

India Consumer Sector

Enjoying a slice of luxury

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Fact file of the consumer / FMCG sector

How do we define the consumer / FMCG sector?

- Products to which consumers are extremely habitualized -- soaps, shampoos, toothpastes
- Demand curve for such products is inelastic – Giffen's goods
- Small-ticket items, high brand loyalty

USP of the sector from an investment point of view

- Ability to raise prices as demand remains stable. Able to maintain margins
- Strong free cash-flows; negative working capital; limited capital expenditure; Debt free companies
- No competitor can easily gain market share. Brands act as entry barriers
- Contribution to GDP expanded from 1.05% in FY05 to 1.1% in FY12. GDP CAGR FY05-12 – 15.7% and Consumer sector CAGR FY05-12 – 16.4%

Ownership of the consumer sector

- Listed MNCs – HUL, Nestle, Colgate, GSK Consumer, P&G, Agro Tech Foods
- Listed Indian cos – Dabur, Marico, Godrej Consumer, Emami, Pidilite, Asian Paints, Bajaj Corp
- The sector has seen strong inflows from FIIs and Indian Funds post market crash in 2008

Major examples of consumer products

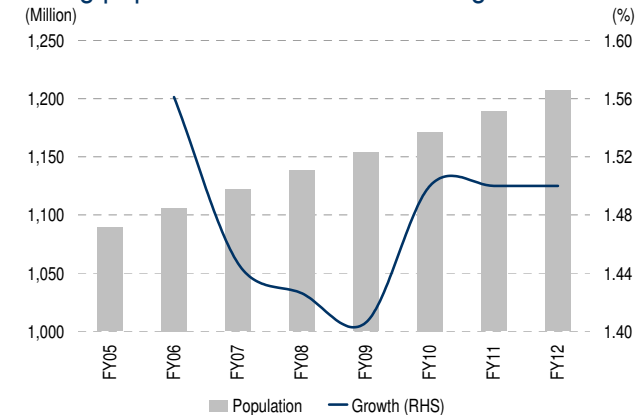
- MNC brands: Colgate, Horlicks, Lux, Lifebuoy, Surf, Dettol, Cadbury, Vicks, Nivea, Vim, Ariel
- Indian brands: Parle, Parachute, Dabur, Cinthol, Good Knight, Ujala, Ghadi, Nirma, Boroplus

Long-term Growth Drivers

Favorable Demographics

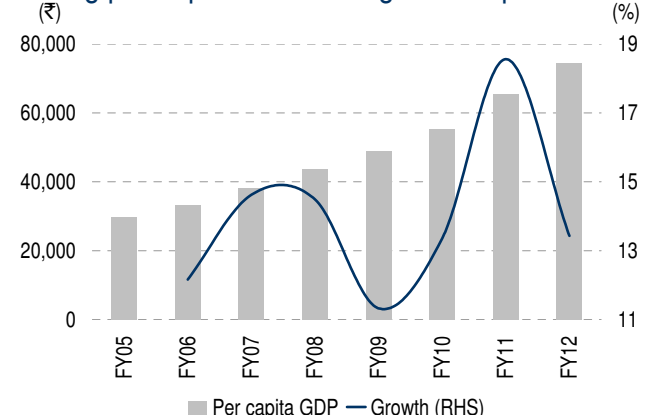
- ~1.5% population growth is growing the market size for all consumer products
- Per-capita GDP growth of more than 13% even in difficult macro conditions
- Industrial growth (IIP), key statistic for urban growth, has been volatile but is still healthy
- Inflation is expected to soften. Over 8% inflation for more than three years has impacted consumption growth
- Lower inflation results in higher share of wallet and releases working capital for traders.

