

October 10, 2022

Price cuts on the cards with sharp dip in commodities

Despite a sharp correction in many edible oil, crude & related commodities, FMCG companies have not taken any major price cuts during the quarter given most companies were holding high cost raw material inventory. The industry would continue to witness price led revenue growth in Q2FY23. We estimate our FMCG coverage universe revenue growth of 15.8% (ex-ITC 11%) largely driven by pricing growth. ITC is expected to continue to witness strong growth across segments considering lower sales in the base quarter of cigarettes, hotels & agri business. We estimate 10% volume growth in cigarette business along with better product mix.

HUL, Nestlé, Tata Consumer & Zydus Wellness are estimated to report double digit revenue growth largely contributed by prices hikes taken in last one year. Volume growth is expected to remain in the range of 3-6% for these companies. Dabur is expected to post mid-single digit sales growth led by strong growth in international business. The company's healthcare segment (Chyawanprash, Honey) are likely to continue to clock muted sales on a high base. Marico is also expected to continue to see dismal sales growth given saturated hair oil segment continue to see lacklustre growth. Moreover, extreme inflation in vegetable oil has derailed volumes of Saffola. However, with a sharp correction in edible oil prices, volume is likely to pick up in H2FY23. Colgate is expected to witness mid-single digit sales growth led by pricing growth. Volume growth has been absent for the company in the last few quarters given a presence in highly penetrated oral care category. Though high inflation has slowed down rural consumption in the last few quarters, we expect a dip in commodity inflation along with stronger agri growth to help the FMCG industry in regaining volumes. We also believe new product launches would accelerate given companies are expected to increase ad-spends with the dip in major commodity prices.

Crude, palm oil down; to reflect in margin from Q3 onwards

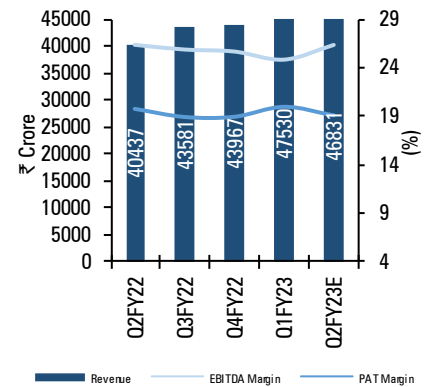
Palm oil prices have declined 50% from the peak in May 2022. Further, crude prices are down 27% from the peak in June 2022. The dip in two major commodities has reflected in prices of derivatives & related commodities in the last few months. Though most FMCG companies were holding high cost inventory, we believe benefit of cooling down of commodity costs would reflect in margin improvement from Q3FY23 onwards. We expect 40-200 bps operating margin contraction for HUL, Dabur, Colgate, Nestlé & Zydus Wellness. On the other hand, benefits of lower copra & tea prices are waning. We expect a slight improvement in operating margins for Marico (13 bps up) & Tata Consumer (70 bps up). We estimate net profit growth of 11.8% for our FMCG coverage universe. We believe a correction in commodity prices would not only help companies to cut prices but also support higher ad-spends to propel volumes, going forward.

Exhibit 1: Estimates for Q2FY23E: (FMCG)

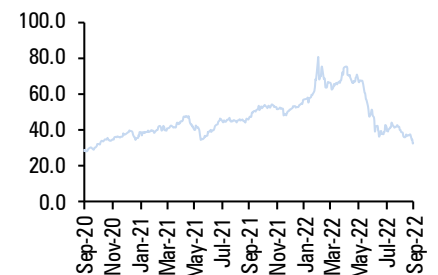
| Company | Revenue | | | EBITDA | | | PAT | | |
|-------------------|-----------------|-------------|-------------|-----------------|-------------|------------|----------------|-------------|-------------|
| | Q2FY23E | YoY | QoQ | Q2FY23E | YoY | QoQ | Q2FY23E | YoY | QoQ |
| Colgate Palmolive | 1,427.9 | 5.6 | 19.3 | 411.4 | 2.7 | 26.3 | 277.8 | 3.2 | -76.6 |
| Dabur India Ltd | 3,031.0 | 7.6 | 7.4 | 616.5 | -0.7 | 13.4 | 495.2 | -2.0 | 12.3 |
| HUL | 14,436.4 | 13.5 | 1.2 | 3,466.1 | 10.7 | 6.7 | 2,446.8 | 11.9 | 6.9 |
| ITC | 16,986.6 | 25.3 | -7.3 | 5,811.0 | 25.9 | 2.9 | 4,280.6 | 15.8 | 2.7 |
| Marico Ltd | 2,499.9 | 3.3 | -2.3 | 440.4 | 4.1 | -16.6 | 308.8 | -2.3 | -18.1 |
| Nestle India | 4,314.5 | 11.1 | 6.9 | 994.0 | 4.8 | 21.3 | 640.7 | 3.7 | 24.3 |
| Tata Consumer | 3,384.0 | 11.6 | 1.7 | 485.0 | 17.4 | 6.1 | 359.3 | 25.7 | 29.9 |
| VST Industries | 321.4 | 18.5 | 7.0 | 116.9 | 12.0 | 3.5 | 89.6 | 12.1 | 2.8 |
| Zydus Wellness | 429.1 | 11.8 | -38.4 | 32.3 | 5.8 | -78.2 | 25.0 | 18.4 | -81.8 |
| Total | 46,830.6 | 15.8 | -1.5 | 12,373.6 | 15.8 | 4.6 | 8,923.8 | 11.8 | -5.9 |

