ArihantCapital
Generating Wealth

8th July 2021

June 2021 Result Preview: FMCG Sector

Look Beyond Numbers

HUL	
Rating	Accumulate
CMP	INR2,480
Target Price	INR2,448
Dabur	
Rating	Accumulate
CMP	INR594
Target Price	INR547

Marico	
Rating	Accumulate
CMP	INR533
Target Price	INR499
Britannia	
Rating	Accumulate
CMP	INR3,530
Target Price	INR4,010

Jyothy Labs	
Rating	BUY
CMP	INR177
Target Price	INR210
Zydus Wellness	
Rating	BUY
CMP	INR2,169
Target Price	INR2,676

Prataap Snacks	
Rating	BUY
CMP	INR697
Target Price	INR1,149

Headwinds are apparent for the FMCG sector, even though March quarter (Q4) results met expectations or beat them due to a strong burst of consumption in January and February 2021. However, the second wave of the pandemic makes it hard to extrapolate the results. In our view, the second wave will affect the Q1FY22E results owing to the account of negative effects on supply chain, with disruptions caused by night curfew + state imposed lockdown, plus increasing fear of rural infection (the number of active kirana stores in urban and rural areas fell more than 12%), and further fuelled by the increase in input costs.

FMCG companies have learnt few lessons during Covid 1.0 and emphasised more on optimising supply chain, SKUs and product assortments this time. Thus, companies have proactively aligned their GTM or go-to-market strategies with those of consumer preferences.

We feel that the gradual recovery in Discretionary categories witnessed in Q3FY21 & Q4FY21 have seen material cuts in spending in Q1FY22E. Staple and value oriented personal, household care categories too have seen pressure on budgets as is evident from down-trading within the staples categories during Q1FY22E. However, we feel that despite down-trading, companies with wider product offerings straddling across the price-value matrix stand to benefit given their brand image, quality of product and affordability.

Last year, as the Covid-19 pandemic raged in bigger cities, rural India offset consumer goods makers' pain. But that hasn't been the case during the second wave that has impacted sales in the nations' hinterland almost as much as in urban. We believe that judicious price hikes and improving product mix won't fully offset rising inflation, putting pressure on gross margins. However, most companies have rationalized their A&SP cost and will use Covid 19 situations last year to bring about some structural changes in their costs. So, we feel that many companies have saved huge amount of costs last year and those buffers will come in handy. We feel that EBITDA margins will tend to be on a lower side and not falling drastically.

Within Staples; we expect: 1) mid to high single digit revenue growth, 2) weak trends in discretionary, 3) dismal performance in OOH categories (out of home consumption) due to limited mobility, 4) strong pricing led growth in select categories (soaps, edible oils), 5) international exposure companies to report strong growth, 6) raw-material inflation to weigh on gross margin expansion, and 7) cost optimization to arrest fall in EBITDA margin.

Q1FY22E will have an impact of 30-45days of complete lockdown depending upon the cities/states, hence aggregate impact is mixed. Given that Q1FY21 witnessed a complete lockdown, this quarter will fare better in terms of Revenue/EBITDA/PAT growth of 16.4%/10.7%/13.3%, respectively. GM to decline by 117bps due to RM push inflation. However, cost optimization to curb the fall in EBITDA margin to 117bps. Britannia will be an exception with 8.5% decline in Sales and 25.5% in PAT. Gowth over Q1FY20 will be driven by staple companies. Hence, we remain structurally positive on HUL, Zydus Wellness, Britannia and Jyothy Labs. We rate Prataap Snacks as top picks in consumption sector led by unlock play. We are cautiously positive on Dabur and Marico.

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Q1FY22 Earnings Estimates:

INR (Cr)	Q1FY22E	Q1FY21	Q4FY21	YoY	QoQ	Remarks
HUL						We model 13.8% YoY growth on the back of ¬8% volume growth. Further, we expect 14%/12%/17% growth in Home Care/Beauty & Personal Care/Food & Refreshments, respectively. We expect 33bps YoY decline in GM as expenses are expected to normalize during the quarter. We have built in the decline in EBITDA margin by 34bps to 24.7% from GSK-CH acquisition balancing RM pressures and higher A&SP spends. We have accounted for higher palm oil prices and crude derivatives cost inflation.
Net Revenue	12,020	10,560	12,132	13.8%	(0.9%)	
Gross Margin	51.5%	51.8%	52.6%	(33bps)	(106bps)	
EBITDA	2,969	2,644	2,957	12.3%	0.4%	
EBITDA Margin	24.7%	25.0%	24.4%	(34bps)	33bps	
PAT	2,179	1,881	2,143	15.9%	1.7%	