Rising population: Obvious driver of growth



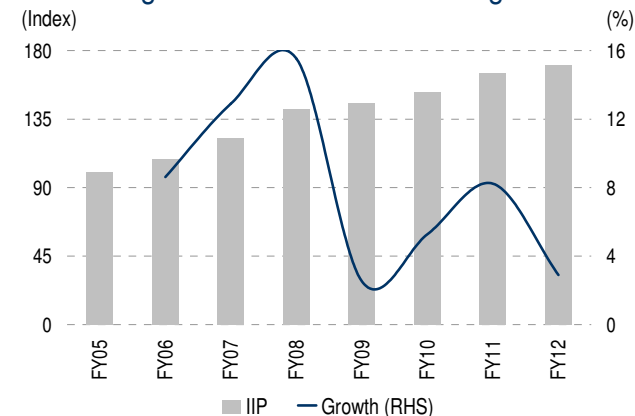
Source: Gol, Anand Rathi Research

Rising per-capita GDP driving consumption



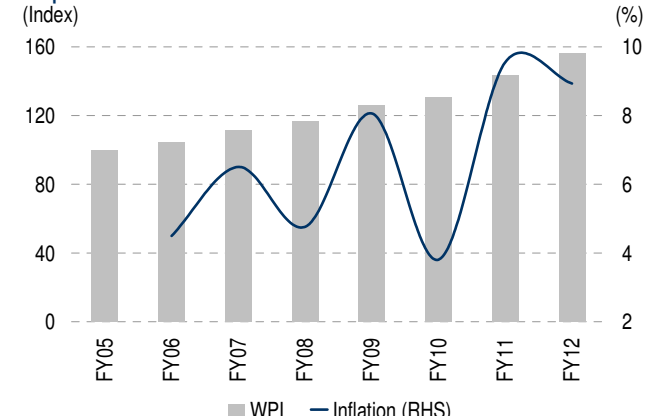
Source: Gol, Anand Rathi Research

Industrial growth volatile but still strong



Source: Gol, Anand Rathi Research

Expect inflation to fall

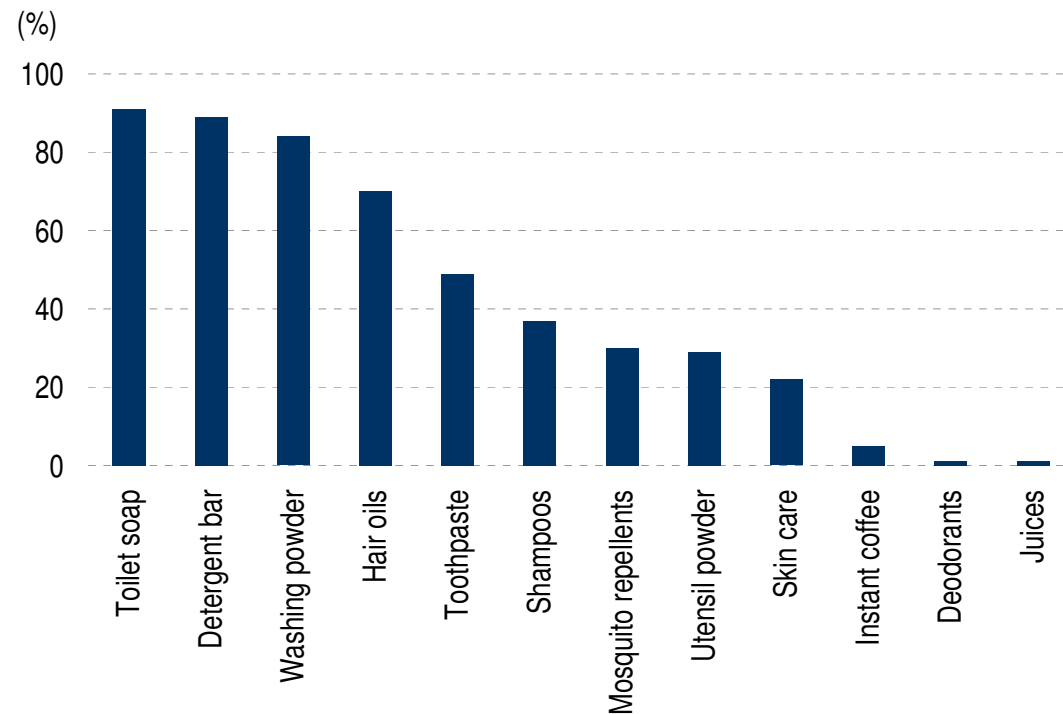


Source: Gol, Anand Rathi Research

Low penetration levels across consumer products

- Low penetration levels of most consumer products in India
- Necessary segments (toothpastes, shampoos, skincare) have less than 50% penetration
- New-age segments (deodorants, juices, instant coffee) have yet to cross 10% penetration mark
- Modern trade provides a strong platform to create awareness and drive penetration

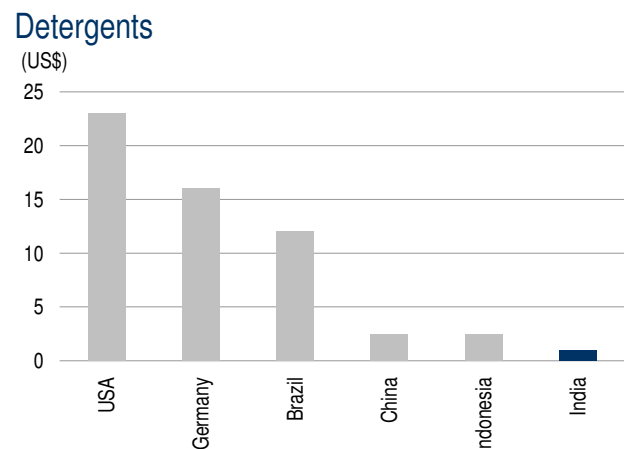
Low penetration levels – An opportunity



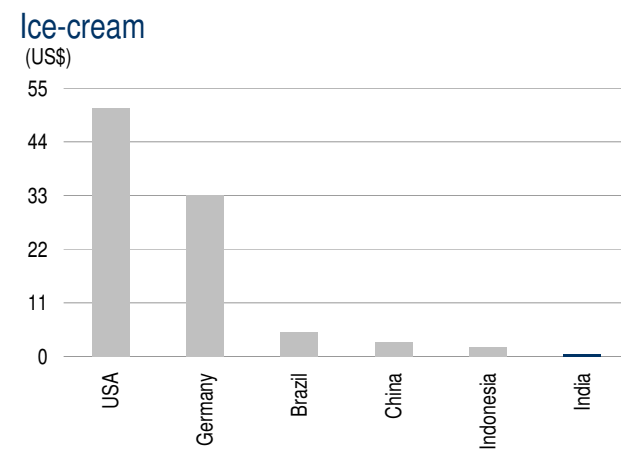
Source: Companies, Anand Rathi Research

Per-capita consumption... 1

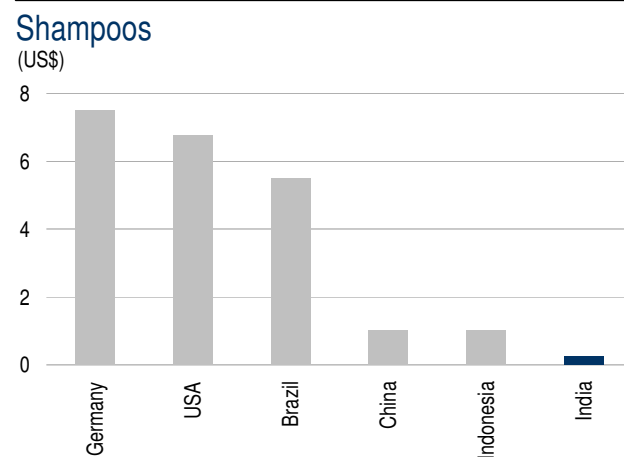
- Even detergents, over 80% penetration, sees per-capita consumption less than most countries
- Skincare consumption needs to be higher than other developed countries considering the harsh water and pollution levels
- Ice-cream is still considered an after-dinner dessert
- Basic hair-care products such as shampoos have limited consumption in India. Others such as conditioners, gels, serums have yet to take off



