

FMCG SECTOR

Buoyant topline growth and easing input cost pressures bode well for the sector

This update is an attempt to take stock of the strong topline growth momentum and easing raw material cost pressures in the FMCG sector.

Strong growth momentum continues

The sector continued its strong topline growth momentum with 20% yoy and 5% qoq growth in 1QFY09. The growth was led by both price hikes (5-7%) and volumes (13-15%).

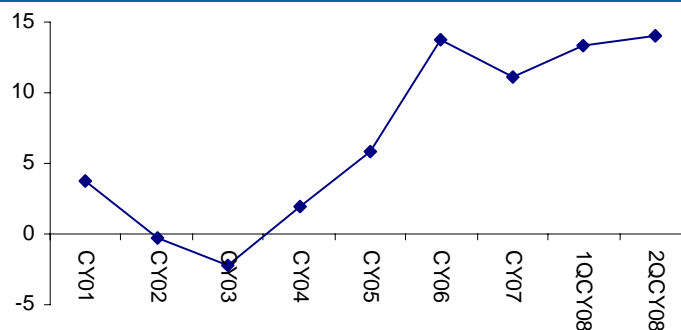
Table 1: Quarterly sales growth

Company	Rs mn	yoy (%)	qoq (%)
Colgate-Palmolive/India	4076	16.2	4.2
Dabur India	6040	16.0	-0.4
Godrej Consumer Products	3616	26.3	33.0
Hindustan Lever	42157	21.1	11.1
ITC	38997	18.4	-0.9
Marico	6009	28.1	28.5
Nestle India	10356	23.5	-5.1
Tata Tea	11347	12.3	-3.6

Source: Company

In 4QFY08, the sector has reported 19% yoy growth in topline. In addition, growth has been broad based with both rural and urban markets growing over the last two years.

Chart 1: FMCG market growth rate (Rural + Urban) %



Source: Industry

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We believe the sector is poised for sustained growth considering the following growth drivers:

- The favorable demographics, higher incomes, low penetration and growing per capita consumption. India's per capita consumption remains the lowest in the world across categories (refer annexure for details).
- Strong rural growth backed by higher agricultural incomes and increase in the value of land which is leading to more money in the hands of farmers. The recent revival in monsoon augurs well for the sector as it would help keep rural growth intact.
- Increase in pricing power as most companies have passed on the cost push inflation to consumers via a judicious blend of price hikes, package size reduction and change in product mix.
- Proliferation of modern trade which currently accounts for 5% of sales but is growing at around 25-30% yoy.

Recently, a 'Mahabachat Ke 5 Din' was organized by the Future group. Its CEO, Kishore Biyani, said "In the midst of an inflationary scenario, crossing the Rs1bn turnover mark on a single day has reassured our belief that our retail operations are able to provide the best value to Indian consumers. **More importantly, this could be a vital indicator that consumer confidence continues to remain buoyant in India.**"

Source: Economic Times

- Increased innovations and forays in new fast growing categories by most players. FMCG companies create value through product differentiation, package innovation, differential pricing and by highlighting the functional aspects of products.

EASING PRICES OF COMMODITIES TO HELP BOOST MARGIN

Though the sector reported strong double digit topline growth, its margins have remained under pressure due to unprecedented rise in input costs. The gross margin of the sector dipped 200bps in 1QFY09. The prices of key raw materials continued to firm up in the quarter.

