CONSUMER

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September 2013

B2C Distributors' Survey

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B2C Distributor Survey

SECTOR UPDATE | September 30, 2013

Widespread moderation in growth

Consumer

Our survey of over 100 large distributors across India suggests that: (a) YoY volume growth across most categories has decelerated further in 2QFY14 as compared to 1QFY14; and (b) urban demand moderation is likely to increase the ratio of rural growth to urban growth (especially in FMCG) to ~2x in 2QFY14 as compared to ~1.5x in 1QFY14. Although segments like paints and companies like TTK Prestige have been exceptions to these broad trends in 2QFY14, temporary factors such as 'channel-stuffing' (for paints) and low base effect would put their normalised growth rates in 3QFY14 at risk. Whilst 3QFY14 demand will be supported by the festive season and agri-crop harvest for rural consumers, some distributors are worried about: (a) price increases related to INR depreciation; and (b) the relatively weak start to the festive season (Onam in Kerala). Overall, we expect the 2QFY14 earnings season to be a negative catalyst for overvalued stocks such as HUL, Marico and Jubilant Foodworks.

Summary of our findings from the distributors' survey

Category	Volume Growth	Price Growth	Promotion intensity	Most at risk	Most secure
Air conditioners	↓	↑	Flat	LG and Samsung	Voltas
FMCG & staples	↓	↓	Up	Marico, Nestle	GSK, GCPL
Footwear	↓	→	Down	Unorganised	Bata, Relaxo
Jewellery	↓	↑	Up	Unorganised	Tanishq, TBZ
Watches	↓	→	Down	Titan	Ethos
Paints	↑	↑	Up	Akzo Nobel	Asian Paints
Kitchenware	→	→	Flat	Hawkins	TTK Prestige
Light electricals	↓	→	Up	V-Guard	Bajaj Electricals, Havells

Source: Ambit Capital research; '↑' indicates acceleration of YoY growth vs 1QFY14; '→' indicates unchanged YoY growth rates vs 1QFY14; and '↓' indicates deceleration in YoY growth vs 1QFY14.

Investment implications: Whilst most categories are undergoing moderation in volume growth currently, we prefer firms whose long-term competitive advantages are relatively unchallenged, that have a presence in categories which offer strong long-term growth prospects and that are trading at decent valuations. This includes stocks such as Asian Paints, TTK Prestige and Bata. Also, we expect the 2QFY14 results to act as a negative catalyst for overvalued stocks such as HUL, Marico and Jubilant Foodworks.

Summary of volume and value growth expectations for 2QFY14

Ticker	2Q volume growth	2Q value growth	2Q= Catalyst?	Ticker	2Q volume growth	2Q value growth	2Q= Catalyst?
GSKCH	7%	15%	Flat	**APNT**	11%	15%	Positive
NEST	6%	12%	Flat	**BRGR**	10%	14%	Positive
CLGT	8%	13%	Flat	**VOLT**	-8%	-2%	Flat
HUVR	4%	7%	Negative	**JUBI**	8%	25%	Negative
DABUR	9%	15%	Flat	**PIDI**	7%	13%	Flat
MRCO	8%	8%	Negative	**VGRD**	-15%	-10%	Negative
GCPL	11%	22%	Positive	**HAVL**	3%	5%	Positive
TTKPT	6%	14%	Flat	**BJE**	5%	10%	Flat

Source: Ambit Capital research; Note: Volume growth is year-on-year and it pertains to the domestic business based on our channel checks; Value growth pertains to consolidated growth based on Ambit estimates.

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Executive summary

Over the course of September, we conducted a survey of more than 100 large distributors and unlisted companies spread across India and across most of the key consumption segments (white goods, FMCG, footwear, jewellery, watches, paints, light electricals and kitchenware). Consequently, this survey focused on identifying the YoY growth trends in consumer demand over July-August 2013 across categories as well as individual brands. The picture that has emerged from our survey shows:

- **Demand growth in rural/mass segment remained robust; premium/urban segment decelerated further:** Whilst urban demand has seen a significant moderation in growth, momentum of rural consumption has remained robust led by a combination of:

  1 Positive consumer sentiment amongst **agri-dependent consumers in anticipation of a good harvest** from October onwards given the strong monsoon this year (a factor prevalent since July 2013).

  2 Growth in household income of traditionally backward regions like Uttarakhand, Bihar and Madhya Pradesh, as a result of which the labour workforce has 'reverse migrated' from urban cities towards rural areas (a factor prevalent over the past 12-18 months).

  3 Continued improvement in distribution network in rural India, thereby supporting consumption. **This factor has been prevalent over the past couple of decades.**

  Consequently, we expect the ratio between rural demand growth and urban demand growth to increase from 1.5x in 1QFY14 to ~2x in 2QFY14.

- **Overall moderation in volume growth across most categories:** Due to a moderation in demand from premium/high-ticket/urban consumers, YoY volume growth across segments (including air conditioners, FMCG, footwear, jewellery, light electricals and watches) has moderated significantly as compared to the YoY growth reported in 1QFY14 as well as in FY13.

Exhibit 1: Summary of our findings from the distributors' survey

Category	Volume Growth	Price Growth	Promotion intensity	Most at risk	Most secure
Air conditioners	↓	↑	Flat	LG and Samsung	Voltas
FMCG & staples	↓	↓	Up	Marico, Nestle	GSK, GCPL
Footwear	↓	→	Down	Unorganised	Bata, Relaxo
Jewellery	↓	↑	Up	Unorganised	Tanishq, TBZ
Watches	↓	→	Down	Titan	Ethos
Paints	↑	↑	Up	Akzo Nobel	Asian Paints
Kitchenware	→	→	Flat	Hawkins	TTK Prestige
Light electricals	↓	→	Up	V-Guard	Bajaj Elect, Havells

Source: Ambit Capital research; '↑' indicates acceleration of YoY growth vs 1QFY14; '→' indicates unchanged YoY growth rates vs 1QFY14; and '↓' indicates deceleration in YoY growth vs 1QFY14

- **Paints sector (primary sales) has been an exception:** Primary sales (from manufacturers to dealers) have accelerated to double-digit volume growth during July and August. This was driven predominantly by 'channel-stuffing' due to a rise in inventory levels on dealers' shop-floors ahead of the price increase of 4-6% (on average) on 1 September across most products. **However, secondary sales growth has failed to accelerate so far.** Whilst manufacturers have intensified trade benefits to dealers to stimulate secondary sales, demand during the festive season in September and October will be a key determinant for the performance of the paints sector.

- **Price increases and higher promotional activity:** Given the INR depreciation and an inflationary environment for commodities (such as copra, wheat and packaging materials), price increases of over 5% have either been implemented during 2QFY14 or are likely to be implemented in 3QFY14. With price elasticity of demand being significantly high in most categories (as compared to the situation two years ago), manufacturers have increased promotional activity, especially for premium/big-ticket products to stimulate demand. Exceptions to this trend are categories, such as apparel and footwear, for which the period of discounts in modern retail has been normal and hence shorter than that of last year.