INR (Cr)	Q1FY22E	Q1FY21	Q4FY21	YoY	QoQ	Remarks
Dabur						We model a 19.6% YoY growth in domestic revenues led by a combination of 15.5% volume growth and ¬5% realization growth. We expect a sequential improvement in the healthcare segment including OTC, ethical & health supplements. In addition, we expect ¬5% growth in international business. We expect consolidated GM to decline 91.5bps YoY led by cost push inflation. However, we expect EBITDA margin down by just 49bps at 20.6% led by cost savings and operating leverage benefit to offset the higher operating expenses.
Net Revenue	2,368	1,980	2,337	19.6%	1.3%	
Gross Margin	48.5%	49.4%	48.7%	(92bps)	(24bps)	
EBITDA	487	417	442	16.8%	10.0%	
EBITDA Margin	20.6%	21.0%	18.9%	(49bps)	162bps	
PAT	402	341	377	17.7%	6.4%	

INR (Cr)	Q1FY22E	Q1FY21	Q4FY21	YoY	QoQ	Remarks
Marico						We model 31.5% revenue growth led by 35% growth in domestic business and 20% growth in international business on constant currency terms. While some key input costs started easing during the quarter, gross margin will remain under pressure in Q1FY22 due to consumption of high cost inventory and will only improve Q2FY22 onwards. We expect GM to decline by 482bps YoY and 34bps QoQ. To counter the continuous impact if steep inflation cost in Q1FY22, Marico had already implemented price hikes in April-May 21 in certain products and SKUs of Parachute Coconut oil, Saffola edible oil, Saffola oats, etc. On account of high base, as management has taken lot of cost savings initiatives and pricing interventions in Q1FY21, the operating margins will see a significant dip YoY, but will improve sequentially. We expect EBITDA margin to decline by 586ps YoY but improve by 255bps QoQ to 34.5%.
Net Revenue	2,532	1,925	2,012	31.5%	25.8%	
Gross Margin	43.8%	48.6%	44.1%	(482bps)	(34bps)	
EBITDA	466	467	319	(0.2%)	46.0%	
EBITDA Margin	18.4%	24.3%	15.9%	(586bps)	255bps	
PAT	356	388	265	(8.2%)	34.5%	

INR (Cr)	Q1FY22E	Q1FY21	Q4FY21	YoY	QoQ	Remarks
Britannia						We have baked in the 9% revenue decline on the back of high base (¬27% YoY growth in Q1FY21). We expect a flat revenue growth QoQ aided by marginal increase in home consumption during the quarter. We believe that the GM and EBITDA margins have peaked out from Q1FY21 levels and we have modelled 39.8% GM and 17.8% EBITDA margins on the back of softening of demand and pressure from RM and other cost overheads. We expect EBITDA margin to contract by 316bps to 17.8% and decline in EBITDA by 22.3% YoY.
Net Revenue	3,130	3,421	3,131	(8.5%)	0.0%	
Gross Margin	39.8%	41.7%	40.5%	(185bps)	(67bps)	
EBITDA	557	717	505	(22.3%)	10.2%	
EBITDA Margin	17.8%	21.0%	16.1%	(316bps)	166bps	
PAT	405	543	360	(25.5%)	12.4%	

Source: Arihant Capital Research

Q1FY22 Earnings Estimates:

INR (Cr)	Q1FY22E	Q1FY21	Q4FY21	YoY	QoQ	Remarks
Jyothy Labs						We expect a 9.5% revenue growth driven by 8%/8%/20%/25% revenue growth in Fabric Care/Dishwashing/Household Insecticide/Personal Care, respectively. However, we expect GM to decline to 146bps on the back high crude derivative cost push inflation and palm oil. In addition, we expect high media spend by 55% during the quarter. This will led EBITDA margin contraction to 15.3%, decline by 241bps YoY.
Net Revenue	474	433	495	9.5%	(4.3%)	
Gross Margin	44.8%	46.2%	45.6%	(146bps)	(83bps)	
EBITDA	72	76	71	(5.5%)	2.0%	
EBITDA Margin	15.3%	17.7%	14.3%	(241bps)	93bps	
PAT	48	50	27	(4.2%)	75.5%	