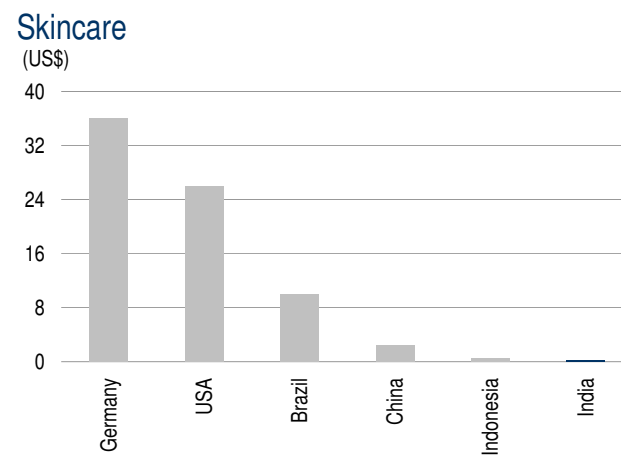
Source: Company, Anand Rathi Research



Source: Company, Anand Rathi Research



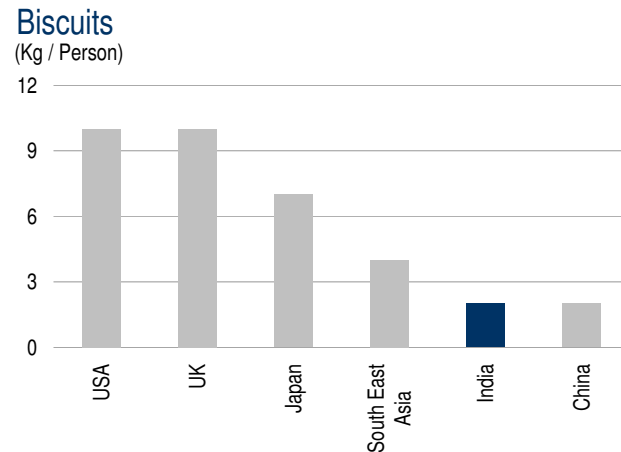
Source: Company, Anand Rathi Research



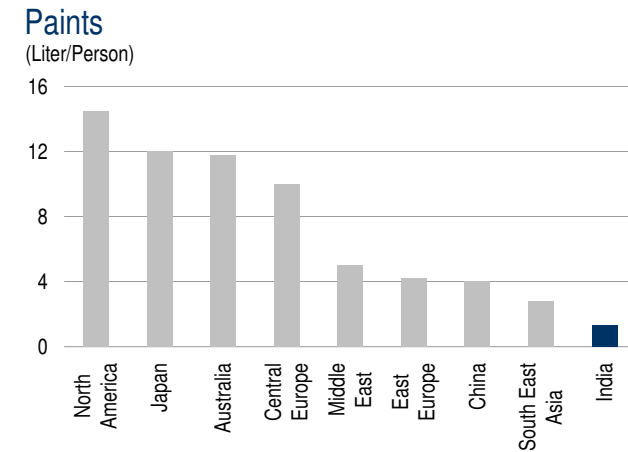
Source: Company, Anand Rathi Research

Per-capita consumption... 2

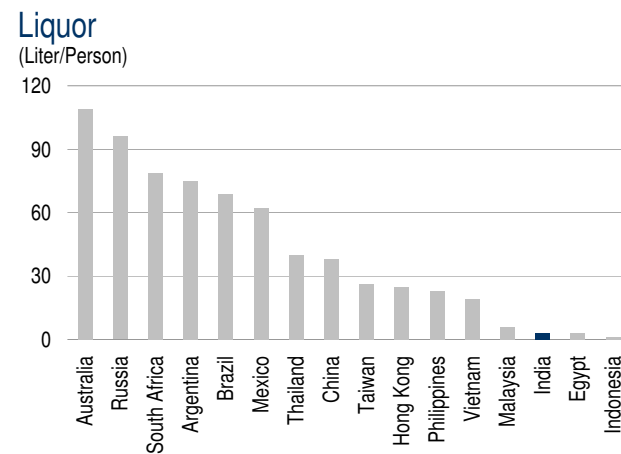
- Biscuits, probably the oldest fast-food in India, has not yet risen beyond consumption of more than 2 kg per person per year
- A long re-painting cycle has resulted in per-capita paint consumption of just 1.3 litres, against a global average of 7.3 litres
- A large amount of illicit and country liquor results in less consumption of branded liquor
- Cigarette consumption is also lower than most other nations



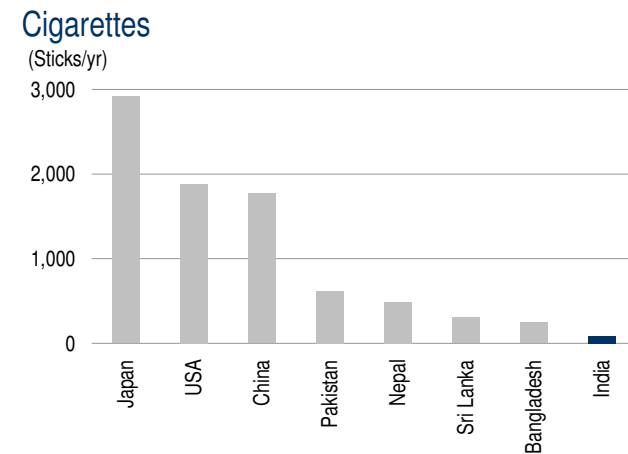
Source: Company, Anand Rathi Research



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Source: Company, Anand Rathi Research

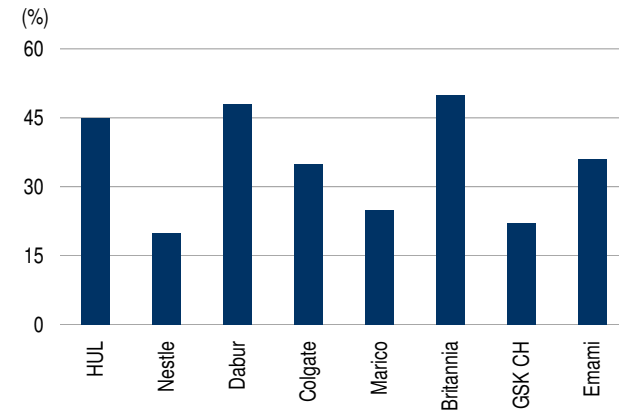


Source: Company, Anand Rathi Research

Major growth drivers

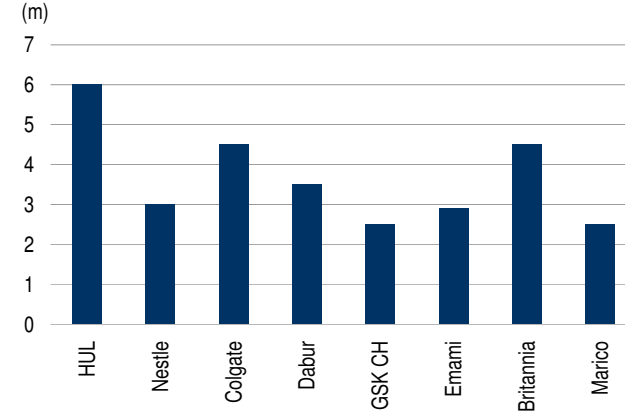
- Rural economy continues to grow at more than national averages but consumption is still lower than urban consumption.
- Out of 7.5m retail outlets in India, only HUL has been able to penetrate deeper.
- Modern trade provides a strong platform for premium products as well as launch of new products.
- Lowest growing segment in India is Furniture which also had CAGR of 13% over FY07-12.

Rural Sales as % of net sales



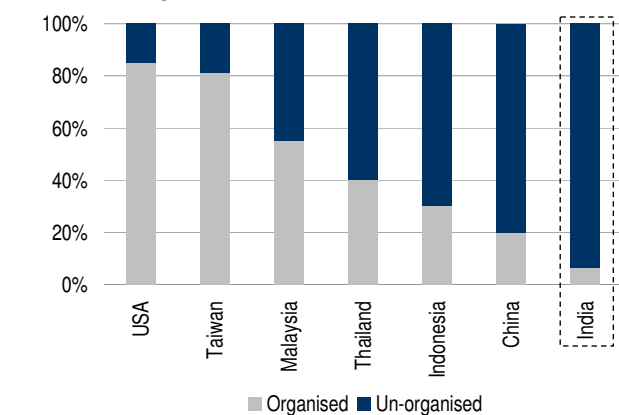
Source: Company, Anand Rathi Research

Distribution structure (m)



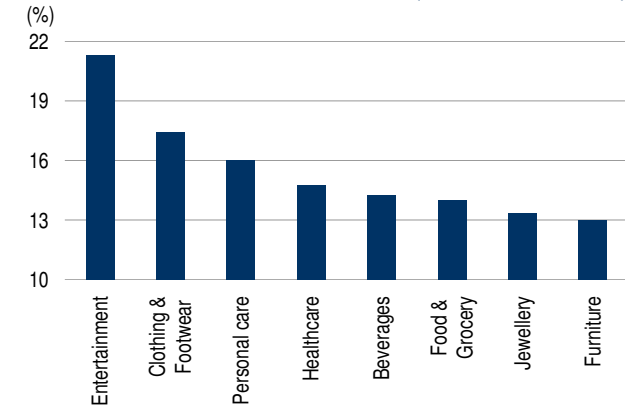
Source: Company, Anand Rathi Research

Share of organized retail



Source: Company, Anand Rathi Research

Growth of overall retail in India (CAGR FY07-12)