- **Major market share changes—gains for TTK Prestige and GCPL (domestic business) but loss for Marico:** TTK Prestige has continued to gain substantial market share from players like Hawkins (pressure cookers and cookware) in the non-south markets and from Preethi (mixer grinders) in the south Indian markets. Also, our discussions with super-stockists and FMCG distributors suggest that GCPL has been gaining share in all three product categories: (a) soaps (through *Godrej No.1*); (b) insecticides (strong double-digit growth for *HIT* and mid-single digit growth for Reckitt and SC Johnson); and (c) hair colour (*Godrej Expert Crème*). However, Marico's distributors in Maharashtra indicated that growth rates for the company have remained weak, with flat revenue growth especially in the western region.

Exhibit 2: Summary of volume and value growth expectations for 2QFY14

Company	2QFY14E Volume growth	1QFY14A Volume growth	2QFY14E Value growth	1QFY14A Value growth	Will 2QFY14 results be a catalyst	P/E FY15 (x)	Comments regarding catalysts
GSK Consumer	7%	7%	15%	17%	Flat	29.2	No major share price movements likely on the back of results given the current valuations
Nestle	6%	3%	12%	12%	Flat	35.2	SELL ahead of results – Core growth to remain weak across segments despite support from a weak base.
Colgate	8%	9%	13%	14%	Flat	28.9	Volume growth supported by promotions; pressure on margins broadly priced in
HUL	4%	4%	7%	7%	Negative	34.9	SELL ahead of results - Premium valuations and weak growth in volumes and earnings
Dabur	9%	9%	15%	13%	Flat	29	No major share price movements likely on the back of results
Marico	8%	10%	8%	9%	Negative	25.4	SELL ahead of results – expect commentary around market share losses
GCPL	11%	13%	22%	24%	Positive	28.1	SELL into the rally following results – although domestic volume growth likely to be strong, longer term overhang remains around capital allocation and performance of Africa/LatAm
TTK Prestige	6%	-5%	14%	1%	Flat	19.6	BUY ahead of results – current share price fully factors in macro weaknesses, but DOES NOT adequately factor in longer term growth potential
Asian Paints	11%	10-11%	15%	12%	Positive	27.3	BUY ahead of results; however valuations higher than 31x-32x not justified – 2QFY14 is likely to be strong due to channel-stuffing
Berger Paints	10%	7%	14%	13%	Positive	25.1	SELL into the rally following results – Strength in volume growth of 2QFY14 will be short lived; deserves at least 15-20% discount vs Asian Paints
Jubilant Foodworks	8%	6%	25%	26%	Negative	35.3	SELL ahead of results – SSG weakness likely to persist; FY2023 store count potential <2000
Pidilite	7%	8%	13%	12%	Flat	22.6	Macro weakness broadly factored in; no surprises expected in 2Q results unless there is a one around international businesses/elastomer
Havells	3%	NA	5%	1%	Positive	15.7	Positive share price movement – strong non-south and south despite weak onam
Bajaj Electricals (Consumer business)	5%	NA	10%	10%	Flat	8.7	Strong promotional campaign - hence strong topline, weak margin
V-Guard	-15%	NA	-10%	28%	Negative	12.7	Negative share price reaction given weak onam (Kerala = >10% of sales). Weak stabilizer & inverter sales given reduced power cut
Voltas	-8%	4%	-2%	-1%	Flat	9.6	Whilst 2QFY14 results are likely to be weak for both room AC's and EMP segments, we believe there is long term value in Voltas resulting in 20% upside even after excluding EMP segment

Source: Ambit Capital research; Note: Volume growth pertains to ONLY the domestic business of these firms based on our channel checks; Value growth pertains to consolidated growth according to Ambit estimates.

Key quotes from distributors

Exhibit 3: Key quotes from distributors/unlisted companies in each B2C category

Sector	Source	Quotes
White goods	Multi-brand AC dealer in Mumbai	"Only Samsung is offering freebies to push sales, others are expected to increase promotional activities before Diwali."
	Multi-brand AC dealer in Bangalore	"Room AC inquiries are very poor. We are waiting for the Diwali season for any pick-up in sales"
FMCG	Multi-brand FMCG super-stockist in Haryana	"Premium products have slowed down. Mass-level soaps like *Godrej No.1* are doing very well and stealing share from HUL. Our rural sales are very strong."
	Large distributor of HUL in Maharashtra	"Almost all segments have slowed down. The company has introduced trade schemes to revive demand. Issues in *Fair and Lovely* are still not rectified - we are hopeful that the relaunch will rectify demand."
	Largest distributor of Nestle in Pune	"August is a key month for us, as our targets are the highest. But we have had a horrible month. This is because our pricing is much higher than competition."
	Large distributor of Marico in Maharashtra	"We are currently looking at de-growth in certain categories as the urban markets are under pressure. However, we don't bother much about new competition in the edible oils category as our brand is very strong and customers are loyal to us."
Footwear	One of the biggest footwear distributors in Gujarat	"I am happy that the Rupee has depreciated. It would be interesting to see the strategy of MNC shoe companies which largely import finished products from China. "
	Shoe distributor catering to NCR and East India regions	Referring to the low value segment: "My business sales are down 10% YoY in 2Q. Customers prefer Relaxo in this segment as they see Film personalities promoting it. Bata's price is not competitive in this segment anymore."
Watches	Store manager of a luxury watch retail chain	"We are growing at 30-35% YoY. Super-rich customers continue to spend, and hence our targeted customers are not affected by a slowdown. Normally July-Sept is better than April-June, because in 2Q these customers receive their bonuses whilst they are busy filing tax returns in 1Q."
	Store manager of the largest watch retail chain	"For the July-Sept period, either the discounts were low this year or the discount period was shorter. Conversion of footfalls has been lower for us this year also because we do not negotiate much on the price unlike the traditional dealers."
Jewellery	Executive Director of an organized jewellery retailer	"In the past few days, customers have brought in huge stock to sell to take advantage of high prices which provided some relief to jewellers who were otherwise starved of gold as imports were virtually on halt in the last one month due to policy confusions."
	Wholesaler in diamond jewellery	"Not seeing any major shift in customers moving from gold to diamond because of the price rise in gold jewellery and also because prices of diamond have also gone up due to INR weakening. The studded segment is also facing a similar slowdown."
Paints	Paint dealer in Bangalore	"Some parts of the city are doing well, but the market as a whole is weak. There are few new customers apart from our regular clients."
	Paint dealer in Jaipur	"Dulux sells much better. Since Akzo gives us better margins, we convert customers of Asian Paints to Dulux. Asian's promotional schemes are also not attractive enough."
	Paint dealer in Surat	"We had stocked up before the price increase, but are not seeing too many customers walk into the shop. With Diwali coming two weeks earlier this year, we hope the demand picks up soon."
Kitchenware	One of the largest multi-brand dealers in Bangalore	"Overall market growth is very sluggish. The pressure cooker markets have never been so weak over the past decade. Footfalls into my two shops have not grown YoY so far this year. Last time this happened was 11-12 years ago."
	TTK Prestige's distributor in Gurgaon	"Markets have been tough this year. But I have been able to grow at over 50% YoY YTD due to TTK Prestige's expansion in the number of outlets and market share gains in existing outlets. I have crossed my full month Sept'12 sales number by 15th Sept 2013 itself"

Source: Ambit Capital research

Investment implications

We recommend SELL on overvalued stocks such as HUL (24% downside, 34.9x FY15 P/E), Marico (10% downside, 25.4x FY15 P/E) and Jubilant Foodworks (27% downside, 35.3x FY15 P/E).

