January 10, 2022

Growth slows down on high base...

FMCG companies are expected to witness slower revenue growth in Q3FY22 with high base quarter sales & adverse impact of commodity inflation on volumes in key categories. The FMCG companies have taken price hikes to the tune of 5-15% in the last six months to pass on high commodity inflation. Further, volume growth is likely to remain flattish for most FMCG companies given base quarter saw pent up demand in discretionary categories. Our FMCG coverage universe is likely to witness revenue growth of 8.3% largely led by pricing growth. The double digit revenue growth in HUL & Marico is estimated to be led by price hikes taken in last two quarters with flat volumes. Dabur, Nestlé, Zydus & Colgate is likely to witness revenue growth mix of volumes & prices. The volume growth in these companies is driven by new products development, rural distribution expansion & capacity enhancement. We believe discretionary categories would have witnessed stronger growth with the normalisation of 'out of home' & 'On-the-go' consumption and some of the essential categories would have seen much slower growth. However, long term trend of unorganised to organised & loose to branded products in foods categories continues. With softening of tea procurement prices, Tata Consumer Products is likely to witness low single digit growth. Its international beverage business is expected to de-grow due to high base effect. Within cigarette space, ITC has become aggressive & likely to gain market share. We expect 5% volume growth for ITC & flat volumes for VST industries. In the last two years, e-commerce channels sales have increased from ~2% to ~9% for FMCG companies. Now these companies are enhancing their digital capability to grow in direct to consumer sales. Disagreements with distributors over trade margins at the end of December may have led to the increase in trade inventories albeit with limited impact for the quarter.

Elevated RM prices continue to pressurise gross margins

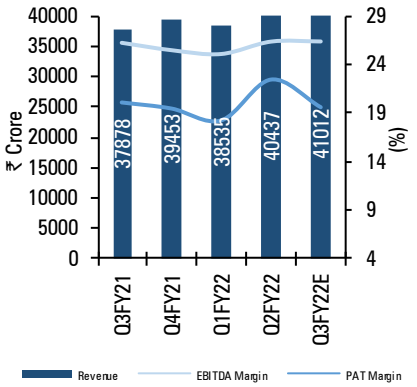
Though crude, vegetable oil, palm oil & milk prices have shown some signs of cooling off in December due to import/custom duty reduction, these prices have remained elevated for most part of the quarter. Moreover, it is difficult to call out at this time that commodity inflation has peaked out. We believe high commodity inflation would result in 200-400 bps contraction in gross margins for FMCG companies. However, marketing spends always give a leeway to these companies to protect operating margins. We estimate flat operating margins for our coverage universe. Nestlé, Marico, Colgate, Zydus is expected to see 50-200 bps contraction in operating margins whereas softening of tea prices is likely to expand operating margins by 222 bps for Tata consumer products. We estimate lower advertisement spends for HUL and hence, a small uptick in operating margins. We expect net profit growth of 5.7% for our coverage universe in Q3FY22

Exhibit 1: Estimates for Q3FY22E: (FMCG) (₹ crore)

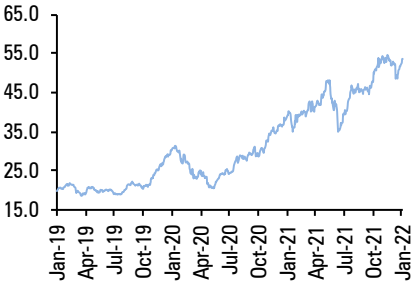
Company	Revenue	Change (%)		EBITDA	Change (%)		PAT	Change (%)	
	Q3FY22E	YoY	QoQ	Q3FY22E	YoY	QoQ	Q3FY22E	YoY	QoQ
Colgate Palmolive	1,327.7	7.8	-1.8	386.2	4.2	-3.6	254.2	2.4	-81.1
Dabur India Ltd	2,978.9	9.2	5.7	621.6	8.3	0.1	480.8	-2.6	-4.8
HUL	13,123.0	10.6	3.1	3,209.9	12.5	2.5	2,276.8	18.5	4.1
ITC	13,623.1	6.7	0.5	4,789.8	7.3	3.8	3,805.6	-1.0	2.9
Marico Ltd	2,366.7	11.5	-2.2	418.1	1.3	0.0	309.3	-0.8	-2.1
Nestle India	3,707.4	8.0	-4.5	812.1	4.5	-14.4	500.4	3.5	-19.0
Tata Consumer	3,168.6	3.2	4.5	443.2	22.7	7.2	301.0	26.8	5.3
VST Industries	290.3	1.3	7.0	111.1	11.1	6.5	85.0	15.4	6.5
Zydus Wellness	426.0	11.6	11.0	48.9	-1.3	60.0	37.0	NC	75.6
Total	**41,011.6**	**8.3**	**1.4**	**10,840.9**	**8.8**	**1.5**	**8,050.2**	**5.7**	**-11.1**

Source: Company, ICICI Direct Research

Topline & Profitability (Coverage Universe)