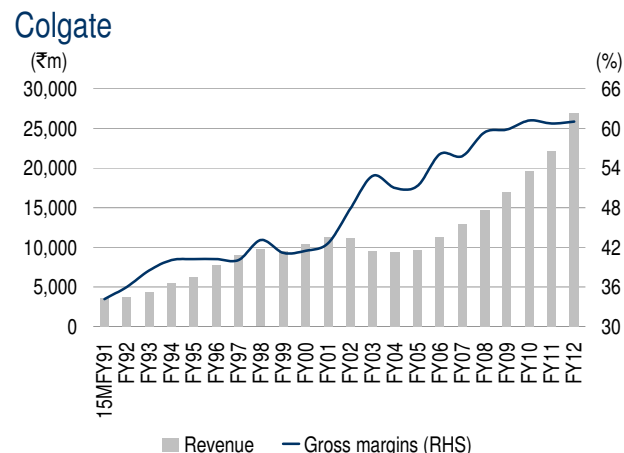


Source: Company, Anand Rathi Research

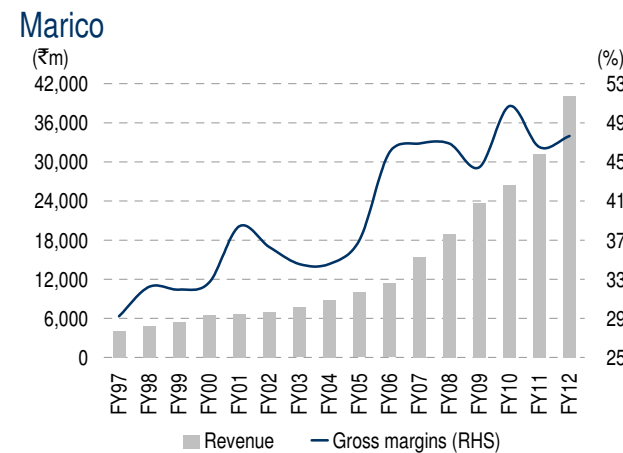
Themes prevalent in recent times

Premiumization - Moving up the brand curve

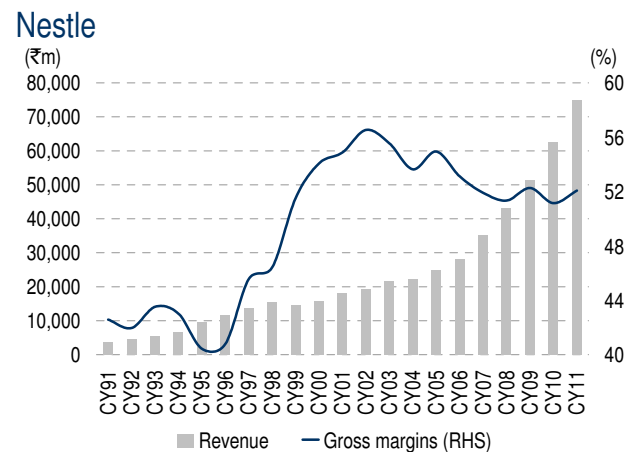
- Premiumization driving gross margins up for consumer companies
- With higher gross margins, sensitivity to input costs eases
- Premiumization also helps reduce competitive pressure
- Modern trade provides a strong platform for premiumization



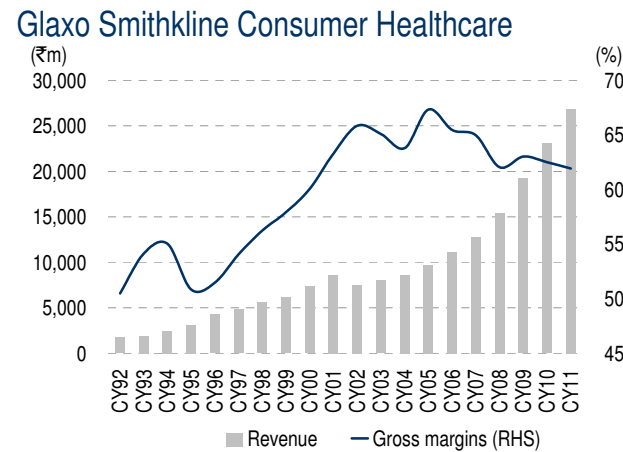
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Source: Company, Anand Rathi Research



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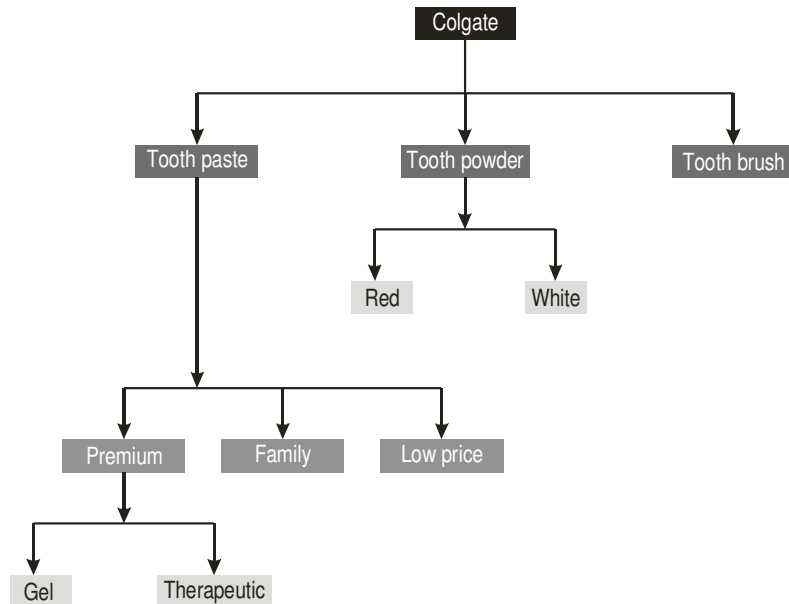


Source: Company, Anand Rathi Research

Sub-segmentation - Divide and Rule

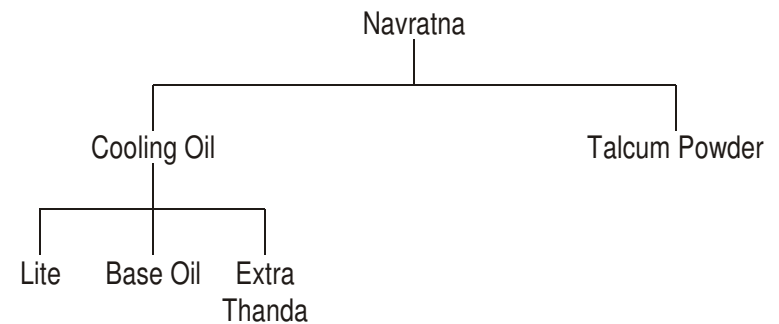
- Launch of products aimed at consumers across income levels – wider reach
- This aids better pricing power. Increases ability to hike prices for select SKUs
- Improves volumes by avoiding competition to some extent
- Easier to launch new products. Benefit of umbrella branding

Sub-segmentation strategy - Colgate Palmolive



Source: Company

Sub-segmentation strategy- Emami Navratna Oil



Source: Company,

What is happening in the consumer sector now?

