportunity to buy.

The company has recently launched *Bingo*, its snacks brand, and is eyeing a 25% share of the Rs2,000-crore organised market in the next four to five years.

(Rs cr)	Net sales			PAT		
	Q4FY07	Q4FY06	% chg	Q4FY07	Q4FY06	% chg
ITC	3,293.0	2784.5	18.3	705.7	567.4	24.4

Marico

In Q4FY2007 the net revenue of Marico is expected to grow by 34.5% yoy to Rs400 crore. The top line growth would be mainly on account of the full contribution from the acquired brands of *Nihar*, *Manjal*, *Camelia*, *Aromatic* and *Fiancée*, and the strong growth of 20% in the focused brand portfolio.

Kaya is expected to break even this year with increasing contribution from skin solution products. We believe a higher utilisation rate is quite achievable with rising disposable incomes and increased consumer spending.

Marico has acquired two Egyptian brands: *Fiancée* and *HairCode*. These two brands command over 50% of the Rs170-crore Egyptian hair care market. In the current quarter we expect both these brands to contribute Rs20 crore. But we believe that these acquisitions will provide the real boost in FY2008 after the operations stabilise.

With the softening in the copra prices, we expect a slight improvement in the margins on a sequential basis but we also expect these savings to be used for aggressive advertising.

Marico has increased the prices of *Saffola* (2-3%) as well as *Mediker* (6%) in the current quarter.

(Rs cr)	Net sales			PAT		
	Q4FY07	Q4FY06	% chg	Q4FY07	Q4FY06	% chg
Marico	400.3	297.6	34.5	29.32	23.97	22.3

Tata Tea

We expect Tata Tea to report a 24.8% growth in the top line that will be primarily due to the inclusion of the income from the recently acquired companies like Good Earth Inc, Jemca and EOC.

We expect organic revenue from Tetley to be stagnant whereas EOC is expected to contribute around Rs170 crore this quarter. While Glaceau reported a loss in the last quarter, we expect it to show profits in this quarter.

Though the tea prices have moved northwards, we do not expect Tata Tea to get affected as it had sufficient stocks till Q4FY2007. Though any upward movement in the coming quarters could hurt its margins. We believe tea prices to soften in the short term with good output being reported in Kenya.

(Rs cr)	Net sales			PAT		
	Q4FY07	Q4FY06	% chg	Q4FY07	Q4FY06	% chg
Tata Tea	1,019.1	816.7	24.8	53.4	54.3	-1.7

ICI

ICI has sold its 100% equity share holding in Quest International India to Givaudari (India) Pvt Ltd and has received a consideration of Rs320 crore, which is expected to come in this quarter.

The company has also received an interim dividend of about Rs31 crore prior to the said sale of shares which is expected to be reported in this quarter. Further, another consideration, of about Rs35 crore for various agreed adjustments, is expected to get reflected in Q1FY2008.

The company has completed the divestment of the Advanced Refinish (2K) business and has received a consideration of Rs45 crore, which is expected to get reflected in this quarter itself. The balance consideration of about Rs7 crore is expected in the next quarter, ie Q1FY2008.

The company has gone for a price increase in the range of 0.75-1% in January across segments. We expect the margins to improve with the softening of crude oil prices as well as the price hikes.

We expect the top line to increase by 9% in Q4FY2007. The profit after tax (PAT) would be higher by 27% due to improved profitability. We expect exceptional income to be around Rs395 crore (interim dividend = Rs31 crore, proceeds from sale of business = Rs365 crore) which has not been accounted below.

(Rs cr)	Net sales			PAT		
	Q4FY07	Q4FY06	% chg	Q4FY07	Q4FY06	% chg
ICI	233.0	214.0	8.9	13.5	10.6	27.4

IHCL

Indian Hotels Company Ltd (IHCL) has acquired Hotel Campton Place, San Francisco and this acquisition has been made through its 100% US subsidiary company. The acquisition would be made at a cost of US$60 million (including the estimated transaction costs).

For the fourth quarter ended FY2007, we expect IHCL to report a top line growth of 29% at Rs459 crore and a bottom line growth of 27%.

The healthy trend in the top line is due to the rise in the number of foreign tourist arrivals into India that has resulted in higher average room rate and occupancy rate.

(Rs cr)	Net sales			PAT		
	Q4FY07	Q4FY06	% chg	Q4FY07	Q4FY06	% chg
IHCL	459.8	355.9	29.2	100.6	78.7	27.8

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