DEALMONEY MONTHLY MAGAZINE

Dealmoney

World-Class Financial Services

SECTOR OF THE MONTH
FMCG

PICKS OF THE MONTH

#1 HINDUSTAN UNILEVER LTD

#2 RELAXO FOOTWARES LTD

EQUITIES | COMMODITIES | WEALTH | MUTUAL FUNDS | INSURANCE

Sector of the FMCG

The Fast-moving consumer goods (FMCG) sector is the 4th largest sector of the Indian economy. It is characterised by high turnover consumer packaged goods, i.e. goods that are produced, distributed, marketed and consumed within a short span of time. FMCG products that dominate the market today are detergents, toiletries, tooth cleaning products, cosmetics, etc. The FMCG sector in India also includes pharmaceuticals, consumer electronics, soft drinks packaged food products and chocolates. India's house hold and personal care is the leading segment, accounting for 50 percent of the overall market, healthcare (31percent) and food and beverages (19percent) comes next in terms of market share. Since the sector encompasses a diverse range of products, different companies dominate the market in various sub-sectors. However, some of the top FMCG companies in India are- Dabur (60%), Colgate (54.7%), Hindustan Unilever (54%).

Growing awareness, easier access and changing lifestyles have been the key growth drivers for the sector. The number of online users in India is likely to cross 850 million by 2025. FMCG industry expected to grow 12-13 percent in fourth quarter FY19.

Retail market in India is estimated to reach US$ 1.1 trillion by 2020, with modern trade expected to grow at 20 percent-25 percent per annum, which is likely to boost revenues of FMCG companies. In 2018, ecommerce segment contribution is projected to be around 1.3 percent of the overall branded packaged FMCG sales.

Rural and Urban Trends

The FMCG industry in India is divided into the demographics of rural and urban India. The urban market contributes 60% of the consumption revenue of the FMCG market in India. In 2017, this sector recorded a market size of $ 29.4 bn. While urban areas have spearheaded the growth of the FMCG industry in India, semi-urban and rural segments are growing at a rate that cannot be ignored. Semi-urban and rural segments contribute over 40% of the overall revenues of the FMCG sector in India. FMCG companies in India have witnessed higher growth in rural areas compared to urban ones. And with 12.2% of the world's population living in the villages of India, the Indian rural FMCG market cannot be ignored by investors.

Covid-19 impact

Not all companies are equally exposed to COVID-19 risk. The Nifty index, , declined by 28% over 21 February-17 March, with the largest declines concentrated in travel and transportation, banks and some tech companies, where stock prices dropped in excess of 30%, and even 50%.

In such a context, consumer goods are a relative safe haven; the declines, while steep, have still not been as pronounced as in other sectors. Stock prices for typical FMCG companies dropped between 10%-20% over 21 February-17 March, which is less than the 28% in the overall stock market. Many consumer goods are considered necessity products and thus do not react to slowdowns as much as products in other sectors.
India's biggest consumer goods companies are ramping up production to meet the steep rise in demand with people rushing to stock up on essentials and groceries in bulk amid fears of a lockdown due to the coronavirus outbreak as several states imposed stringent curbs on movement.

This marks a reversal of last year's fortunes when companies cut production because of weak consumption across segments. Still, companies and experts said the surge may be temporary and not make up for slowing sales in the past two months in this quarter.

Immediate changes in Consumer Behavior amidst COVID 19 threat

Immediate changes in Consumer Behavior amidst COVID 19 threat	Categories Impacted	Impact
High demand for Hygiene/Immunity products	Hand Sanitizers/Hand Wash, Chyawanprash, other OTC Healthcare categories	POSITIVE
Sharp reduction in out-of-home dining; Panic buying in many packaged food products	Branded food categories like Biscuits, Bread, Noodles	POSITIVE
Schools shutdown leading to decline in kids led impulse purchase categories	Packaged Snacks, Chocolates, Flavoured drinks, Ice creams, etc.	NEGATIVE
Avoiding social gathering (Social Distancing) and Working from home	Beauty & Personal Care categories	NEGATIVE
Lockdown/closure of commercial malls and large format sores to impact consumer demand	Modern trade channels	NEGATIVE
Demand of summer led consumption like cooling oil to deteriorate as consumers 'Stay at Home'	Cooling oil, Cooling talc, Glucose drinks, Ice creams	NEGATIVE
Availability Challenges as most cities/towns brace of complete lockdown	As witnessed during demonetization, Cos. with agile supply chain and wider manufacturing footprint to gain in such scenario	POSITIVE

The Centre as well as many states have asked companies to shut manufacturing units to curb the spread of Covid-19. Manufacturers of groceries and essential products, especially in the food, hygiene and pharmaceutical segments, are exempted but will have to stagger shifts besides adopting other safety protocols.

In these tiring times, wider the companies distribution reach better it is since consumers are picking items which are readily available on shelf. This will significantly be an advantage for companies like HUL and Dabur. On the other hand, with malls, pubs, etc closing and with consumer's cautiousness being more in Urban areas, companies like United Sprits will be worst impacted.

Unfortunately, this pandemic is likely to push the already stressed rural areas (growing 0.5x urban) to the brink. Hence, we expect overall recovery to be delayed by at least two quarters (from H2FY21). Having said that, we believe consumer goods companies will provide a safety net and should continue to outperform.