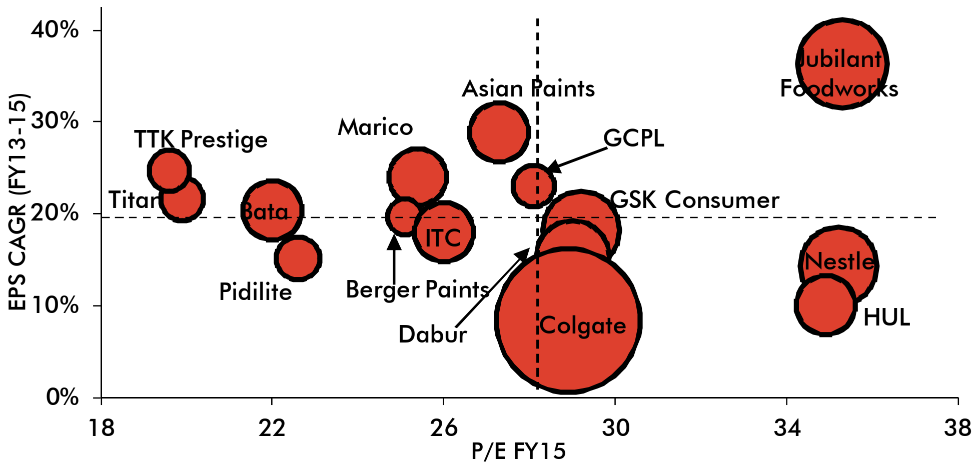
1 **HUL** is likely to report EPS CAGR of 10% over FY13-16, as: (a) 60% of its revenues are derived from fully penetrated categories; (b) market share losses would continue and advert spends in oral care, skin care and beverages would increase; and (c) royalty rates and tax rates would increase over time, which would be a drag on earnings growth.

2 **Marico** relies heavily on commodity prices for earnings growth of *Parachute* as well as the *Saffola* portfolio. Competitive intensity has been rising substantially in its premium edible oils portfolio. Also, the company's capital allocation philosophy has NOT been impressive over the past decade.

3 Given **Jubilant Foodworks** strong execution capabilities and operational efficiencies, we expect the stock to trade at an implied FY15 valuation of 28.0x. However, the current FY15 trading multiple of 35.3x does not adequately factor in a drag on earnings growth related to: (a) high store penetration and hence store splits in tier-1 cities; (b) high competitive intensity in the QSR sector; and (c) store count potential of only 2,000 Domino's stores by 2023.

We recommend BUY on high-quality growth stocks that are available at decent valuations. As shown in the chart below, we prefer stocks which offer a favourable trade-off between EPS CAGR, P/E multiples, and defensiveness. From this perspective, we prefer discretionary names such as TTK Prestige, Asian Paints and Bata, as these firms are likely to offer more than 20% EPS CAGR over the medium to longer term.

Exhibit 4: Level of defensiveness in consumer stocks with valuations and EPS growth



Source: Ambit Capital research; Note: Size of the bubble indicates the level of defensiveness determined by the coefficient of variation of revenue growth rates over the past 25 quarters.

Exhibit 5: Relative valuation

Company	Rating	CMP (₹)	Mcap (US$ bn)	Target Price	Upside/ Downside	P/E (FY15)	EV/EBITDA (FY15)	EPS CAGR (FY13-15)	ROE (FY14)
GSK Consumer	SELL	4,237	2.8	3,945	-7%	29.2	23.8	18%	34.7%
Nestle	SELL	5,097	7.9	4,389	-14%	35.2	20.6	14%	60.3%
Colgate	SELL	1,240	2.7	1,227	-1%	28.9	19.1	10%	100.9%
HUL	SELL	621	21.8	487	-24%	34.9	26.6	10%	103.0%
Dabur	SELL	170	4.7	136	-20%	29.0	21.5	15%	37.0%
Marico	SELL	220	2.3	198	-10%	25.4	16.6	24%	22.0%
GCPL	SELL	832	4.6	748	-10%	28.1	19.3	23%	24.3%
TTK Prestige	BUY	3,346	0.6	4,067	22%	19.6	13.5	21%	31.0%
Asian Paints	BUY	471	7.4	493	5%	27.3	17.6	18%	34.4%
Berger Paints	SELL	225	1.2	204	-9%	25.1	14.5	20%	24.3%
Voltas	BUY	74	0.4	106	43%	9.6	8.6	41%	9.9%
Blue Star	SELL	144	0.2	175	22%	10.6	7.4	75%	21.3%
Bata	NOT RATED	853	0.9	NA	NA	21.0	13.1	21%	25.6%
Jubilant Foodworks	SELL	1,173	1.2	856	-27%	35.3	18.3	28%	32.3%
Pidilite	SELL	253	2.1	227	-10%	22.6	18.2	18%	28.0%
Titan	NOT RATED	235	3.4	NA	NA	21.8	14.2	43%	36.0%
Bajaj Electricals	BUY	163	0.3	251	54%	8.7	4.5	64%	16.0%
Havells	BUY	633	1.3	682	8%	15.7	9.9	14%	25.6%
V Guard	BUY	486	0.2	593	22%	12.7	8.1	35%	31.1%

Source: Ambit Capital research

Summary findings of our survey

Air conditioners

Exhibit 6: Summary findings for air conditioners

Particulars	Jul/Aug'13 vs Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY volume growth	Declined by 5-10%	24%	Sales volume have declined sharply owing to a good monsoon and a 5-9% increase in AC prices
Market share changes	**Gain:** Voltas, Daikin **Loss:** LG and Samsung	**Gain:** Voltas, Blue Star **Loss:** LG and Samsung	Korean players continue to lose market share due to a low-quality product and an ineffective product placement strategy
Promotions and incentives	Only Samsung is offering freebies such as fridge containers	On account of strong demand, companies did not materially increase promotions YoY	The companies would increase promotions and freebies before the Diwali season to push AC sales before energy ratings changes come into effect from January 2014
Conclusion	Post the onset of monsoon and 5-9% increase in room AC prices, room AC volumes have declined sharply after strong summer sales in April/May	The industry reported strong summer sales after a gap of two years but volumes declined YoY in June due to early monsoons	We expect room AC sales volumes to be flat or decline YoY in the last nine months of FY14 owing to increase in prices with high price elasticity of demand; volumes in the room AC industry declined by 20% in FY12 and by 5% in FY13 due to annual price increases of 7-10% YoY

Source: Ambit Capital research

Volume growth has declined YoY: Room AC volumes increased by over 30% during the summer months of April and May. Blue Star was out of stock towards the end of May. Dealers across India suggested that room AC volumes have declined by 5-10% YoY during June-August owing to higher prices and good monsoons. Daikin has increased market share at the expense of LG and Samsung during this period.