Source: Company, ICICI Direct Research

Topline & Profitability (Coverage Universe)



Palm oil prices trend (MYR/tonne)



* MYR – Malaysian Ringgit

Operating margins FMCG Coverage (%)

| Company | EBITDA Margin % | | | | |
|-------------------|-----------------|-------------|-------------|-------------|-------------|
| | Q2'22 | Q3'22 | Q4'22 | Q1'23 | Q2'23E |
| Colagte | 29.6 | 29.7 | 33.0 | 27.2 | 28.8 |
| Dabur | 22.0 | 26.9 | 18.0 | 19.3 | 20.3 |
| HUL | 24.6 | 25.0 | 24.1 | 22.8 | 24.0 |
| ITC | 34.1 | 30.4 | 31.8 | 30.8 | 34.2 |
| Marico | 17.5 | 17.9 | 16.0 | 20.6 | 17.6 |
| Nestle | 24.4 | 23.2 | 23.2 | 20.3 | 23.0 |
| Tata Cons. | 13.6 | 14.4 | 14.0 | 13.7 | 14.3 |
| VST Ind. | 38.5 | 33.2 | 35.1 | 37.6 | 36.4 |
| Zydus Welln | 8.0 | 13.0 | 22.1 | 21.3 | 7.5 |
| FMCG Total | 26.4 | 25.9 | 25.7 | 24.9 | 26.4 |

Top Picks

Tata Consumer Products
ITC
Dabur

Research Analysts

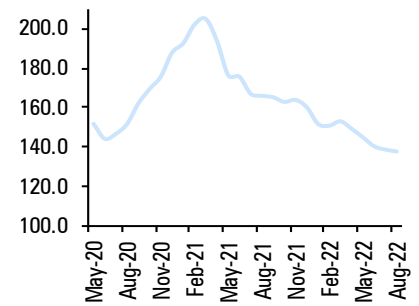
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Exhibit 2: Company Specific Views (FMCG)