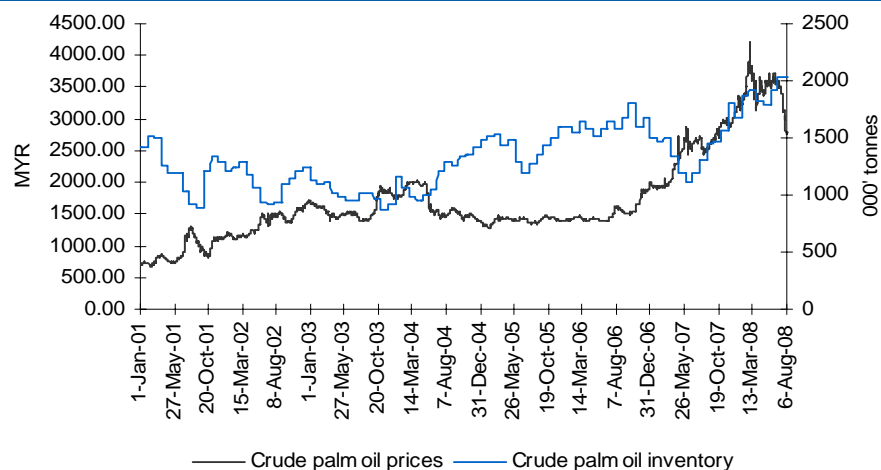
Table 2: Increase in prices of key raw materials

in %	1QFY09		FY08
Products	yoy	qoq	yoy
Palmoil	18	-3	16
LAB	49	22	-5
Wheat	13	-2	4
Sugar	11	2	-19
Milk	-1	5	20
Copra	29	8	-2
Coffee	29	5	23

Source: Industry, IAS

However, some raw materials prices are witnessing a declining trend on a month-on-month (mom) basis. For example, prices of crude palm oil (CPO) declined 37% from its high of 4,203 ringgit in March 2008 to 2,635 ringgit in August 2008 due to rising palm oil reserves and worries of overseas demand slowing down. CPO has given up all gains and prices were lower by 15% since January 2008. But on an annual basis, CPO prices were still higher by 8%.

Chart 2: Crude palm oil data

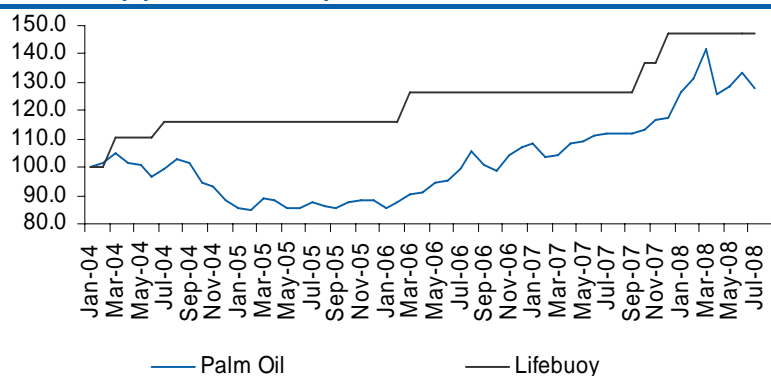


Source: Bloomberg, Alchemy

Similarly, wheat prices have fallen by 10% mom in July 2008.

Besides, the recent fall in crude oil prices to US\$113 per barrel (from the all time high of US\$147 per barrel) would lead to price softening of other petro based products like LAB and HDPE. In this background, any decrease in raw material costs would directly benefit the sector as it will drive up overall margins. However, it is difficult to quantify the extent of increase in margins.

Chart 3: Soap prices vis-à-vis palm oils



Source: Bloomberg, Alchemy

OUTLOOK

The Indian FMCG sector is trading at a P/E of 20.5x FY09E and 18.6x FY10E. The BSE FMCG Index has outperformed the BSE Sensex by 30% since the beginning of 2008 due to its defensive niche.

