ICICI direct Research

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Changing operational dynamics, new trend emergence in consumption space…

The Indian consumer sector has been going through volatile times as the lockdown across the country, due to Covid-19, has disrupted the entire manufacturing, supply chain & retail operations. Though essential categories continue to see strong growth due to pre-buying or bulk buying, some discretionary categories witnessed a slack in demand conditions. New trends have also emerged with sanitisers, disinfectants & immunity booster products staring at exponential growth in next few years. Even distribution channels have been seeing a swift change with e-commerce & digital space gaining prominence. Product companies have been tying up with food delivery aggregators to directly reach out to consumers.

Key observations from managements & distributors interaction

In our post result discussions with management and distributors of consumer companies (FMCG, paints, consumer durables, retailers, multiplexes), we observed certain trends & their impact on consumer sector.

FMCG

- Manufacturing & supply chain operations of FMCG companies were halted for 20-25 days in the first phase of the lockdown with only essential being allowed to manufacture. Lockdown relaxation started on April 20 with steady opening up of manufacturing & distribution. The regulation was distinguished zone wise (red, orange and green). Non-essential manufacturing started with 33% capacity & social distancing norms. Currently, operations are still at ~75-80% of last year's capacity
- Most companies are largely fulfilling high demand for essentials. Some categories where demand remained intact/increased are soaps, atta, rice, edible oil, milk based products, biscuits, tea, packaged foods (noodles). However, discretionary categories like skin care, cosmetics, hair oils, ice creams, carbonated drinks, juices are seeing a dismal demand environment. Companies are realigning their manufacturing to produce more of essential & higher demand products
- Carbonated drinks took a massive hit in April with ~50% reduction in volumes as restaurants & cafes remained closed. Notably, 40-45% of their sales are generated in the June quarter
- Packaged foods (specifically noodles, biscuits, oats) sales have seen strong growth as 'out of home' consumption is completely halted. On the contrary ultra-high temperature (UHT) milk demand has been impacted with visible signs of down-trading
- Saloon based categories like hair colour, skin care products have seen significant sales decline. Moreover, these categories would bear the brunt for prolonged period as saloons would take much longer to reopen
- Companies are facing challenges in increasing production with unavailability of labour at various levels of supply chain. Inventory at trade, which used to be 10-20 days, has dried up completely and they are currently holding two to three days inventory. Companies believe a complete lifting of lockdown would lead to smooth re-stocking of the trade channel to previous levels

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- Most FMCG companies have started rationalising media spend with television commercials (TVC) increasing on news, kids and Doordarshan and substantially reducing on general entertainment channels (GEC). Even digital platforms are being used more effectively with similar eyeballs and lower spends
- Sanitisers & disinfectants are witnessing exponential growth. All FMCG companies have forayed into the sanitisers & disinfectant category (introduction of more than 400 brands) with a massive demand surge in the last two months. The category can see ~₹ 2000-2500 crore sales in the next three to four years. Further, many companies have launched veggie clean products, which could also grow as one of the sub-categories in the sanitiser space
- Some of the other categories that have seen increased demand in the last two months are immunity booster products like Chyawanprash and honey
- With the distress at rural income levels and migrants returning to villages, downtrading to value brands & low unit pack (LUP) would be imminent. However, pantry & urban general trade is witnessing higher demand for larger & bulk packs with consumers preferring less frequent visits to retail stores
- E-commerce channels are witnessing significant growth with urban general trade still slacking on concerns over lack of social distancing. Wholesalers are still struggling to return to pre-lockdown sales levels given the extended lockdown aggravated liquidity issues
- Some FMCG companies have extended credit to distributors, specifically at the initial phase of the lockdown. However, distributors have completely stopped any credit to retailers (that used to be ~10 days earlier) mainly due to uncertainty over sustainability of smaller business
- We also heard of a trend where distributors in rural areas are pooling resources (trucks and tempos) due to reduced availability of truckers and drivers
- With a sharp decline in crude based commodity prices, packaging cost for FMCG companies is likely to decline significantly. This should improve gross margins, going forward
- FMCG companies have deferred/halted any expansion plans except in categories where growth is exponential (sanitisers, disinfectants, immunity booster products)

Consumer durable & paints

- Business activities for consumer durable companies started from the first week of May 2020 with various government restrictions. While ~80% of districts witnessed good secondary sales of domestic appliances post relaxation from lockdown, 20% of districts (includes metro cities) started operations with strict government norms and are still facing demand challenges. Total 20% of districts contribute a good chunk of annual turnover (~40%) and also help drive sales of the premium product category
- With distressed income level, the home appliances category is likely to witness downtrading in the medium term. The last two weeks of May 2020 witnessed strong demand traction of lower ticket electrical appliances. Small appliances companies witnessed pent up demand of fans after the lockdown was relaxed in early May
- AC companies have missed the peak season sales for AC (April-June contributes ~40% of annual turnover). The industry has inventory level of 75 days (higher than normalised inventory of 50 days).