Rural juggernaut to continue... 1

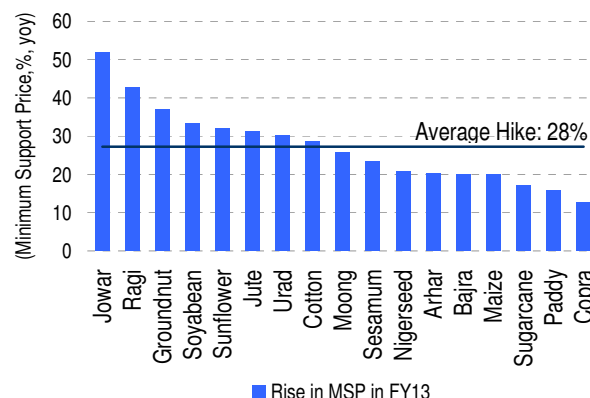
■ In the last six years, the minimum support prices (MSP) of crops have been rising at a ~15% CAGR

■ Since FY05 rural wages in different parts of India have risen two- to three-fold

■ NREGA wages have been linked to CPI

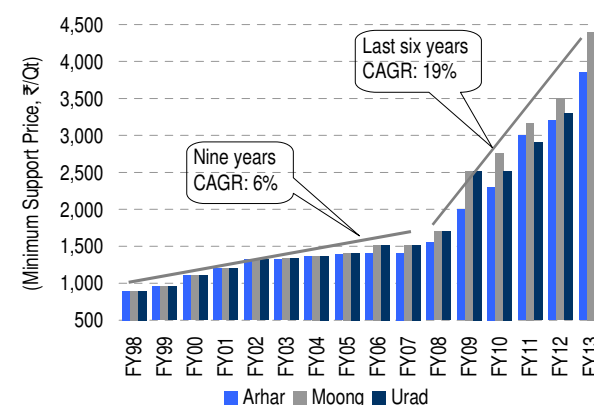
■ High CPI would mean higher wages for the rural population

Around 30% increase in MSP in FY13



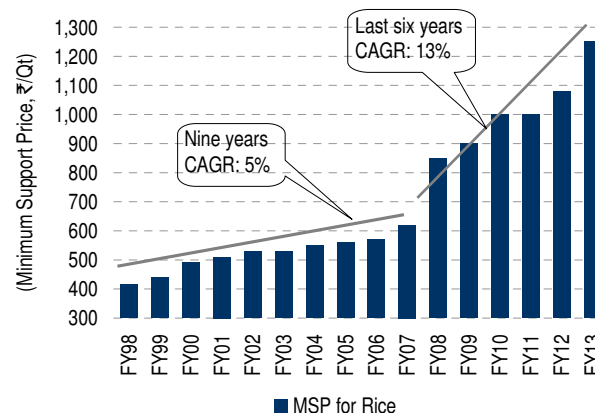
Source: Gol

Higher minimum support prices (MSP) of pulses



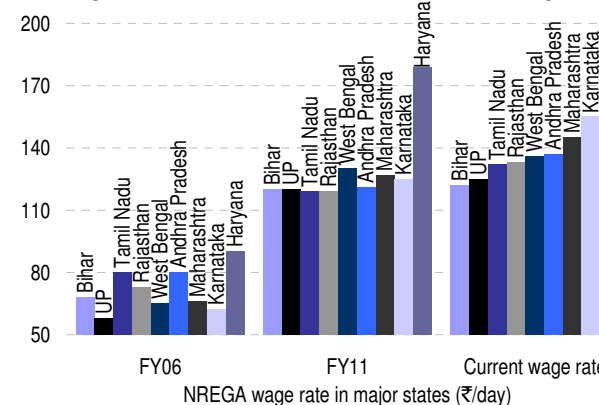
Source: Gol

Three-fold rise in MSP of rice



Source: Gol

Linking of NREGA to CPI to drive rural wages

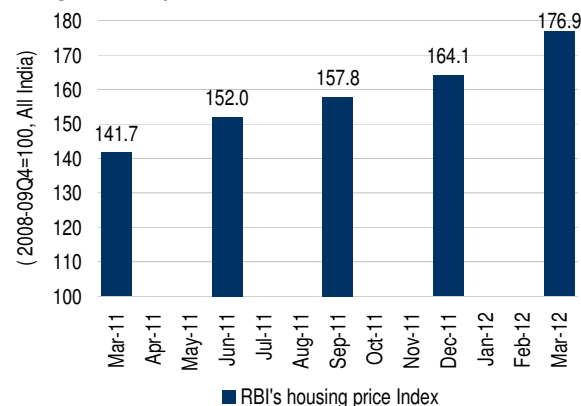


Source: Gol

Rural juggernaut to continue... 2

- The wealth effect – rising land / house, gold / silver prices – has provided the boost to rural consumption
- Consumer companies have invested in building distribution networks and launching products for rural consumption
- Advertising is now aimed at rural young consumers (Amitabh Bacchan advertising Chhotu Maggi)

Rising house prices



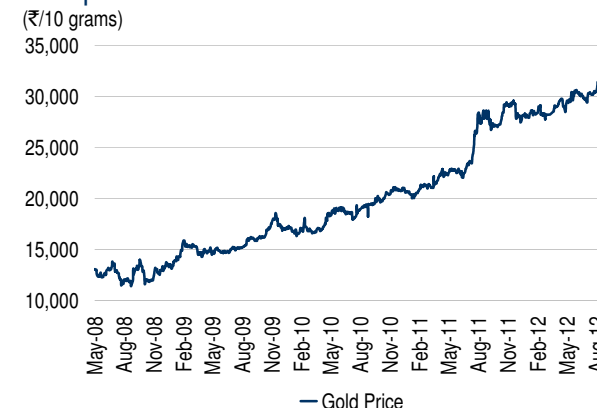
Source: RBI

Higher silver prices



Source: Bloomberg

Gold prices continue to rise



Source: Bloomberg

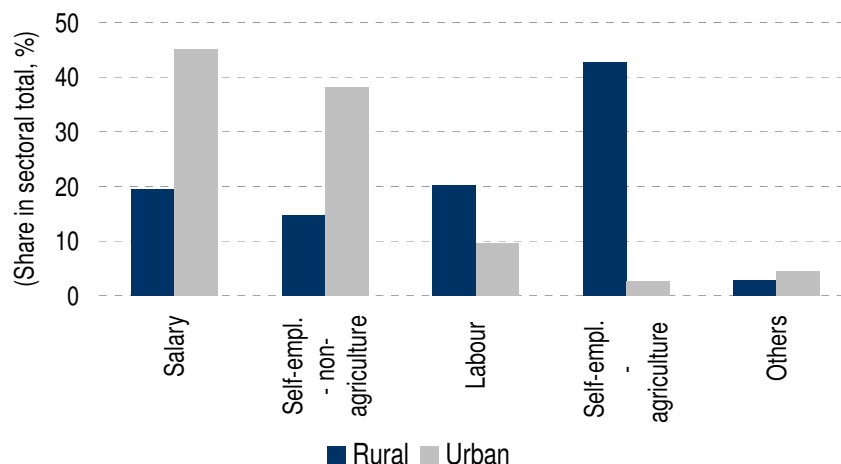
Consumer companies' investment in rural areas

