FMCG Q2 FY09 Review

Growth in line with expectations

November 05, 2008

Performance of most companies in our universe was in line with our expectations during Q2 FY09. All companies recorded double digit revenue growth led by strong volume growth across segments. However, operating margins remained under pressure due to a sharp rise in raw material prices. Over the past month, most of the key raw material prices like LAB, crude oil and palm oil have started correcting and are expected to ease the margin pressure in the coming quarters. Food companies though, are likely to continue to witness margin pressure on account of firm agri commodity prices. Most players have taken measures like price hikes and reduction in pack sizes to mitigate cost pressures. We continue to remain positive on the sector with ITC and Marico as our top picks.

Key Q2 FY09 result highlights

Company	Revenues (Rs mn)	Growth yoy (%)	OPM (%)	Inc / (Dec) (bps)	Net profit* (Rs mn)	Growth yoy (%)
Britannia	8,385	27.3	8.0	(240)	597	15.6
Colgate	4,125	13.4	12.4	(300)	635	16.0
Dabur	6,912	18.3	18.1	(180)	1,074	12.2
GLSM	4,225	20.2	14.9	(430)	530	4.9
Godrej CP	3,465	26.4	11.5	(680)	347	(6.3)
HUL	40,279	19.7	11.8	(150)	4,379	6.9
ITC	37,633	15.1	29.7	(190)	8,027	4.1
Marico	6,035	30.1	12.2	(170)	471	11.6
Nestle	11,076	22.2	18.7	(270)	1,326	9.9
Total	**122,134**	**19.3**	**18.2**	**(230)**	**17,386**	**6.5**

Source: India Infoline Research ** Before exceptional items.*

Topline growth momentum sustained

Our universe of 9 companies registered a healthy 19.3% yoy growth in revenues at Rs122bn during Q2 FY09 led by strong volume growth across segments. Categories like biscuits, cigarettes, toothpastes and soaps witnessed strong growth during the quarter. Sector heavyweight ITC (48.1% weight in BSE FMCG index) recorded 15% yoy growth in revenues at Rs37.6bn (slightly below our expectations) driven by strong ~11% yoy growth in core cigarettes (~2% decline in volumes) segment. The other FMCG major Hindustan Unilever (28.7% weight in BSE FMCG index) recorded 19.7% yoy growth in revenues at Rs40.3bn led by an impressive 7% underlying volume growth during the quarter.

Operating margins remain under pressure

Sharp rise in raw material cost put pressure on operating margins resulting in a mere 5.7% yoy growth in operating profit at Rs Rs22.2bn. Increase in adspend on account of intense competition, added further pressure on margins. As a result, aggregate sector operating margins declined by 230bps to 18.2%. Among all the companies, Godrej Consumer witnessed a sharp 680bps decline in margins due to higher channel inventory built-up in Q1 FY09. The players have implemented various options like price hikes, cost saving techniques like reducing the packaging size, change in product mix and better sourcing of raw materials to mitigate the input cost impact. The recent correction in some of the key raw material prices like LAB, crude oil, palm oil over the past one month, is expected to provide some respite to margins. However, expectations of firm agri-based commodity prices will continue to put pressure on margins of food companies like GlaxoSmithKline Consumer, Britannia and Nestle in the coming quarters.

Sharp rise in operating costs dampens bottomline growth

Aggregate sector net profit grew by a mere 6.5% yoy to Rs17.4bn during the quarter. The growth was lower primarily on account of increase in operating costs due to input cost pressure. All the companies in our universe, except Godrej Consumer (profit down by 6.3%) reported net profit growth in the range of 4-16%. Colgate and Britannia reported healthy double-digit growth in net profit. ITC could have recorded better growth but for the sharp rise in operating costs and increased losses from the FMCG-Others segment.

Remain positive on the sector

The FMCG sector is showing strong volume growth across product categories with improving pricing power of leading payers. Many players have regained their pricing power and have implemented successful price hikes during the quarter. Most companies have indicated a significant revival in rural demand (rural market growing faster that the urban market). The recent correction in some of the key raw materials like LAB, crude oil is expected to provide some respite to margins. However, expectations of firm agri commodity prices are likely to put pressure on margins, especially for the food companies.