Chart 4: FMCG sector PE vs Sensex PE

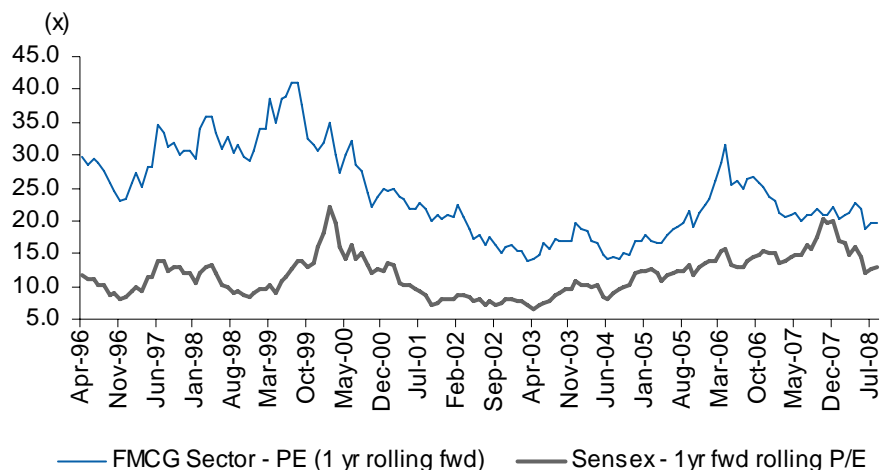
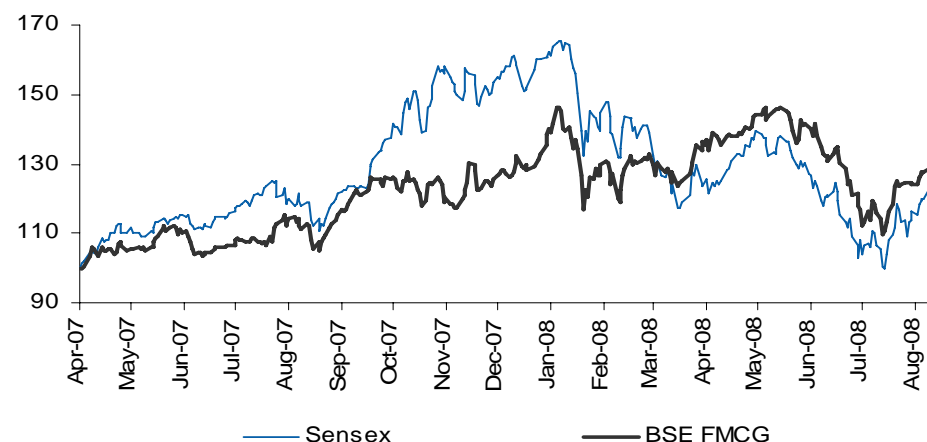


Chart 5: Sensex vs BSE FMCG



Source: Bloomberg, Alchemy

We are not seeing any immediate demand slowdown in the sector but one needs to be cautious as price hikes that may be effected in 2QFY09 could pose a risk to growth. The overall profitability of the sector would improve if raw material prices decline further and companies are not compelled to roll back product prices due to competitive pressures.

Thus, in the wake of strong and sustained demand with easing input cost pressures, the outlook for the sector looks encouraging. Hence, we are upgrading Hindustan Lever to 'Accumulate' from 'Market performer' - by virtue of it being a leader in several FMCG categories. Therefore, it would be a major beneficiary of any softening in commodity prices. We have kept ratings of the other FMCG companies in our coverage unchanged.

Table 3: Valuation summary

Company name	Price (Rs)	Mkt Cap (Rs bn)	Ratings	P/E		EV/EBITDA (x)		RoE (%)	
	CMP			FY09E	FY10E	FY09E	FY10E	FY09E	FY10E
Colgate Palmolive	419	56.9	MP*	20.9	17.5	20.8	16.7	124.3	90.5
Dabur India	90	77.8	MP*	20.5	17.6	16.4	13.7	53.3	48.1
Godrej Consumer Products	132	34.1	MP*	17.0	14.6	12.3	10.5	49.5	34.3
Hindustan Unilever	243	529.9	Accumulate	26.5	22.6	23.0	19.9	126.9	126.2
ITC	184	692.5	Sell	19.9	16.8	13.5	11.2	27.1	28.1
Marico	62	37.7	MP*	20.0	16.8	13.5	11.3	49.4	42.0
Nestle	1718	165.7	MP*	30.8	25.8	19.7	16.5	120.4	127.6
Tata Tea	728	45.0	MP*	10.3	9.0	7.7	6.7	12.2	12.8
FMCG		1639.6	Neutral	20.5	18.6	15.4	13.7	39.7	37.7