Particulars	Companies
Launch of small SKUs	Nestle, Marico, HUL, Dabur
Communication targeted at rural consumers	Nestle, HUL, Dabur
Expansion of distribution network	Project Shakti (HUL), Project Swadesh (Emami), Project Jagruti (Colgate)
Launch of products for rural consumption	Emami, Nestle, Dabur

Source: Company, Anand Rathi Research

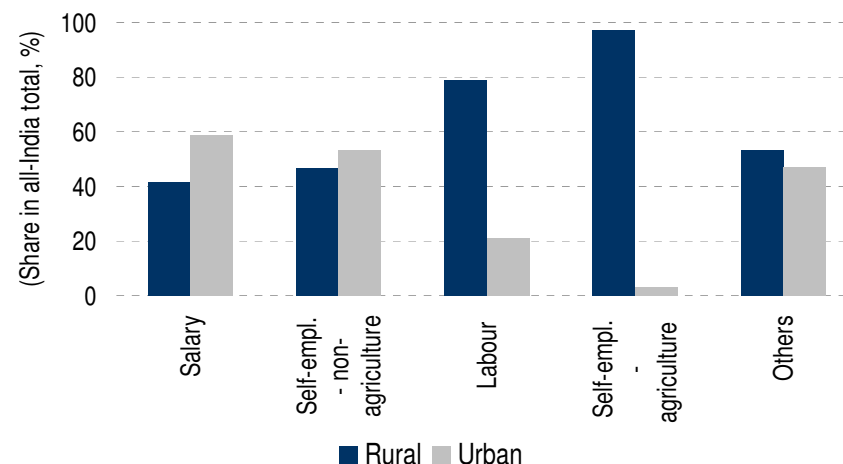
Rural economy depends on agriculture... Not really

Non-agriculture main source of rural income



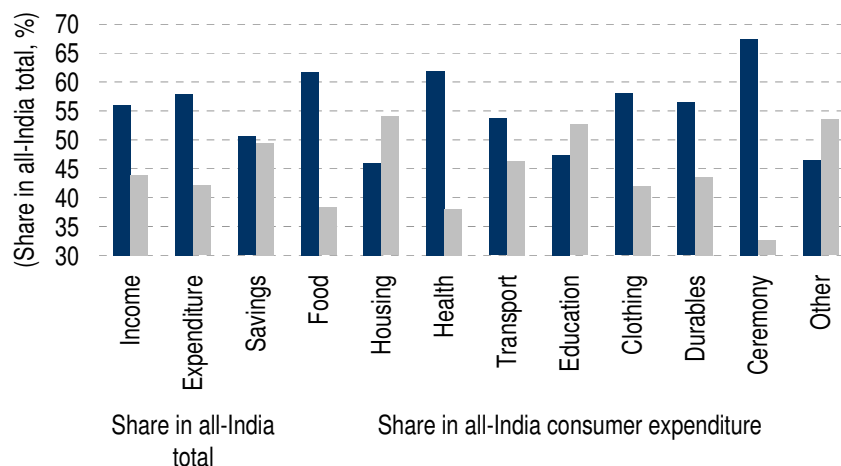
Source: NCAER and Anand Rathi Research

High share of rural economy in most forms of earnings



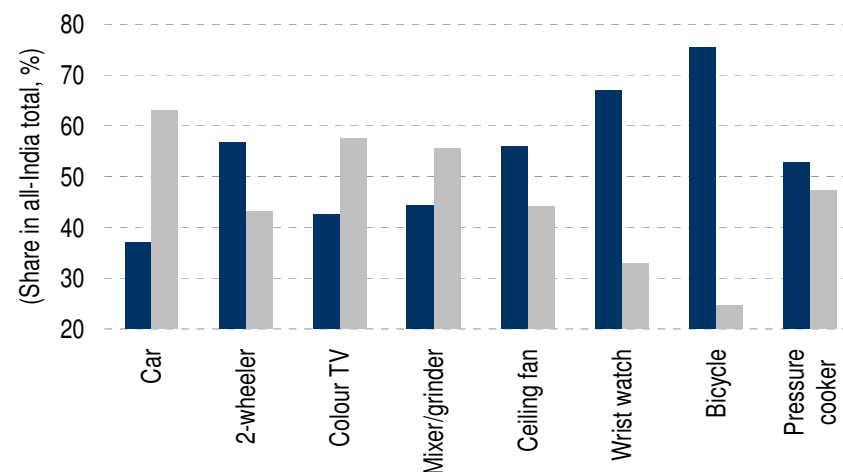
Source: NCAER and Anand Rathi Research

Rural economy large under most macroeconomic parameters



Source: NCAER and Anand Rathi Research

High consumer asset share of rural economy

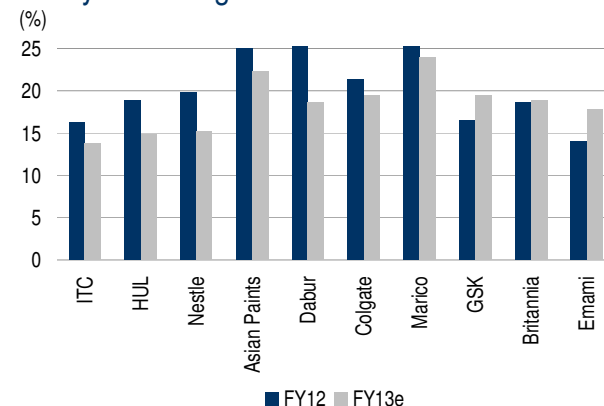


Source: NCAER of India and Anand Rathi Research

Defensive character protects any downside

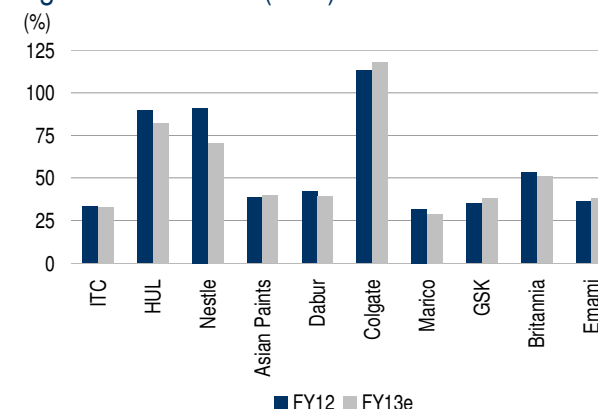
- With a turbulent global economy and a volatile inflationary scenario, the defensive appeal of the consumer sector would attract investors
- Companies with volume growth & premiumization to benefit the most
- Debt-free status and high free-cash generation protects against global uncertainties
- Brand loyalty allows pricing power and ensures good returns on investment