"Room AC inquiries are very poor, and we are waiting for the Diwali season for any pick-up in sales." - Multiple brand AC dealer in Bangalore

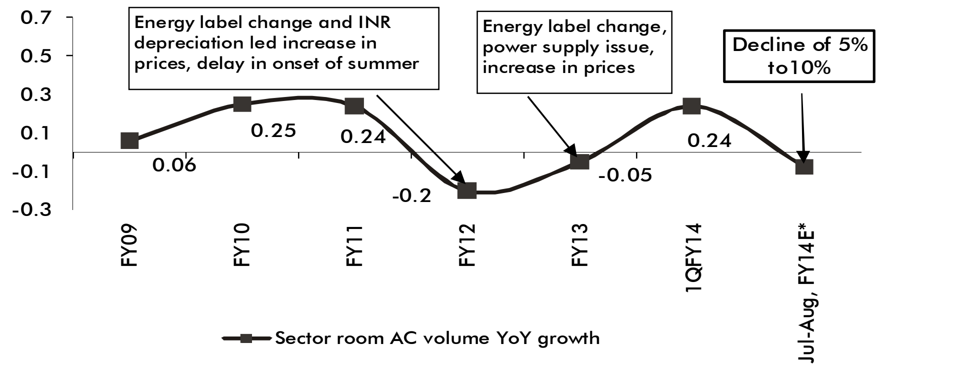
Price increase of 5-9% owing to INR depreciation: Based on our dealer checks, room AC prices have increased by 5-9% over the past two months on account of INR depreciation. Whilst Daikin, Panasonic and Blue Star have increased prices, market leaders such as Voltas, LG and Samsung have not increased prices yet. We expect prices to increase further by ~5% over the next three months on account of energy label changes.

Promotional activity likely to pick up before Diwali: Companies did not resort to heavy promotions during the summer season owing to high industry volume growth (30% YoY in April/May). However, dealers expect promotional activity to pick up before the Diwali season in a bid to clear old inventory before the new energy label rating comes into effect from January 2014. Samsung is the first company to offer freebies on fridges before Diwali. According to industry sources, the share of sales from 0% financing schemes has increased from 4-5% in FY13 to 7-8% during FY14.

Investment implications: We expect prices to increase by 6-12% from the current levels due to INR depreciation and energy label changes. After this price increase, ACs would cost 16-25% more in January, thereby creating uncertainty around demand. Since India is a price-sensitive market, we estimate volumes to remain flat or marginally decline YoY in FY14 and FY15. We reiterate our BUY stance on Voltas with a target price of ₹106/share using segment-wise DCF valuation—comprising ₹40 from Unitary cooling products (UCP), ₹18 from Engineering products and services (EPS), ₹20/share from Electromechanical projects (EMP), ₹22 from cash/investments and ₹6 from rental—implying 43% upside.

Our fair value of Voltas (₹106/share) implies 20% upside excluding the EMP segment

Exhibit 7: Price increase led to volume declines in FY12/13 for the industry



Source: Company, Industry, Ambit Capital research

FMCG and staples

Exhibit 8: Summary findings for FMCG and staples

Particulars	Jul/Aug'13 vs Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY volume growth	5-6%	7%	Most dealers highlighted further weakness in demand, especially for the premium segment; mass brands continue to have strong growth; significant moderation in urban demand but rural demand is holding up
Market share changes	**Gain**: GSK, GCPL **Loss**: Marico, Nestle	**Gain**: Colgate, GCPL **Loss**: HUL, Nestle	GCPL has gained share in soaps (*No.1*) and insecticides (*HIT*); GSK (*Horlicks*) continues to gain share in south India; Marico has lost share in premium edible oils and hair oils in urban markets; Nestle continues to lose share in coffee and noodles
Promotions and incentives	Promotional activity was higher than normal especially in detergents, toothpastes, hair oils, edible oils and ketchups	Categories like soaps, coffees and hair oils saw increased promotions during 1QFY14	Volume growth pressure saw most companies increase their promotional spends both QoQ and YoY; competitive intensity increased meaningfully during the quarter
Conclusion	Volume growth pressure intensified during the quarter, with premium segments and urban markets being the most impacted	Whilst volume growth was under pressure, expanding margins helped support increased promotional spends	Increasing evidence of down-trading in the urban markets; any incremental price increases will likely have negative repercussions on volume growth

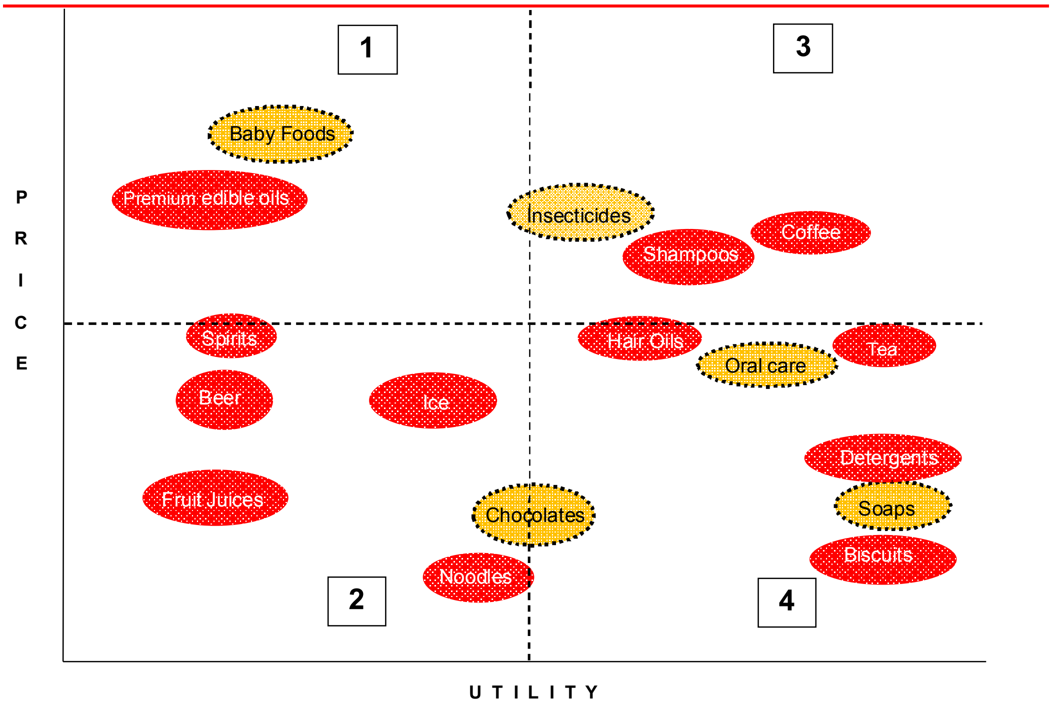
Source: Ambit capital research;

Volume growth moderates further: Our channel checks suggest that categories like biscuits, premium edible oils, shampoos, skin creams and hair oils have seen significant moderation in volume growth both on a YoY as well as QoQ basis. We expect **volume growth of 5-6% for the overall sector** (as against 7% reported in 1QFY14).