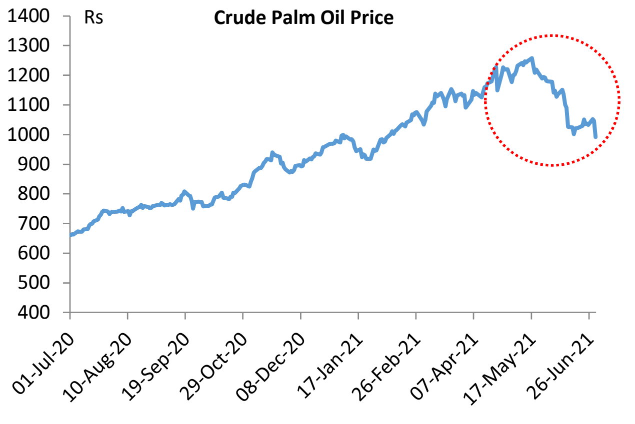
INR (Cr)	Q1FY22E	Q1FY21	Q4FY21	YoY	QoQ	Remarks
Zydus Wellness						Summer is generally a good quarter for the company. With increasing online presence, doubled its direct reach to 5.5 lakh outlets, increasing penetration in the hinterland and increasing the export sale contribution, we expect company to post a revenue growth of 12%. However, with the increasing RM prices mainly sugar, milk and palm oil, we expect GM to decline by 215.4bps to 53.5%. However, with cost rationalization in place, we have baked in EBITDA margin contraction of just 47bps to 22.3%.
Net Revenue	602	537	606	12.0%	(0.6%)	
Gross Margin	53.5%	55.7%	54.6%	(215bps)	(109bps)	
EBITDA	134	122	145	9.7%	(7.7%)	
EBITDA Margin	22.3%	22.8%	24.0%	(47bps)	(170bps)	
PAT	122	89	133	36.3%	(8.7%)	

INR (Cr)	Q1FY22E	Q1FY21	Q4FY21	YoY	QoQ	Remarks
Prataap Snacks						Due to lockdown, many of manufacturing operations facilities witness a shut down during April and May and only resumed operation in the last week of May 2021. in addition, 18-20% of revenue comes from institutional sales (bus depots, railways, schools, etc), which due to restricted mobility negatively impacted the most. However, with June witnessing an opening up of the economy, we have baked in 2% revenue growth for the quarter. We expect GM to decline to 321bps as palm oil constitutes a major RM cost of ¬15-16%. However with cost optimization in terms of controlled freight cost and A&SP spend, we expect EBITDA margin to decline by 51bps to 3.7% during the quarter.
Net Revenue	200	196	310	2.0%	(35.5%)	
Gross Margin	25.0%	28.2%	26.1%	(321bps)	(110bps)	
EBITDA	7	8	14	(10.3%)	(46.9%)	
EBITDA Margin	3.7%	4.2%	4.5%	(51bps)	(80bps)	
PAT	1	(6)	7	(121.2%)	(82.3%)	

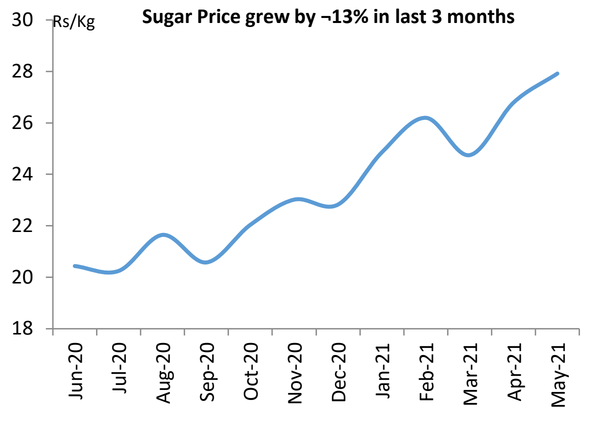
Source: Arihant Capital Research

Q1FY22 Earnings Estimates:

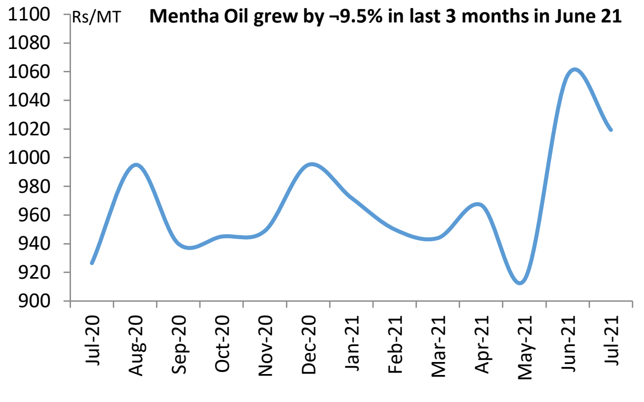
Key Raw Material Price Trend



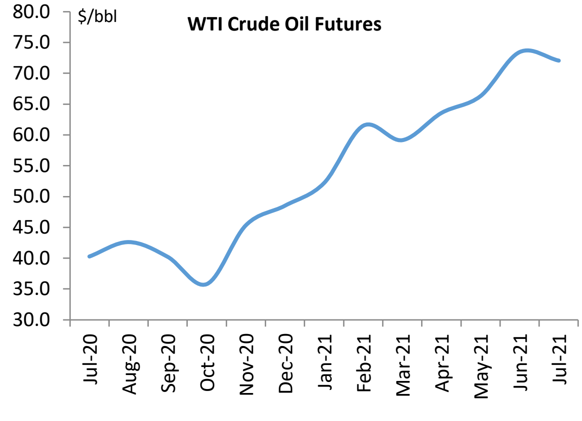
Source: Investing & Arihant Capital Research



Source: Indexmundi & Arihant Capital Research



Source: Investing & Arihant Capital Research



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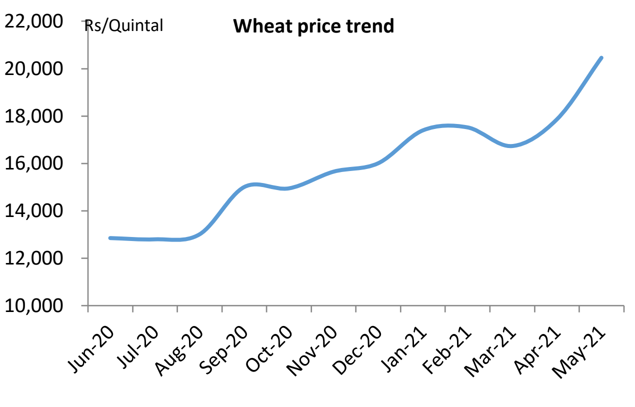

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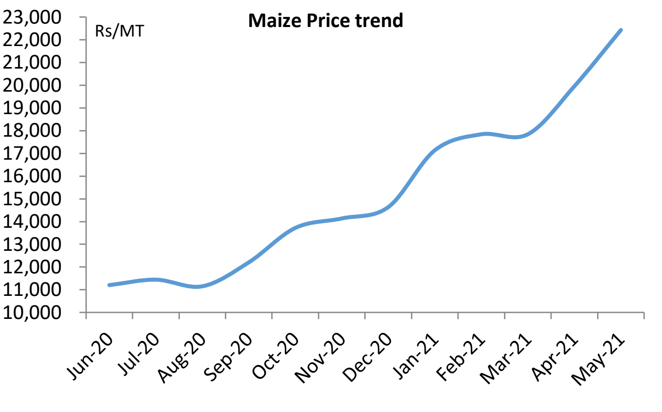

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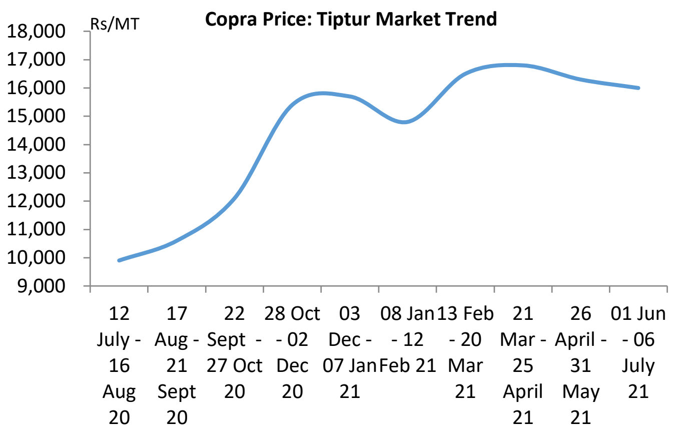
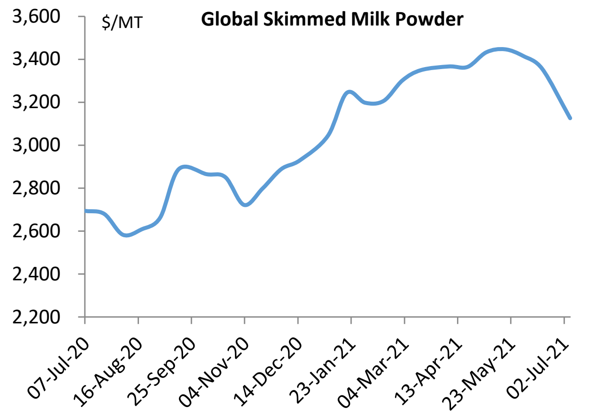
Q1FY22 Earnings Estimates:

Key Raw Material Price Trend



Source: Napanta & Arihant Capital Research



Source: Global Dairy Trade & Arihant Capital Research

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Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

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