Steady revenue growth



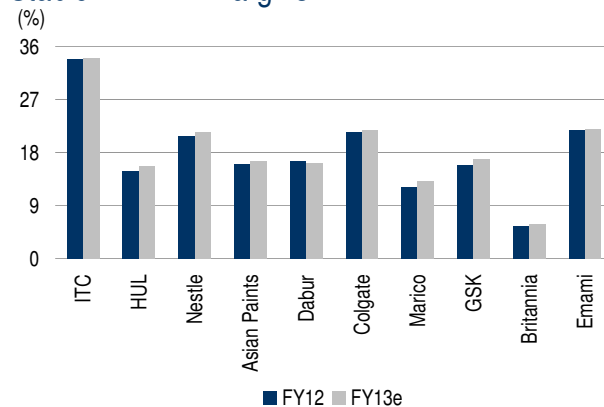
Source: Company, Anand Rathi Research

Higher return ratios (RoE)



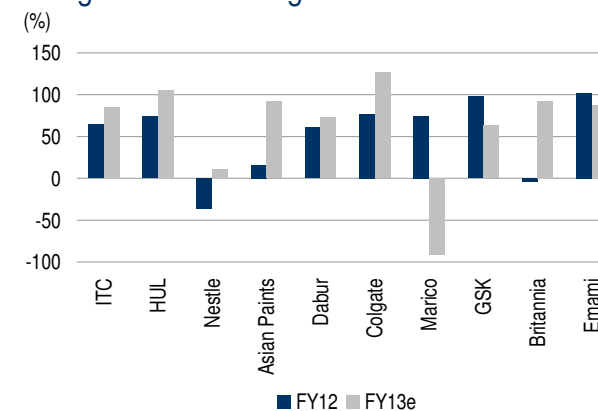
Source: Company, Anand Rathi Research

Stable EBITDA margins



Source: Company, Anand Rathi Research

Strong free-cash-flow generation



Source: Company, Anand Rathi Research

Case Studies

Colgate Palmolive (Price: ₹1,318)

Regaining leadership

- Colgate continues to gain marketshare in all oral care sub-segments
- With less competition from HUL, ad-spend to come down. Market-share gains from Pepsodent
- Steady revenue growth as penetration of oralcare is still low in India
- Risk: No new launches despite strong free-cash generation

Key Financials

YE 31 Mar	FY08	FY09	FY10	FY11	FY12
Sales (Rsm)	14,739	16,952	19,625	22,206	26,932
Net profit (Rsm)	2,368	2,910	4,341	4,026	4,465
EPS (Rs)	17.4	21.4	31.9	29.6	32.8
Growth (%)	24.0	22.9	49.2	(7.3)	10.9
PE (x)	75.8	61.7	41.4	44.6	40.2
PBV (x)	129.2	89.7	57.4	48.9	42.4
RoE (%)	120.4	167.8	169.3	118.4	113.0
RoCE (%)	114.1	147.0	154.5	121.7	131.3
Dividend yield (%)	1.0	1.1	1.5	1.7	1.9
Net gearing (%)	(149.1)	(142.9)	(116.0)	(120.3)	(77.0)

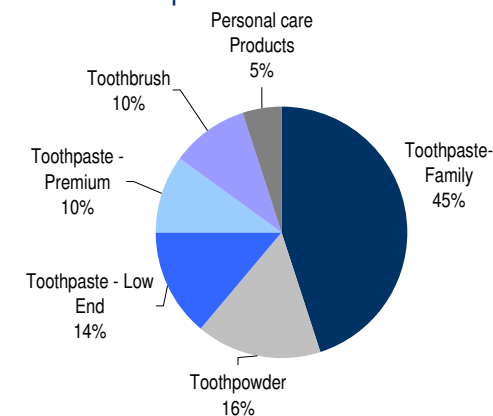
Source: Company, Anand Rathi Research

Competitive positioning, by sub-segment

Sub-segment	Colgate	HUL	Dabur	Amar	Anchor	Ajanta
Mouthwash	Y	N	N	N	N	N
Floss	Y	N	N	N	N	N
Therapeutic	Y	Y	N	N	N	N
Gels	Y	Y	N	Y	N	N
Family	Y	Y	Y	Y	Y	Y
Low price toothpaste	Y	N	Y	Y	Y	Y
Tooth powder	Y	N	Y	Y	N	N

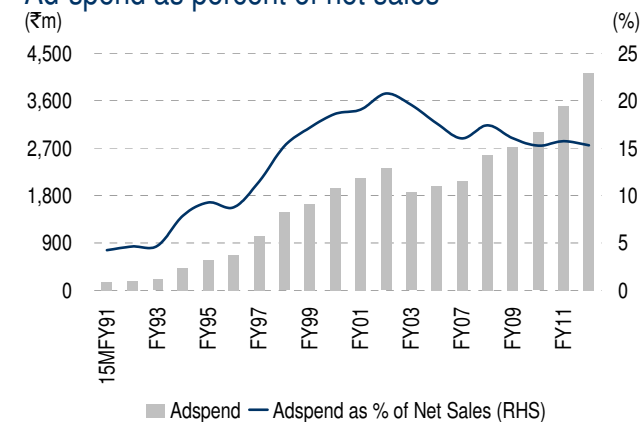
Source: Company, Anand Rathi Research

Revenue break-up



Source: Company, Anand rathi Research

Ad-spend as percent of net sales



Source: Company, Anand Rathi Research

Glaxo SmithKline Consumer Healthcare (Price: ₹4,150)

Sub-segmentation strategy

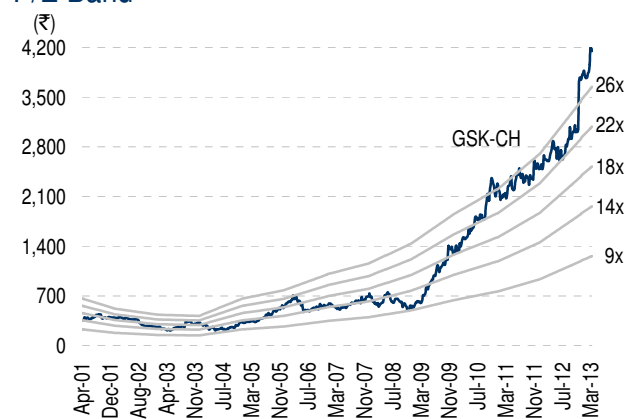
- Sub-segmentation strategy driving growth. Helping to launch new products at better margins
- Steady launch of new products. On track to double revenues in four years
- Dabur and HUL have withdrawn their products from the HFD market. However HUL launched HFD again, under Kissan.
- Rising raw material prices of milk and sugar