| Company | Remarks |
|--------------|--|
| Colgate | Colgate is expected to post revenue growth of 5.6% entirely led by price hikes. We believe dismal demand conditions in rural regions have taken a toll on volume growth. The impact of easing of commodity inflation on volumes as well as margins would be reflected from Q3FY23 onwards. We estimate gross margin contraction of 167 bps on account of utilisation of high price raw material inventory. With some savings in employee & marketing spends, operating margins are likely to contract by 82 bps to 28.8%. We estimate net profit growth of 3.2% to ₹ 277.8 crore |
| Dabur | Dabur is likely to report 7.6% revenue growth led by 11.8% growth in international business and 6.2% growth in domestic business. High cost of raw material inventory would continue to adversely impact gross margin. We estimate 226 bps contraction in gross margins. Food & beverage business is expected to grow in double digit even on a high base whereas home & personal care product products are estimated to grow in mid-single digits on a relatively high base. However, healthcare segment, which includes Chyawanprash & Honey would see muted sales on a high base. We expect 169 bps contraction in operating margins with lower ad-spend as percentage to sales. We estimate net profit to de-grow by 2% to ₹ 495.2 crore |
| HUL | We expect HUL to witness 13.5% revenue growth with 26.3% growth in home care, 6.9% growth in beauty & personal care and 4.2% growth in the foods business. Given the company has taken ~10% price hike in the last one year, volume growth is likely to be 3% Considering, most FMCG companies were holding high cost raw material inventory during Q2, gross margin is expected to contract by 250 bps. With cost cutting measures & lower marketing spends, operating margin is expected to dip by 62 bps. We estimate net profit growth of 11.9% to ₹ 2446.8 crore. We believe easing of commodity inflation would reflect in terms of volume & margin recovery in H2FY23 |
| ITC | ITC is likely to continue to report strong numbers with 25.3% revenue growth. We estimate cigarette business sales of 16.9% led by strong volumes as well as better product mix. We estimate 10% volume growth during the quarter. We expect 10.7% sales growth in FMCG largely led by prices, improved product mix and higher contribution of stationary brands. Paperboard business is expected to continue to grow at higher pace of 22.1% led by pricing growth. Though agri business may de-grow significantly sequentially due to highest even agri commodity export in Q1, we expect 58% YoY growth in agri business due to low base last year. Hotel business is also expected to grow 98.4% on low base quarter sales. Hotel business is expected to see robust occupancy levels with higher ARRs. We estimate 25.9% growth in operating profit. Net profit is estimated to grow by 15.8% to ₹ 4280.6 crore |
| Marico | We anticipate Marico will post muted sales growth of 3.3% on the back of 1.2% India business sales growth & 11.3% international business sales growth. Hair oils brands under Parachute & VAHO are expected to continue to post dismal volumes. Saffola is likely to post mid-single digit volume growth with some correction in vegetable oil prices. Foods business is also expected to continue to grow at a robust pace of above 20%. We estimate gross margin expansion of 74 bps with benign copra prices and correction in vegetable oil prices. The company has passed on the benefit of cut in commodity inflation in terms of price cuts. Ad-spend is likely to go up by 58 bps as percentage to sales to 8.6%. Operating margin is expected to inch up by small 13 bps to 17.6%. With higher income tax provisioning, net profit may dip by 2.3% to ₹ 308.8 crore |
| Nestlé India | Nestlé is estimated to witness sales growth of 11.1% led by both volumes as well as pricing. Despite high inflation in raw material, foods segment is expected to witness volume growth. Though milk prices have remained high, edible oil, crude & other related costs have come down considerably. We believe a dip in commodity prices would reflect in margins from Q3FY23 onwards. We estimate gross margin contraction of 169 bps & operating margin contraction of 139 bps. Net profit is expected to grow 3.7% to ₹ 640.7 crore |

Source: Company, ICICI Direct Research

Copra Price Trend (₹/kg)



Crude Price Trend (USD / barrel)

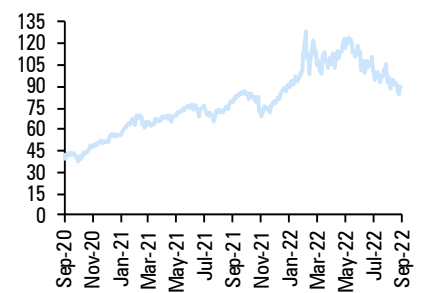


Exhibit 3: Company Specific Views (FMCG)

| Company | Remarks |
|----------------------|---|
| Tata Consumer (TCPL) | <p>TCPL is estimated to see revenue growth of 11.6%. We expect India beverage & International beverage business to witness a sales growth of 6% & 5.3% respectively. With strong pricing growth, India foods business is likely to witness 22.1% revenue growth during the quarter. We estimate mere 22 bps gross margin expansion given tea prices have slightly inched up in 2022-23 season. With small benefits of lower fixed costs, operating margins is expected to expand by 71 bps to 14.3%. We estimate 50% jump in profit from associates given seasonal profitability for plantation & Starbucks turning profitable at operating level. Net profit is expected to jump by 25.7% to ₹ 359.3 crore</p> |
| VST Industries | <p>VST Industries is likely to witness sales growth of 18.5% with sustainable cigarette volumes after two years of disruption. Further tobacco export is also likely to recover after increased availability of containers. We estimate gross margin contraction of 213 bps due to higher sales of tobacco. Operating margins is likely to contract by similar 209 bps to 36.3%. We estimate net profit growth of 12.1% to ₹ 89.6 crore</p> |
| Zydus Wellness | <p>Zydus Wellness is expected to see revenue growth of 11.8% led by 7% pricing growth & 5% volume growth. We expect 113 bps gross margin contraction given milk prices still remain at higher levels. We believe the company would maintain its ad-spend at 12.5% of sales. Lower employee & other fixed overheads are likely to offset gross margin contraction. Operating profit is expected to grow 5.8% while operating margin is estimated to contract by 43 bps. The interest cost reduction is likely to result in net profit growth of 18.4% to ₹ 25 crore</p> |