Surge in palm oil prices (₹/kg)



Operating margins FMCG Coverage (%)

Company	EBITDA margin %				
	Q3'21	Q4'21	Q1'22	Q2'22	Q3'22E
Colagte	30.1	32.9	30.5	29.6	29.1
Dabur	21.0	18.9	21.1	22.0	20.9
HUL	24.1	24.4	23.9	24.6	24.5
ITC	35.0	31.6	30.8	34.1	35.2
Marico	19.4	15.9	19.0	17.3	17.7
Nestle	22.6	25.8	24.4	24.4	21.9
Tata Cons.	11.8	9.9	13.3	13.6	14.0
VST Ind.	34.8	35.3	33.4	38.5	38.3
Zydus Wellne	13.0	24.0	23.5	8.0	11.5
FMCG Total	**26.3**	**25.6**	**25.2**	**26.4**	**26.4**

Top Picks

Dabur
Tata Consumer Products

Research Analysts

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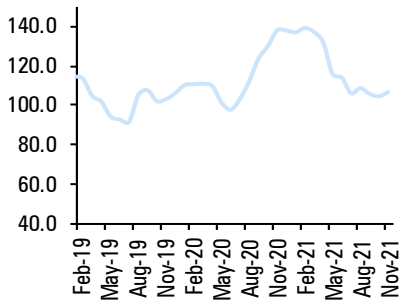
Exhibit 2: Company Specific Views (FMCG)

Company	Remarks
Colgate	Colgate is expected to register revenue growth of 7.8% led by mix of volume & pricing growth. Given the oral care category penetration levels have been closer to 90%, Colgate's revenues are growing at a mid-single digit contributed by naturals & ayurvedic product portfolio. Though key raw material prices like sorbitol & calcium carbonates have not seen any sharp increase in last two years, crude based packaging cost is likely to keep gross margins under pressure. We expect 324 bps contraction in gross margins. Considering savings in marketing spend would help in restricting the operating margins dip to 100 bps. Net profit is expected to post 2.4% growth to ₹ 254.2 crore
Dabur	We estimate Dabur will register 9.2% revenue growth on a high base in the corresponding quarter. The growth would be contributed by mix of volumes & prices given the company has taken ~5% price increase in last six months to pass on increase in commodity costs. We expected 210 bps dip in gross margin on the back of high crude based commodities. However, savings in overhead & marketing spends is expected to protect operating margins at 20.9%. Considering the completion of tax benefits in some facilities, income tax rate is expected to increase from 16% to 24%. Net profit is expected to decline 2.6% to ₹ 480.8 crore
HUL	HUL is expected to witness 10.6% revenue growth largely led by price hikes taken in home care & beauty & personal care category (BPC). We estimate home care, BPC & foods business will see 11.8%, 9% & 6.9% sales growth respectively during the quarter. With continuous increase in key raw material prices (palm oil, crude based packaging costs), we expect 202 bps contraction in gross margins. However, tea prices have softened considerably during the quarter. We estimate 170 bps & 53 bps dip in marketing & overhead spends in Q3, which would keep the operating margins at 24.5% (40 bps higher). Operating profit growth of 12.5% & sharp increase in other income would drive net profit to grow at 18.5%
ITC	ITC is likely to see revenue growth of 6.7% on the back of recovery in hotels, paperboard business. Moreover, cigarette volumes are expected to see ~5% volume growth on the back of normalisation of out of home activity. We estimate cigarette, FMCG business to witness 5.4% & 10.6% sales growth, respectively, during the quarter. Agri & paperboard business is likely to witness 16.5% & 23.3% sales growth, respectively. We estimate hotels business to register 41.3% revenue growth with normalisation of occupancies to the pre-Covid levels. However, ARRs are still below pre-Covid levels. We estimate 7.3% growth in operating profit with flattish operating margins. Net profit is likely to decline 1% on the back of lower other income
Marico	With the high commodity inflation in vegetable oil, crude based packaging cost, Marico is expected to see flat volumes during the quarter. However, aggressive price hikes taken in previous quarter would lead to the double digit revenue growth during the quarter. Parachute & VAHO sales is likely to remain subdued on the back of high base & Saffola edible oil business is likely to witness volume dip with reduced 'at-home' consumption & high commodity inflation. However, foods business would continue to see more than 20% growth during the quarter. We estimate 353 bps contraction in gross margins during the quarter. Considering overhead & marketing spend savings, we estimate 178 bps dip in operating margins
Nestlé India	Nestlé India is likely to witness 8% revenue growth during the quarter with the sustainable penetration led demand for Maggi, chocolate & coffee segments. Further, new product launches, commissioning of Sanand facility & enhancement in rural distribution network is likely to aid growth during the quarter. Milk prices have remained at an elevated level from last six to eight months. We estimate 373 bps contraction in gross margins. Considering savings in overhead & employee spends, we expect operating margins dip is restricted to 73 bps during the quarter. Net profit is likely to witness 3.5% growth during the quarter