Key Financials

YE 31 Dec	CY08	CY09	CY10	CY11	CY12
Sales (Rsm)	15,428	19,215	23,061	26,855	30,794
Net profit (Rsm)	1,883	2,328	2,999	3,552	4,368
EPS (Rs)	44.8	55.4	71.3	84.5	103.9
Growth (%)	15.8	23.6	28.8	18.5	23.0
PE (x)	92.8	75.1	58.3	49.2	40.0
PBV (x)	22.8	19.5	18.7	15.8	13.4
RoE (%)	26.3	28.0	32.8	34.9	36.3
RoCE (%)	27.3	32.4	36.9	37.2	34.4
Dividend yield (%)	0.4	0.4	1.2	0.8	1.1
Net gearing (%)	(61.4)	(91.7)	(104.6)	(97.8)	(109.3)

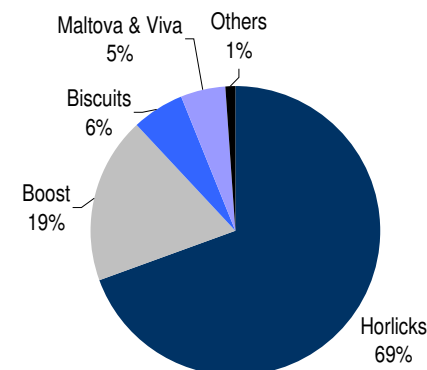
Source: Company, Anand Rathi Research

P/E Band



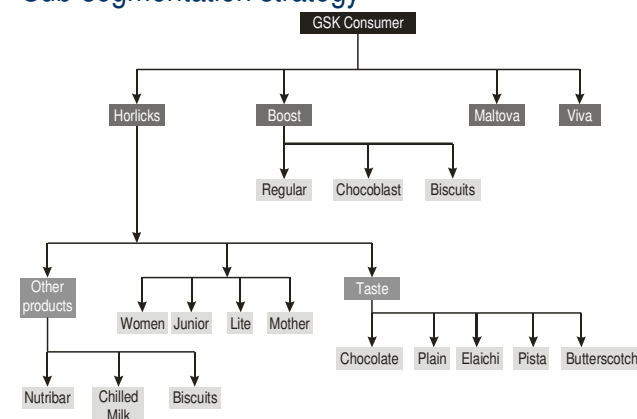
Source: Company, Anand Rathi Research

Revenue break-up



Source: Company, Anand Rathi Research

Sub-segmentation strategy



Source: Company, Anand Rathi Research

Pidilite Industries (Price: ₹195)

Market leader in niche segments

■ Limited competitive pressures for most of its products

■ Pidilite operates in a largely unregulated market, allowing for market leadership in the long term

■ Fall in crude oil and rupee appreciation to drive profitability

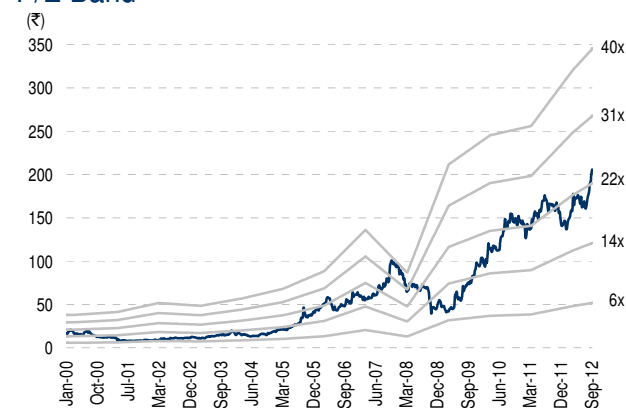
■ Risk: Delay in resolving the synthetic elastomer project

Key Financials

YE 31 Mar	FY08	FY09	FY10	FY11	FY12
Sales (Rsm)	17,082	19,863	21,916	26,439	31,266
Net profit (Rsm)	1,722	1,105	2,726	3,100	3,244
EPS (Rs)	3.4	2.2	5.4	6.1	6.4
Growth (%)	54.0	(35.8)	146.7	13.7	4.3
PE (x)	57.3	89.3	36.2	31.8	30.5
PBV (x)	15.0	13.4	10.8	8.8	7.2
RoE (%)	29.4	15.8	33.0	30.4	26.0
RoCE (%)	21.1	12.0	22.7	27.5	26.0
Dividend yield (%)	0.4	0.4	0.8	0.9	1.0
Net gearing (%)	54.0	57.5	17.1	5.5	2.2

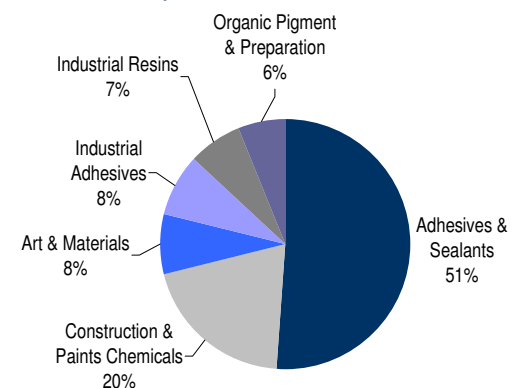
Source: Company, Anand Rathi Research

P/E Band



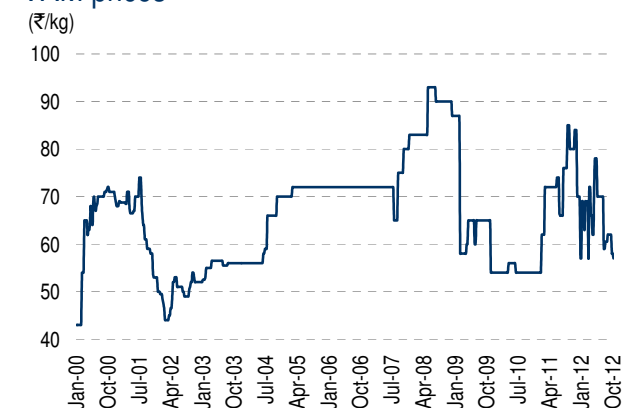
Source: Company, Anand Rathi Research

Revenue break-up



Source: Company, Anand Rathi Research

VAM prices



Source: Company, Anand Rathi Research

Summary

Long-term growth drivers

- Population growth of ~1.5%; per-capita GDP growing ~5-6% per annum
- Despite inflation and volatile growth rates, consumers need FMCG products. (Giffen's goods)
- Penetration for most consumer products, below 15%
- Per-capita consumption less than other developed as well as developing nations

Themes prevalent in recent times

- Rising competitive forces across segments compel companies to go the sub-segmentation way
- Inability to hike prices aggressively results in the need for premiumization

What is happening with the consumer sector now?

- Rural economy now prospering and accounting for the lion's share of growth
- Average ~30% increase in Minimum Support Prices (MSP) for FY13
- MSP of rice and pulses recording 13% and 19% CAGRs over the past six years
- Gold and silver have moved up 200% in three years. Sharp rise in land and cattle prices
- Defensive companies – Good investments for the long term and the conservative investor

Thank You

Appendix

Analyst Certification

The views expressed in this research report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report.

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