"Premium products have slowed down. Mass-level soaps like Godrej No.1 are doing very well and stealing share from HUL. Our rural sales are very strong."

- Multi-brand FMCG super-stockist in Haryana

Exhibit 9: FMCG Price-Utility matrix



Source: Ambit Capital research; RED SHADE=slowdown in the rate of volume growth on a YoY basis; YELLOW SHADE=Volume growth rates are maintained on a YoY basis; GREEN SHADE=acceleration in the rate of volume growth on a YoY basis

"Almost all segments have slowed down. The company has introduced trade schemes to revive demand. Issues in Fair and Lovely are still not rectified - we are hopeful that the relaunch will rectify demand."

– Large distributor of HUL in Maharashtra

Rural growth rate likely to be ~2x that of urban growth rates: Conversations with distributors suggest that the divergence between rural and urban growth rates for staples consumption has widened considerably during 2QFY14. Rural demand has remained strong, supported by three factors:

- Positive consumer sentiment amongst agriculture-dependent consumers in anticipation of a good harvest from October onwards given the strong monsoon this year **(This factor has been prevalent over the past three months.)**

- Growth led by traditionally backward regions such as Uttarakhand, Bihar and Madhya Pradesh, due to which the labour workforce 'reverse migrated' from urban cities towards rural India **(This factor has been prevalent over the past 12-18 months.)**
- Continued increase in penetration of distribution network into the rural parts of India, thereby supporting rural consumption **(This factor has been prevalent over the past couple of decades.)**

Consequently, we expect the ratio between rural demand growth and urban demand growth to increase from 1.5x in 1QFY14 to ~2x during 2QFY14.

Promotions intensify across categories: Volume growth pressure across categories has led to higher-than-normal promotional intensity by the industry (see the table below).

Exhibit 10: Promotional offers during 2QFY13

Category	Product	Company	Offer
Premium edible oils	Saffola Gold	Marico	20% free on 1 litre pouch
Premium edible oils	Riso	Kamani Oil Industries	Buy 5 litres, get 2 litres free
Glucose	Glucon D	Heinz	Get 25% free on 200gm
Coffee	Nescafe	Nestle	Free shaker
Deodorants	Axe	HUL	Win a smartphone offer
Toothpaste	Colgate Total	Colgate	12% off on 280gm
Toothpaste	Pepsodent Germicheck	HUL	14% off on 300gm
Hair Oils	Parachute	Marico	8% off on 175ml
Shampoo	Pantene	Procter & Gamble	75ml free on 340ml
Shampoo	L'Oreal shampoo	L'Oreal	13% off on 275ml
Detergents	Surf Easy Wash	HUL	24% off on 700gm
Detergents	Tide	Procter & Gamble	11% off on 500gm
Insecticides	Hit	Godrej Consumer	16% off on 425ml
Milk Food Drinks	Complan	Heinz	9% off on 500gm
Sauces	Maggi Ketchup	Nestle	Free Nescafe worth ₹60 on SKU worth ₹122

Source: Ambit Capital research

Market share changes: Godrej Consumer stood out as a key beneficiary with: (a) strong growth of its *No.1* soap in rural India; and (b) market share gains from Reckitt Benckiser and SC Johnson in the insecticide business. **GSK Consumer** is maintaining its growth momentum especially in the southern region, with limited impact seen in the urban segment and strong growth in rural sales. **Marico** is likely to have lost market share with poor growth in both its hair oils as well as premium edible oils portfolio. We expect Nestle to have lost market share to ITC's *Yipee* in the noodles segment, to HUL's *Bru* in the coffee segment, and to other organised players in the packaged milk segment. Distributors attributed the market share losses in coffee and packaged milk to Nestle's premium pricing.

"We are currently looking at de-growth in certain categories as the urban markets are under pressure. However, we don't bother much about new competition in the edible oils category as our brand is very strong and customers are loyal to us." – Large distributor of Marico in Maharashtra

Investment implications: The seven frontline FMCG stocks are currently trading at an average FY15 P/E multiple of 28.0x. We expect earnings growth in 2QFY14 to be weak, owing to: (a) sector volume growth of only 5-6% YoY for 2QFY14; (b) increased promotional activity; and (c) impact of INR depreciation and commodity price inflation (for instance, copra, wheat and LAB) on input costs. We reiterate our SELL stance on the seven frontline FMCG names and we highlight HUL and Marico as our top SELL ideas in the sector, with the 2QFY14 results announcements likely to act as a negative catalyst for these stocks.

Footwear

Exhibit 11: Summary findings for footwear

Particulars	Jul/Aug'13 vs Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY volume growth	Flat volume growth (0% growth) YoY	Growth of 0-5% YoY	Weakness in the overall market due to the impact of high consumer inflation on discretionary spending
Market share changes	**Gain:** Bata; Relaxo **Loss:** Unorganised/regional brands	**Gain:** Bata; Relaxo **Loss:** Unorganised/regional players	Strong branding and marketing initiatives helping the organised segment to gain share
Promotions and incentives	YoY decline in promotional activity due to a high base effect	No major changes in promotional schemes YoY	Promotional activity has declined YoY since 2QFY13; higher magnitude and longer duration of promotions in modern retail formats
Conclusion	Overall weak volume growth with the mass segment affected more than premium segment; established brands gaining market share led by marketing activities and competitive pricing	Growth rates were positive but impacted by an overall consumer slowdown	Further deterioration in consumer spending especially in the inflation-impacted mass segment

Source: Ambit Capital research

Flat market volume growth; shift from unorganised to organised continues: Our conversations with distributors suggest that given a YoY decline in the overall footfalls in multi-brand retail outlets, volume growth of the overall footwear retail market has moderated during 2QFY14. However, the extent of this moderation was more pronounced in unbranded sales as compared to branded footwear sales. This moderation in growth is possibly due to reduction in discretionary spending given high inflation and product price increases of over 7-8% YoY across all categories of footwear.

Promotional activity declined YoY: Given the longer duration of discounts and wider range of merchandise on discount in 2QFY14 for the broader modern retail formats (including footwear), promotional activity declined on a YoY basis during 2QFY14 to normal levels. This high base effect created a drag on YoY volume growth rates for footwear dealers and distributors during the quarter.