Source: Company, ICICI Direct Research

Exhibit 4 : ICICI Direct coverage universe (FMCG)

| | CMP | TP | Rating | M Cap | EPS (₹) | | | P/E (x) | | | Price/Sales (x) | | | RoCE (%) | | | RoE (%) | | |
|------------------------------|--------|--------|--------|----------|---------|-------|-------|---------|-------|-------|-----------------|-------|-------|----------|-------|-------|---------|-------|-------|
| | (₹) | (₹) | | (₹ Cr) | FY22E | FY23E | FY24E | FY22E | FY23E | FY24E | FY22E | FY23E | FY24E | FY22E | FY23E | FY24E | FY22E | FY23E | FY24E |
| Colgate (COLPAL) | 1,581 | 1,690 | Hold | 42,548 | 39.6 | 40.6 | 44.4 | 39.9 | 39.0 | 35.6 | 8.4 | 7.8 | 7.2 | 77.8 | 84.1 | 91.2 | 62.2 | 64.1 | 69.6 |
| Dabur India (DABIND) | 540 | 700 | Buy | 1,01,458 | 9.9 | 11.2 | 12.8 | 54.8 | 48.3 | 42.1 | 9.3 | 8.3 | 7.5 | 24.9 | 25.2 | 26.7 | 20.8 | 21.9 | 22.7 |
| Hindustan Unilever (HINLEV) | 2,600 | 2,700 | Hold | 6,10,844 | 37.5 | 40.9 | 44.8 | 69.3 | 63.6 | 58.0 | 12.1 | 10.8 | 10.1 | 20.2 | 22.5 | 24.6 | 18.1 | 19.7 | 21.5 |
| ITC Limited (ITC) | 334 | 360 | Buy | 3,78,047 | 12.4 | 14.2 | 16.4 | 27.0 | 23.5 | 20.4 | 6.4 | 5.4 | 5.1 | 31.4 | 35.2 | 38.3 | 24.5 | 27.0 | 29.4 |
| Jyothy Lab (JYOLAB) | 196 | 145 | Hold | 6,077 | 4.3 | 5.6 | 6.4 | 46.2 | 35.1 | 30.9 | 2.8 | 2.5 | 2.3 | 18.7 | 24.2 | 27.7 | 16.6 | 21.2 | 23.8 |
| Marico (MARLIM) | 521 | 515 | Hold | 67,645 | 9.7 | 10.3 | 11.4 | 53.6 | 50.6 | 45.7 | 7.1 | 7.0 | 6.4 | 41.2 | 43.8 | 47.0 | 37.5 | 38.5 | 41.2 |
| Nestle (NESIND) | 19,321 | 21,600 | Hold | 1,84,201 | 222.4 | 238.3 | 294.0 | 86.9 | 81.1 | 65.7 | 12.6 | 11.2 | 10.2 | 58.7 | 57.0 | 64.7 | 111.3 | 111.1 | 118.3 |
| Patanjali Foods (RUCSOY) | 1,401 | 1,750 | Buy | 50,721 | 27.3 | 30.9 | 43.5 | 51.4 | 45.3 | 32.3 | 2.1 | 1.7 | 1.5 | 13.2 | 15.6 | 17.3 | 13.1 | 11.3 | 14.2 |
| Tata Consumer Products (TAT) | 781 | 950 | Buy | 71,261 | 11.0 | 14.5 | 17.4 | 70.9 | 53.9 | 45.0 | 5.7 | 5.1 | 4.6 | 8.4 | 9.8 | 11.2 | 7.0 | 8.5 | 9.8 |
| Varun Beverage (VARBEV) | 1,135 | 1,100 | Buy | 60,171 | 17.2 | 20.6 | 23.4 | 65.9 | 55.2 | 48.6 | 6.8 | 4.9 | 4.3 | 17.1 | 28.1 | 30.8 | 18.3 | 26.3 | 25.3 |
| VST Industries (VSTIND) | 3,348 | 3,425 | Hold | 4,937 | 207.4 | 229.3 | 252.9 | 16.1 | 14.6 | 13.2 | 4.2 | 3.8 | 3.5 | 39.2 | 44.6 | 50.6 | 30.0 | 33.4 | 37.8 |
| Zydus Wellness (ZYDWEL) | 1,741 | 2,100 | Buy | 10,254 | 48.5 | 57.5 | 71.0 | 35.9 | 30.3 | 24.5 | 5.1 | 4.5 | 4.1 | 6.1 | 7.1 | 8.4 | 6.4 | 7.3 | 8.7 |

Source: Company, ICICI Direct Research

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Reduce: -15% to -5%;

Sell: < -15%



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