Source: Company, Alchemy * Market performer

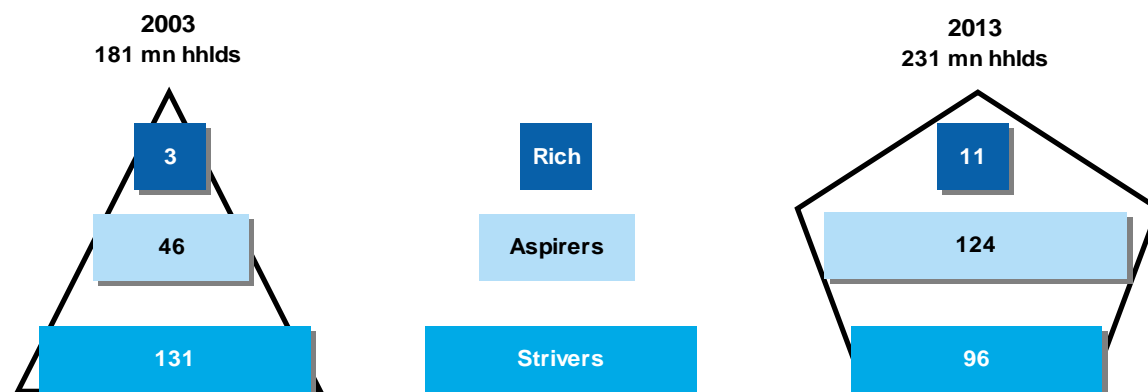
Table 4: FMCG stock price performance

	CMP (Rs)	52 week		Absolute (%)				Relative (%)			
		high	low	1M	3M	6M	12M	1M	3M	6M	12M
Colgate Palmolive India	419	521	324	13.9	-6.1	9.0	13.1	6.8	12.6	35.5	9.9
Dabur India	90	134	72	1.3	-9.1	-8.8	-8.3	-5.0	9.0	13.4	-10.8
Godrej Consumer	132	158	94	11.1	-3.8	15.0	-2.9	4.2	15.3	43.0	-5.5
Hindustan Unilever	243	256	170	10.8	-0.1	10.1	26.7	3.9	19.8	36.8	23.2
ITC	184	239	152	4.2	-19.0	-10.5	19.8	-2.3	-2.9	11.2	16.5
Marico	62	83	47	14.2	-4.1	-4.8	8.2	7.1	15.0	18.4	5.2
Nestle India	1718	1880	1140	11.2	-6.6	28.2	45.9	4.3	11.9	59.4	41.9
Tata Tea	728	1014	586	-0.7	-23.1	-11.5	9.4	-6.9	-7.8	10.0	6.4