"I am happy that the Rupee has depreciated. It would be interesting to see the strategy of MNC shoe companies which largely import finished products from China. " – One of the largest footwear distributors in Gujarat

Pricing actions and market share changes: Due to an inflationary environment for input costs, cumulative price increases across branded products both in mass as well as premium categories varied from 7% to 10% on a YoY basis. Based on our discussions with distributors, whilst Bata appears to have gained market share in the category of products priced at over ₹1,000 per pair, the firm has lost market share to peers like Relaxo, Lakhani and Liberty in products priced at less than ₹800 per pair.

Investment implications: Whilst few large footwear manufacturers are listed, we see the moderation in footwear retail sales to be a clear indicator of weakness of entry-level discretionary consumption in India currently for categories including apparel, footwear and light electricals. We expect Bata and Relaxo to report revenue growth of~10% YoY, led predominantly by price increases and market share gains from new store openings. Bata currently trades at 21.0x CY14 EPS with an expected EPS CAGR of 21% over CY12-14 (based on consensus forecasts).

Jewellery

Exhibit 12: Summary findings for jewellery

Particulars	Jul/Aug'13 v/s Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY volume growth	-10% to 0%	50%	Sharp increase in gold prices led to short-term decrease in volume during 2QFY14; accumulation of demand during 1QFY14 led to weakness in 2QFY14
Market share changes	The shift from the unorganised to the organsied segment has continued	The reported results suggest that players like Tanishq and TBZ gained market share over peers	No changes to the market share trends between the two quarters
Promotions and incentives	Most organised jewellers increased promotional offers in July and August both in terms of quantum as well as duration of these offers	Strong demand due to lower gold prices saw fewer promotions	Whilst organised players are offering promotions around discounts or making charges, 'Mom & Pop' shops are trying to attract customers through discount on gold prices
Conclusion	Overall, jewellery demand was weak (across both gold and diamonds), as most gold purchases were made last quarter	Sharp drop in gold prices led to strong sales of gold jewellery	Moderation in discretionary consumption, accumulation of jewellery purchases in the previous quarter and volatility of gold prices have all led to a YoY decline in jewellery demand

Source: Ambit Capital research

YoY decline in volumes during 2QFY14: Jewellery sales volumes and organised retail footfalls in the sector have seen significant weakness during the quarter driven by a combination of the following three factors:

- Customer demand was accumulated towards April and May 2013 when gold prices reduced by ~25%. Consequently, demand declined substantially in the subsequent three months when gold prices rose sharply (30% increase since May 2013). The jewellery sector is facing the brunt of the slowdown in discretionary spending.
- Overall discretionary spends in the consumer sector moderated, which was a result of high consumer inflation and a tough macroeconomic environment.
- 'Shrad' (a period when metal purchases by customers is deferred) which was a part of 3QFY13, predominantly became part of 2QFY14 due to a relatively early festive season this year.

Promotional activity accelerated substantially during the quarter: Given the uncertainty around RBI's circulars on gold imports, the industry has seen a substantial reduction in gold imports for the organised channel and a substantial increase in smuggled gold into India for the mom-and-pop retail channel. This resulted in the mom-and-pop retailers selling gold to customers at a 10-15% discount as compared to the organised retailers. In response to this, several organised jewellers, including Titan and TBZ, either put their merchandise on 15-20% discount offers or they were offering a 'zero making charge' on gold jewellery for several weeks during 2QFY14.

Market share changes: Given the superiority of their designs, organised jewellers continued to gain share from the unorganised sector during the quarter.

Diamond purchases have not replaced the moderation in gold either: Unlike 4QFY13, when high gold prices led to a shift in consumer preference towards diamond studded jewellery, the July-August period saw a reduction in demand for both gold as well as diamond studded merchandise. This has been due to a combination of: (a) INR depreciation which led to an increase in the prices of diamond; and (b) an overall weakness in luxury spends by customers during 2QFY14 as compared to 4QFY13.

Investment implications: We expect the organised players including Titan, TBZ and PC Jewellers to have seen a 0-5% decline in volumes and hence only a 10-15% YoY growth in value during 2QFY14.

"July was weak month. August when prices went down demand for bullion picked up but demand pick up for jewellery was moderate and not that good. September again, saw slowdown in customer demand."

– Jewellery wholesaler operating Pan-India

"Organised retailers are gaining market share from unorganised players albeit the market is not growing. However, in the organised market too, the regional organised players are growing much faster than pan-India organised players."

– Jewellery wholesaler operating pan-India

"We are not seeing any major shift in customers moving from gold to diamond because of the price rise in gold jewellery and also because prices of diamonds have also gone up due to the weakening INR. The studded segment is also facing a similar slowdown."

– Wholesaler in diamond jewellery

Watches

Exhibit 13: Summary findings for watches

Particulars	Jul/Aug'13 v/s Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY Volume Growth	**Mass/Fashion:** -10% to -5%, **Luxury/Premium:** 5% to 10%	**Mass/Fashion:** -5% to 0%, **Luxury/Premium:** 0% to 5%	2QFY14 saw a further deceleration in mass/fashion segment sales volumes and an acceleration in luxury/premium sales volumes.
Market Share Changes	Ethos has gained share from Helios in premium/luxury segment; no material changes elsewhere	No change	Premium/Luxury market is growing at a much faster pace as compared to the Mass/Fashion segment. As of now, Premium/Luxury watch demand has been unaffected by the economic slowdown.
Promotions and incentives	Discount for the season was lower than last year	Selective discounting in Mass segment watches	The discount period started in July this year (similar to last year) but the magnitude and duration of discounts were lower than last year. Traditionally substantial discounts are not offered in 1Q.
Conclusions	Value growth in Mass/Fashion: 5-10%; Luxury/Premium: 15-25%. Overall sentiment is weak, but luxury space seems to be unaffected	Macroeconomic factors led to a very modest growth in Mass/Premium segment	For, Mass/Premium, YoY volume declined in 2QFY14. Value growth was predominantly led by price increases of 5-10%. Premium/Luxury segment benefits from the large pocket size of its customers where the proportion of reduction in their discretionary spends is small as compared to the upper/middle class consumers.

Source: Ambit Capital research

Deceleration in mass/fashion watches: Demand for the Mass/Fashion watch segment has been adversely affected by the overall economic slowdown and sharp price increases (of at least 5-10% YoY). This segment includes watches ranging from ₹200-75,000. Volumes appear to have declined by 5-10% YoY during 2QFY14.

Luxury/Super-premium watches – robust demand: This segment includes watches priced at over ₹100,000. Speaking to store managers of MBOs (multi-brand outlets) selling luxury watches across India, it was evident that demand for luxury/premium watches continues to be robust at a volume growth of 10-15% YoY during the quarter, slightly better than that achieved in 1QFY14.