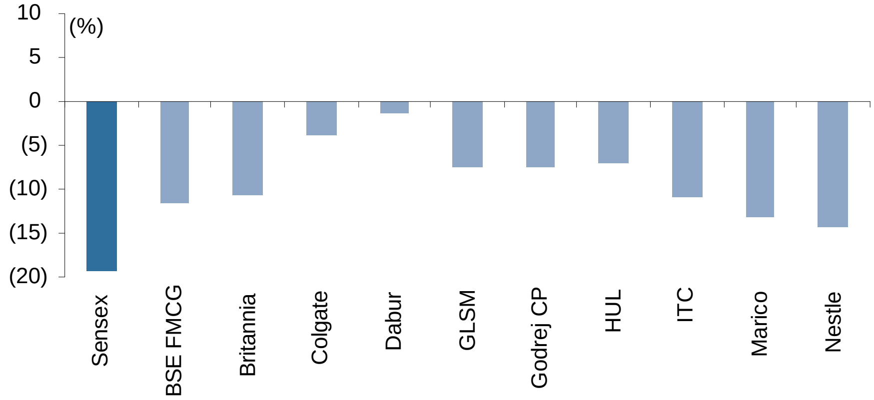
We believe the FMCG sector will continue its growth momentum going forward driven by strong volume growth across segments. The players are spending heavily on promotions and new launches while, fast growth of modern retail is also spurring consumption of branded goods. Three consecutive years of good monsoon, rising standard of living, fast growth of modern retail and a strong upsurge witnessed in rural demand would help keep the sector growth momentum intact.

Valuation summary

Company	CMP	EPS (Rs)		P/E (x)		Target	Up/(Down)	Reco
	(Rs)	FY09E	FY10E	FY09E	FY10E	(Rs)	(%)	
Britannia	1,176	95.9	111.8	12.3	10.5	1,398	18.8	Buy
Colgate	378	20.2	23.6	18.8	16.0	432	14.2	Buy
Dabur	88	4.5	5.3	19.8	16.7	91	3.0	MP
GLSM*	571	43.5	49.1	13.1	11.6	712	24.8	Buy
Godrej CP	104	6.8	8.1	15.2	12.7	111	7.6	MP
HUL*	238	9.6	11.3	24.9	21.0	238	(0.2)	MP
ITC	170	9.2	10.7	18.5	15.9	214	25.9	Buy
Marico	51	3.0	3.8	16.6	13.4	64	27.3	Buy
Nestle*	1,417	58.6	70.2	24.2	20.2	1,756	23.9	Buy

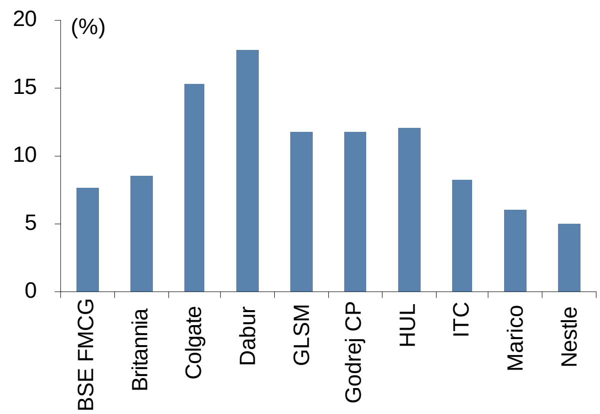
Source: India Infoline Research
**Year-end December*

Stock performance over the past one month

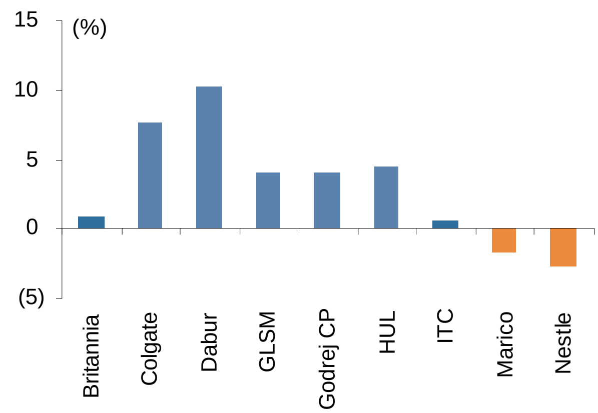


Source: BSE

Performance v/s Sensex



Performance v/s BSE FMCG



Source: BSE

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