However, secondary sales of cooling products inched up in the last two weeks of May 2020 supported by favourable weather and good discounts offerings. Companies expect good festive demand and inventory build-up in February (for the next season) to help recovery in H1FY21

- The supply issues (of compressor, PCBs) from China have normalised and FMEG companies have enough inventory to serve any sudden spike in sales post relaxation from lockdown
- Companies in the white goods space witnessed increased inquiry for TVs, washing machines, refrigerators and dish washers during the lockdown period. In the first two days of opening up of consumer durable and electronic stores in Kerala, footfalls at the store were similar to any liquor shop
- Post relaxation from the lockdown, air cooler sales by the trade channel have been robust aided by soaring temperatures and a delayed summer. The companies believe if the present trend continues for a few more weeks, the channel inventory would be at acceptable levels by the end of summer. However, labour shortage issues are going to affect production in the near term
- According to paint companies, industry works with ~70% of local painters. Hence, migration of 30% painters would have a bearing only for a few months given migrants are likely to return to cities as soon as the situation normalises. Paints and piping companies are expected to see a good demand recovery in H2FY21 (which contributes ~55% of sales). However, Q1FY21 is likely to be a near washout quarter
- Consumer durables as well as paints companies would benefit from a sharp decline in crude based raw material cost. The benefit is expected to percolate down in FY22E with expectation of benign crude prices for a prolonged period

Retailers

- In the retail space, companies are re-negotiating rentals from fixed to variable model. Further, during the lockdown period, many retailers invoked 'force majeure' clause, which absolves them from paying rentals during pandemic
- Apparel retailer are saddled with spring summer season inventory. They are expected to sell it in the next season (autumn-winter). This would lead to cash release from working capital. However, post reopening of stores in some states, pent up demand has been visible across product categories with higher average customer basket value
- Owing to store closures due to Covid-19, retailers have seen a sales decline of 40-60% in March while April sales decline has been steeper due to complete closure of store and marginal revenue generation through digital channels. Most retailers have been able to open around 30-35% of stores. With the lockdown relaxation in certain states, the stores have seen pent up demand with increase in customer basket value
- Retailers are looking to curtail advertisement spend, travel/meeting expense and other such discretionary spends. Retailers are negotiating with landlords/malls to move to variable rent to mitigate the cost impact of lower sales. They have deferred store expansion plans and capex could be lower by 60-70% in FY21 to preserve cash

- There is a definite trend of companies planning to focus on digital channels of distribution like e-commerce/socio commerce. Companies are likely to spend on enhancing technology backbone for their e-commerce platforms. Tie ups with major marketplaces are also likely to increase further
- Maintaining adequate inventory would be key. The companies are trying to move from two to three seasons to monthly refresh of product portfolios with limited inventory. This provides higher freshness of products to customers and lowers inventory holding cost for retailers. Customer sentiment to reduce spends on discretionary items is likely to impact demand for products including watches, jewellery, perfumes and accessories
- Akshaya Tritiya, which is the second most important period for the jewellery sector after Dhanteras was a total washout with only 5-10% revenues generated through online platforms. Wedding jewellery, which is a more stable category than adornment jewellery, has also been negatively impacted by postponement of marriages. The industry expects H1FY20 to be an extremely weak revenue period with demand expected to pick up only in H2FY20
- Most jewellery retailers are enhancing their online presence and engaging with customers through digital communication. The demand for buying online has emanated from key metro cities and the response in tier II/III towns have also been encouraging. Furthermore, average ticket size was spurred 2.5-3.0x compared to the usual online average, implying new customers have come online

Media

- For multiplexes, Q1FY21E will be a washout as theatres remain shut since mid-March. The management indicated invoking force majeure. Pay cuts led to a reduction of ~45% in fixed costs like rent, common area maintenance, etc. Companies are confident of enough liquidity to survive prolonged lockdown. Industry expects theatres to open by July end-August
- For broadcasters, the major segment to be hit was advertisement (industry body pegging ad volume loss of ~35% during the lockdown coupled with some pricing downgrade) given the respective client business challenges and further aggravated no fresh GEC content inventory due to lockout
- The worst hit segment, in terms of ad volume loss, was sports with IPL postponement, followed by GEC where lack of fresh content meant ad volumes/pricing suffered. News was the only key segment, which showed some resilience, albeit pricing there remains lower, given the lack of special events

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