Market share changes: Titan (including brands such as Sonata, Fastrack and Titan) has held on to its share in the Mass/Fashion segment, whereas Helios is falling behind to keep pace with its benchmark market. The explanation from store managers suggests that Helios' stores are yet to find the optimal store location, visual merchandise and store size before it is ready to catch up with Ethos and similar MBOs selling luxury/premium watches in India.

"For the July-Sept period, either the discounts were low this year or the discount period was shorter. Conversion of footfalls has been lower for us this year also because we do not negotiate much on the price unlike the traditional dealers." – Store manager of a single brand watch retailer

Promotions and incentives: Store managers suggested that fewer discounts were given during July-August 2013 as compared to the same period last year. Whilst this included similar discount rates as compared to last year, the discount period was shorter in the current quarter as compared to last year.

Expecting price increases before October begins: Most of the small MBOs of mass/fashion watches have been conveyed by the companies that prices will be increased by 7-10% towards the end of September, which we believe is solely on account of the INR depreciation.

Investment implications: Titan is the only sizeable listed player in the watches segment. Although Titan is likely to have been able to protect its market share in the mass segment, a combination of weak macro demand, market share losses in the luxury/super-premium segment, and upcoming price increases given the INR depreciation does not bode well for the sales growth momentum of Titan's watch division.

Paints

Exhibit 14: Summary findings for paints

Particulars	Jul/Aug'13 v/s Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY Volume Growth	10-12%	5%	Recovery in July/August led by increased inventory with dealers prior to price increases; however, secondary sales remain moderate.
Market Share Changes	**Gain:** Asian Paints, Berger; **Loss:** Akzo Nobel, Kansai Nerolac	**Gain:** Asian Paints, Berger; **Lose:** Kansai Nerolac, Akzo Nobel	Whilst Asian Paints and Berger have continued to gain share, Akzo and Kansai suffer from a weak supply chain and narrow product range.
Promotions and incentives	Trade incentives for dealers increased during September	Usual dealer incentives and promotions	Given weak secondary sales, manufacturers have increased the extent of trade incentives offered to dealers during September.
Conclusions	Two price increases during the quarter led to 'channel stuffing' for dealers; September sales will be crucial as it marks the beginning of the festive season demand	Weak discretionary spending impacted overall consumption; industrial businesses were the worst affected	Volume growth rates for manufacturers have accelerated during the quarter. However, since this is related only to primary sales with no material improvement in secondary sales yet, a weak Diwali season could act as a substantial drag on sales growth rates for 3QFY14.

Source: Ambit Capital research

'Channel stuffing' led acceleration in primary sales growth: With price increases of up to 6% taken across products on 1 September 2013, dealers increased inventory levels on their shop floors during August 2013, thanks to the prior announcement of the September price increase. This led to strong double-digit volume sales growth for the manufacturers during July and August. As a large part of the growth was led by 'channel stuffing', September sales remain crucial as the benefits from the base effect would not be significant (2QFY13 industry volume growth was ~6%).

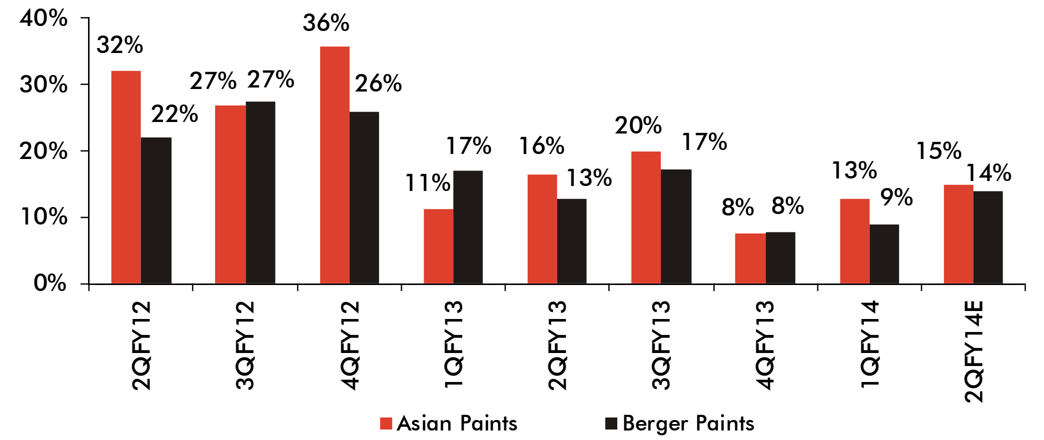
Secondary sales still remain weak: Whilst inventory levels on dealer's shop floors have increased substantially during July-August, secondary sales have remained weak during this period. Our discussions with paint dealers suggest that the sluggishness during July and August was led by: (a) weak construction activity; (b) seasonally weak demand during monsoons; and (c) poor discretionary consumer demand. However, dealers remained optimistic on the festive season and expect demand to pick up in the last two weeks of 2QFY14 since the festive season in 2013 is two weeks earlier than 2012. Also, manufacturers have increased their trade incentives/benefits to dealers to stimulate secondary sales growth during September.

"We had stocked up before the price increase, but are not seeing too many customers walk into the shop. With Diwali coming two weeks earlier this year, we hope the demand picks up soon."

– Paint dealer in Surat

Investment implications: We expect volume growth of 8-9% for the industry in 2QFY14 with high levels of inventory on dealers' shop floor currently. However, we expect Asian Paints and Berger Paints to record volume growth of more than **10%** driven by market share gains from Akzo Nobel and Kansai Nerolac during the quarter. This is likely to lead to revenue growth of 15% for Asian Paints and 14% for Berger during 2QFY14. Over the longer term, we expect Berger to lag Asian Paints in premiumisation of its product mix over the next few years primarily due to better scale economies around marketing and a more aggressive supply chain management strategy followed by Asian Paints. This justifies a premium rating for Asian Paints over Berger to the extent of 15-20% on P/E multiples. We view Asian Paints as fairly valued (our DCF fair value is ₹493) and we reiterate our SELL stance on Berger with 9% downside.

Exhibit 15: YoY growth in standalone quarterly sales



Source: Company, Ambit capital research

Kitchenware

Exhibit 16: Summary findings for kitchenware

Particulars	Jul/Aug'13 v/s Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY volume growth	4-5%	5%	Category growth rates have remained similar to what they were in 1QFY14.
Market share changes	**Gain:** TTK Prestige; **Loss:** Hawkins, Preethi (Phillips)	**Gain:** TTK Prestige; **Loss:** Hawkins	TTK Prestige has continued to gain share from Hawkins in the north (pressure cookers and non-stick cookware) and from Preethi in the south (mixer grinders).
Promotions and incentives	Trade incentives for dealers in September; modern retail discounts	Exchange offers for customers	No changes to promotional activity on a YoY basis.
Conclusion	Whilst the segment growth rates remained weak in 2QFY14, material divergence between the growth rates for Hawkins and TTK Prestige was seen due to market share changes	Pressure cooker volumes declined by 7% YoY; gas stove sales accelerated replacing induction cooktop growth rates; Non-stock cookware expanded at modest rates	Segment volume growth rates have continued to be moderate during 2QFY14. This moderation has been more pronounced for pressure cookers and induction cooktops and less so for non-stick cookware. Mixer grinders and gas-stoves have continued to grow strongly.