Source: Bloomberg, Alchemy

Annexure I

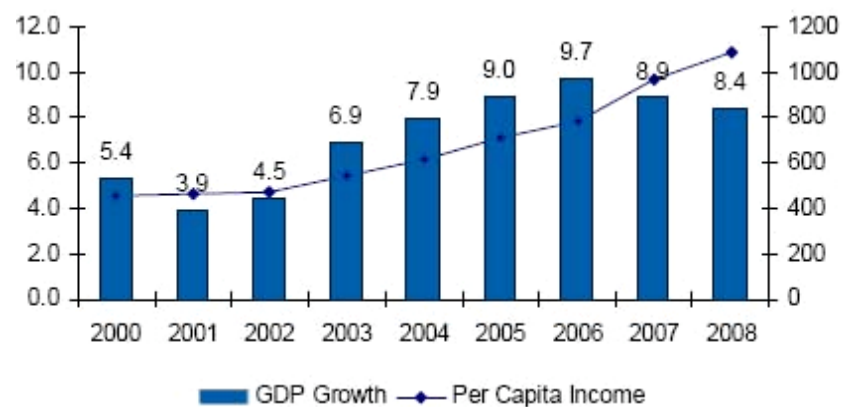
Chart 6: Favourable demographics



The shape of India is going to change...
from a pyramid to a diamond

Source: Industry

Chart 7: GDP growth and per capita income



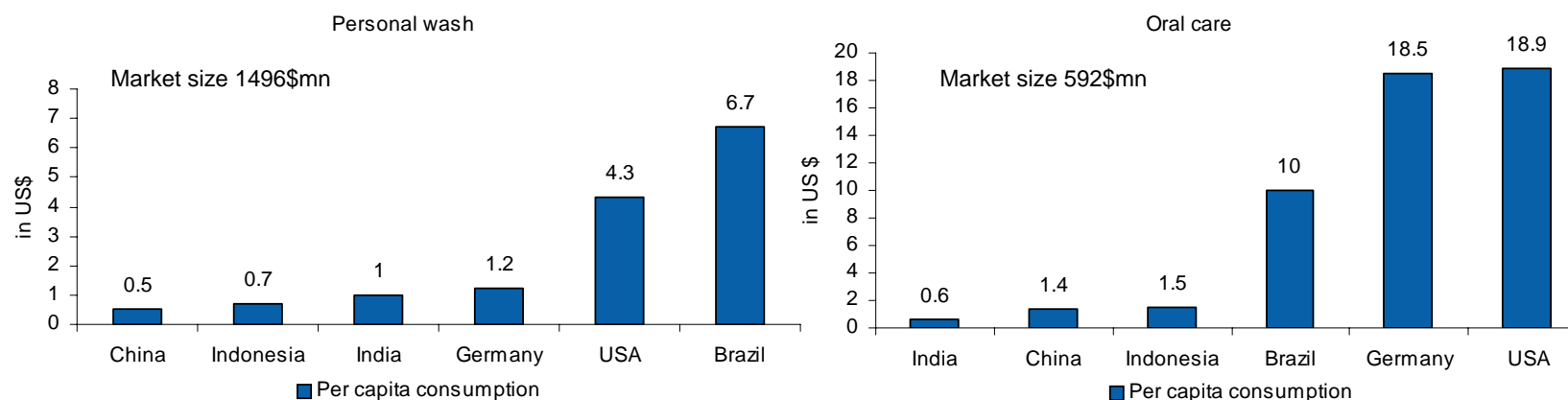
Source: Industry

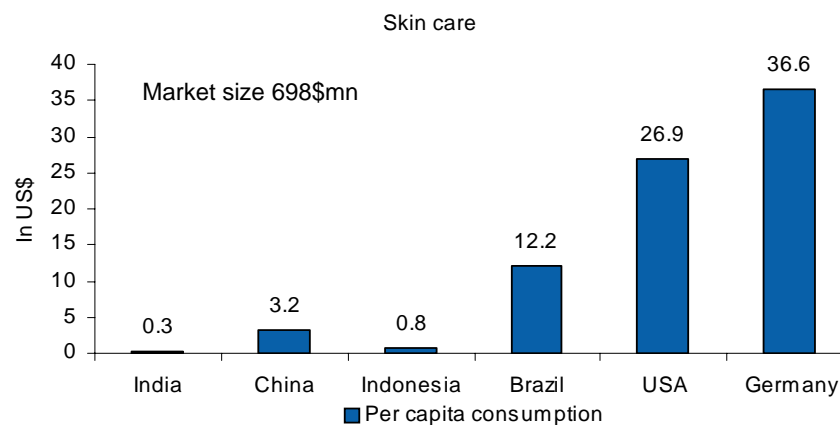
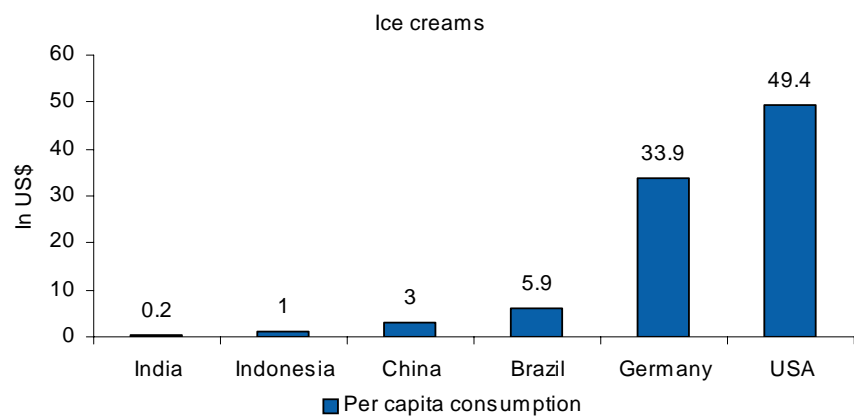
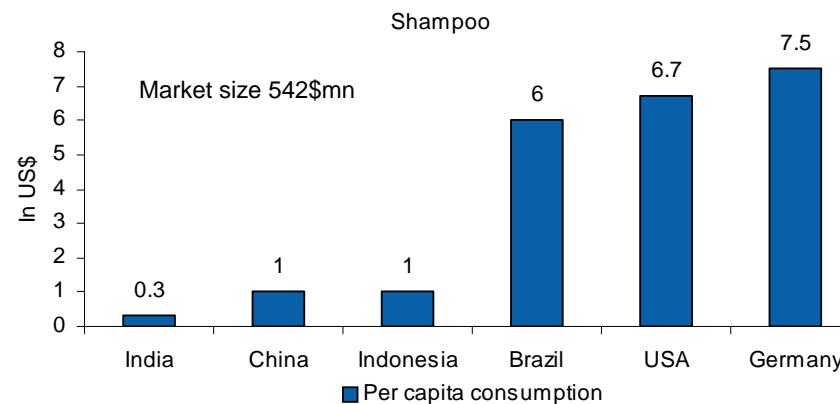
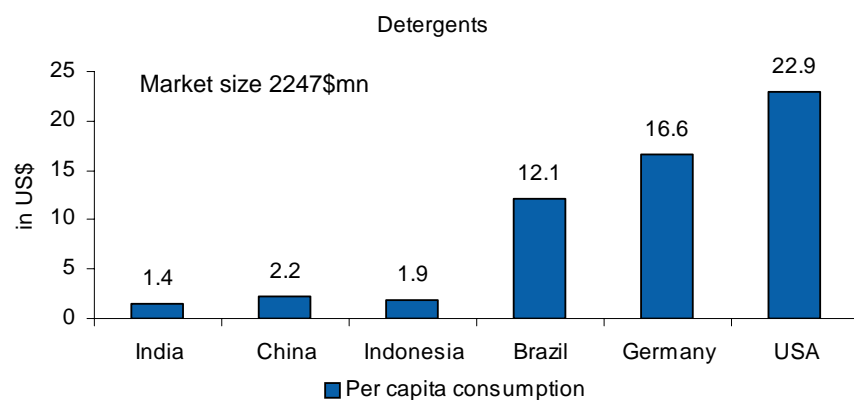
Table 5: Penetration – an opportunity to grow

Category	All India%	Urban%	Rural%
Deodorants	2.1	5.5	0.6
Toothpaste	48.6	74.9	37.6
Skin Cream	22	31.5	17.8
Shampoo	38	52.1	31.9
Utensil Cleaner	28	59.9	14.6
Instant Coffee	6.6	15.5	2.8
Washing Powder	86.1	90.7	84.1
Detergent Bar	88.6	91.4	87.4
Toilet Soap	91.5	97.4	88.9

Source: Industry

Chart 8: India's per capita consumption is the lowest in the world across categories





Report trail

Date	Title
30 Jun 08	Inflation woes: Are we staring at a slowdown? Downgrading to neutral
2-Jan-08	Time to participate in India's wealth effect

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