Source: Company, ICICI Direct Research

Copra Price Trend (₹/kg)



Crude Price Trend (US$/barrel)

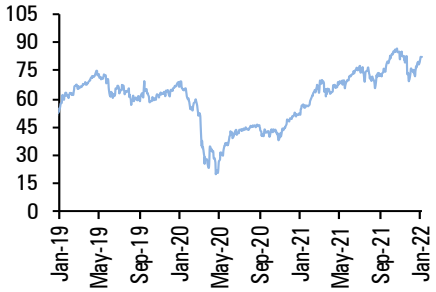


Exhibit 3: Company Specific Views (FMCG)

Company	Remarks
Tata Consumer (TCPL)	We expect slower 3.2% revenue growth during the quarter for TCPL on a high base. Given tea prices have cooled off considerably, the company would have passed on the benefit of dip in commodity prices during the quarter. Further international business is likely to de-grow 12% on a high base. We estimate 3.7% revenue growth in India beverage business & 16.2% revenue growth in India food business in Q3. With the significant decline in tea procurement prices, gross margin is expected to expand 480 bps. The higher gross margins would give leeway to the company to push new products & premiumisation trend through high spend on marketing. We estimate 222 bps improvement in operating margins. Net profit is likely to grow by 26.8% during the quarter
VST Industries	VST industries is expected to witness slower 1.3% revenue growth during the quarter. The slower growth is likely to remain impacted by decline in tobacco exports due to high container prices. Moreover, lower trade offers & extensive competitive activity is likely to impact the cigarettes sales in Q3 as well. We estimate 308 bps expansion in gross margins on the back of lower trade margins & similar expansion in operating margins during the quarter. We estimate net profit growth of 15.4% in Q3
Zydus Wellness	We estimate Zydus wellness to post 11.6% revenue growth during the quarter despite strong base quarter. We believe the company has been aggressively expanding its distribution reach of newer products & variants, which would have aided the sales during the quarter. With the elevated milk & palm oil prices, gross margins are expected to contract by 144 bps during the quarter. We estimate similar contraction of 151 bps in operating margins. With the lower interest cost due to repayment of debt, high other income with increasing cash reserves, net profit is likely to grow to ₹ 37 crore from mere ₹1.7 crore profit in corresponding quarter. (base quarter includes one-time expenditure towards the premium of pre-payment of debt)

Source: Company, ICICI Direct Research

Exhibit 4 : ICICI Direct coverage universe (FMCG)

	CMP	TP		M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)	Rating	(₹ Cr)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Colgate (COLPAL)	1,470	1,800	Buy	39,979	38.3	41.1	45.3	38.4	35.7	32.5	7.7	7.1	6.5	110.5	113.2	116.5	84.8	87.0	89.5
Dabur India (DABIND)	588	745	Buy	103,817	10.5	12.1	13.5	55.8	48.6	43.5	9.4	8.5	7.7	25.7	27.3	27.9	22.2	23.3	23.3
Hindustan Unilever (HINLEV)	2,416	2,750	Hold	567,650	39.3	44.3	48.6	61.4	54.5	49.8	11.1	10.2	9.4	25.0	27.6	29.5	19.5	21.5	23.0
ITC Limited (ITC)	218	260	Hold	268,462	12.0	13.7	15.3	18.1	15.9	14.2	5.0	4.6	4.2	31.4	34.1	36.0	24.2	26.2	27.6
Jyothy Lab (JYOLAB)	137	170	Hold	5,040	5.0	6.7	7.0	27.7	20.6	19.5	2.3	2.1	2.0	21.5	27.3	28.5	18.8	23.7	24.1
Marico (MARLIM)	504	630	Buy	65,058	10.4	11.5	12.5	48.7	43.8	40.2	7.0	6.5	6.1	42.8	46.6	48.3	38.4	40.4	41.7
Nestle (NESIND)	19,903	20,450	Hold	191,903	249.9	279.6	314.2	79.6	71.2	63.3	13.0	11.9	10.8	54.9	56.4	57.5	87.8	86.3	83.1
Tata Consumer Products (TAT	736	910	Buy	67,833	11.8	14.1	16.2	62.6	52.3	45.4	5.4	5.0	4.5	8.9	9.9	10.8	7.2	8.3	9.2
VST Industries (VSTIND)	3,187	3,700	Hold	4,921	223.1	245.8	277.0	14.3	13.0	11.5	4.2	3.9	3.6	44.2	47.7	55.1	32.8	35.7	41.2
Varun Beverage (VARBEV)	851	1,020	Buy	36,864	16.0	20.3	22.7	53.1	41.9	37.6	4.4	3.9	3.6	19.6	23.4	26.3	17.2	18.9	19.0
Zydus Wellness (ZYDWEL)	1,844	2,800	Buy	11,738	56.2	67.8	77.6	32.8	27.2	23.8	5.6	5.1	4.6	7.3	8.6	9.7	7.5	9.0	10.0

Source: Company, ICICI Direct Research

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Sell: <-15%

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