Source: Ambit Capital research

Segment growth rates remain weak: Store-level footfalls and hence segment volume growth has remained weak for the sector. The only possible temporary benefit for the industry is the likelihood of a shift in a part of the festive season sales from October to the last two weeks of September due to a relatively early Diwali this year as compared to last year. Volumes in the pressure cooker segment declined by 7% YoY in 1QFY14. We expect volume growth of 0-5% across categories including pressure cookers, induction cooktops and non-stick cookware, with volume growth of ~10% YoY for categories like gas stoves and mixer grinders.

Market share gains can be the largest driver of company-specific growth: TTK Prestige has continued to gain substantial share from Hawkins in non-south geographies, with the north region within non-south likely to have expanded by ~50% YoY. This growth in the non-south region has been predominantly led by: (a) increase in the number of outlets selling TTK Prestige's products; (b) stronger push of the company's products driven by the sales force; and (c) weaknesses of Hawkins around lack of a diverse portfolio of products across categories. In the south region, TTK Prestige has gained significant share from Preethi in mixer grinders. This has been driven by a relative lack of focus from Phillips on Preethi's largest strength traditionally i.e. after-sales service, on which TTK Prestige has been able to capitalise.

"Markets have been tough this year. But I have been able to grow at over 50% YoY YTD due to TTK Prestige's expansion in the number of outlets and market share gains in existing outlets. I have crossed my full month Sept'12 sales number by 15th Sept 2013 itself" - TTK Prestige's distributor in Gurgaon

Investment implications: TTK Prestige, Hawkins and Gandhimathi are the only three listed kitchenware manufacturers, and we expect substantial outperformance by TTK Prestige over the other two players around earnings growth for 2QFY14, driven largely by market share gains. In absolute terms, we expect revenue growth of 10-15% YoY for TTK, with gas stoves and mixer grinders being the fastest-growing product segments within the overall portfolio. However, it is worth highlighting that 3QFY14 is likely to be a weak quarter both for the sector as well as for the industry especially due to a strong base effect (delayed Diwali last year led to pent-up demand in 3QFY13) and full impact of currency depreciation being felt on raw material procurement during 3QFY14. Despite the near-term weakness in earnings growth momentum driven by a sluggish macro environment, we reiterate our BUY stance on TTK Prestige (22% upside), which is the fastest evolving kitchenware provider in India with strong growth across products, distribution channels and geographies.

Light Electricals

Exhibit 17: Summary findings for light electricals

Particulars	Jul/Aug'13 v/s Jul/Aug'12	1QFY14 (YoY growth)	Difference between our findings and 1QFY14 growth
YoY volume growth - **Electricals***	Declined by ~10% YoY	Growth of 13% YoY	Sales volumes have declined primarily due to lower sales during Onam given: (1) the extended monsoons and (2) demand getting impacted by price increases of 5-7% across categories given increase in raw material prices.
Market share changes	**Gain:** Bajaj, Crompton, Havells **Loss:** V-Guard, Preethi	**Gain:** Crompton, V-Guard, Bajaj **Loss:** Havells	Because of the Onam failure, south Indian companies like V-Guard and Preethi have lost market share. Bajaj Electricals has been taking market share given its aggressive ad spends and promotion spends. Havells and Crompton has gained market share given strong demand in north India as growth in the agriculture-dominated states like Punjab and Haryana has been strong.
Promotions and incentives	Given prices increases; companies had to offer freebies to push demand. Several companies offered schemes like buy a cook-ware free with Induction cooktop, etc.	On account of strong demand, companies did not materially increase promotions on a YoY basis.	Several companies including MNCs like Philips have taken two to three rounds of price increases to offset the impact of INR depreciation. Price increases including the one taken in 1Q have resulted in prices increasing by 10-12% YoY across several categories.
Conclusion	Post onset of monsoon and 5-7% increase in prices, volumes across categories have declined by ~10% after a growth of 13% in 1QFY14	The industry reported strong summer sales given strong summer in April and May; but volumes declined YoY in June due to early monsoons.	Whilst we expect volumes to decline by ~10% YoY in 2Q, we do not see equivalent decline in revenues given the price increases across product categories. Over the longer term, strong growth momentum is likely to continue given the increasing share of the middle class and rising share of the urban population.

*Source: Ambit Capital research; Note: *represents sales of V-Guard, Havells and Bajaj Electricals' consumer business*

Volume growth has declined YoY: Volumes across product categories increased by ~13% during the summer months of April and May. Several electrical companies ran out of stock, as they started the quarter with low inventory. Note that copper prices were extremely volatile in March which meant that companies stayed away from buying raw materials. Dealers across India suggested that volumes across categories have declined by ~10% YoY in June-August owing to higher prices and poor sales during Onam (given the extended monsoon). Bajaj Electricals, Crompton and Havells have increased market share at the expense of V-Guard and Preethi.

"Demand for inverters and UPS has been hit given lower power outages. However we believe this is only temporary. Once elections are done, we expect outages to increase."

- UPS/Inverter dealer in Tamil Nadu

Price increase of 5-7% owing to INR depreciation: According to our dealer checks, prices across categories have increased by 5-9% over the past two months on account of INR depreciation. Both domestic players like Bajaj, Havells, Crompton and V-Guard and MNC players like Philips have increased prices. Philips, in fact, has taken two rounds of price increases, which is very unusual for the company. We expect prices to stabilise at these levels assuming the INR stabilises at the current levels.

Promotional activity likely to pick up before Diwali: Companies did not resort to heavy promotions during the summer season owing to lower opening inventory and decent industry volume growth (13% YoY in April/May). However, dealers expect a pick-up in promotional activity (as compared to July and August) in the run up to the Diwali season to clear inventory given the sales failure during Onam (big festival season in south India which is ~35% of India's market). Several companies have started offering freebies such as cookware free with induction cooktop and return family tickets to Dubai (as many family members in south India work in Dubai).

Investment implications: We expect FY14 to be a tough year as demand is unlikely to improve given the price increases (of ~10%) across product categories. We do not expect prices to be cut in FY14, as there are limited signs of rupee appreciation, given the rising fiscal deficit. We expect margins to decline by ~150bps YoY in FY14, as companies have not completely passed on the increase in raw material costs to consumers. Also, rising promotion spends will dent margins, given sluggish demand and inventory pile up. We reiterate our high-conviction BUY stance on V-Guard and Bajaj Electricals with a target price of ₹593/share and ₹251/share using segment-wise DCF valuation, implying 22% and 54% upside respectively.

Our fair value of V-Guard and Bajaj Electricals implies 22% and 54% upside

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E&C = Engineering & Construction

Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	>5%
Sell	<5%

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