Source: Ace equity, CARE, IBEF

Pick of the Month (Hindustan Unilever Ltd.): CMP: 2160 Target: 2550

Hindustan Unilever (HUL) Ltd is India's largest fast moving consumer goods company, with leadership in Home & Personal Care Products and Foods & Beverages. HUL's brands - like Lifebuoy, Lux, Surf Excel, Rin, Wheel, Fair & Lovely, Pond's, Sunsilk, Clinic, Pepsodent, Close-up, Lakme, Brooke Bond, Kissan, Knorr-Annapurna, Kwality Wall's – are household names across the country and span many categories - soaps, detergents, personal products, tea, coffee, branded staples, ice cream and culinary products. The company's product portfolio includes Home & Personal care-Personal wash-Lux, Breeze, Lifebuoy, Dove, Liril, Pears, Hamam & Rexona. Laundry-Surf Excel, Rin, Wheel & Sunlight . Hair care. Deodorant-Axe & Rexona. Ayurvedic Personal & Health Care-Ayush. Skin Care-Fair & Lovely, Pond's, Vaseline, & Aviance. Oral Care- Pepsodent & Closeup. Colour Cosmetic-Lakme. Foods-Tea-Brooke Bond & Lipton. Coffee-Brooke Bond Bru. Foods-Kissan, Annapurna & Knorr. Ice Cream-Kwality Wall's. The company also engagged in the business of Beverages, Packaged Foods, Other Operations, Personal Products, Soaps & Detergents

Margin expansion in weak demand environment: The company has reported the topine growth of 2.5% to Rs. 9808 crs in Q3FY20 in tough demand scenario and benign inflation cycle. Breaking down further, its food and refreshment vertical jumped 8% and home care segment garnered 9.8% growth during the quarter. The operating performance were strong as it reported 19.5% growth on YoY basis while EBITDA margins expansion by 350 bps to 24.9% owing to declining in cost with COGS brought down by ~12%.

HUL-GSK merger to trigger growth: HUL- GSK has got approval for the merger, this will now make fast completion of the merger. This merger will bring syngergies for HUL and possible accretion in the EPS. Secondly, the goodwill in the HUL books are tested for impairment might not be depreciated and no depreciation if it is not impaired.

Outlook: The company showcasing strong margin and growth in the difficult times signals outperformance. Currently, the company is trading at 68x TTM PE. At the CMP price of Rs. 2140, we recommend a buy with the target price of Rs. 2550

NSE / BSE Code	HINDUNILVR / 500696
Sector	FMCG
Industry	Household & Personal Products
Face value / Book Value (Rs per share)	1 / 43.7
Dividend yield (%)	1.4
52 H/L (Rs.)	2307 / 1650
Market Cap. (Rs. Cr)	4,756,112
Shares Outstanding (Cr)	2,164.8

(In Rs.Mn)	FY16	FY17	FY18	FY19
Net Sales	323,030	332,520	355,500	393,110
Sales Growth	1.0%	2.9%	6.9%	10.6%
EBITDA	60,130	63,270	75,010	88,800
EBITDA Margin	18.6%	19.0%	21.1%	22.6%
PAT	41,600	44,900	52,270	60,600
NPM%	12.9%	13.5%	14.7%	15.4%
Adj. EPS (Rs.)	19.2	20.7	24.1	28.0

	FY16	FY17	FY18	FY19
P/E (x)	114.3	105.9	91.0	78.5
P/B (x)	72.4	70.5	65.3	60.5
EV/Sales(x)	14.6	14.1	13.2	12.0
EV/EBITDA(x)	78.2	74.3	62.7	53.0
ROCE(%)	111.9%	94.4%	102.5%	113.3%
ROE(%)	79.1%	67.8%	74.9%	80.3%

Source: Ace equity, CARE, IBEF

Pick of the Month (Relaxo Footwares Ltd.): CMP: 582 Target: 780

Relaxo Footwear stepped into the footwear industry in 1976 promoted by M L Dua and R K Dua .It started off with the manufacture of Hawaii slippers and subsequently diversified into manufacturing casuals, joggers, school and leather shoes. Relaxo is one of India's most quality conscious and progressive footwear companies. Headquartered in Delhi, India, it maintains a fine combination of comfort, style and workmanship and is embarking upon appreciable growth plans for the future. Relaxo has the capacity to manufacture over 100 million pairs, per annum. It is second only to Bata - a name of international repute in the footwear market. In India, Relaxo has a customer base of around 100 million people. Relaxo's capacity to manufacture 300,000 pairs of Hawaii slippers per day is the highest in the footwear industry. At present, there are 10 actively functioning facilities at the following locations: Bahadurgarh, Bhiwadi and Haridwar. It has an extensive range within each category Hawai, Canvas, Dip, Bahamas, Leatherite, Joggers and Flite.

Strengthening distribution and spreading across India: Relaxo has a strong distribution network and also pan India present. The company has also well diversified strategy which also reduces the risk level of the company. The company has various distribution channel like multi brand outlets ((MBOs), exclusive brand outlets, large format stores and e-commerce. On the domestic scale, the company has a firm presence in north and underpenetrated in west and south zone. Its brand sprax has gained good response in south and west while other brand Flite has similar presence in north and east.

Aiming to increase share of premium product: The company has projected stellar achievement by growth 15% on the topline since FY06 on the back of volume growth and premiumisation. Since last many years the company has been gaining market share, brought premium brands and efficient supply chain management. Also, a modest price hike in the product portfolio has welcomed a rise in blended realization. All in all, Relaxo continue to maintain the same practice along with bringing new product in the portfolio.

Outlook: The company has been putting its best performance in past few years and this correction has not changed the perception around the company but a opportunity to buy with attractive valuation. We give a buy at the CMP of Rs. 582 with the target price of Rs. 780.

NSE/BSE Code	RELAXO / 530517
Sector	FMCG
Industry	Footwear
Face value/Book Value (Rs.per share)	1 / 50.5
Dividend yield(%)	1.2
52H/L(Rs.)	830 / 373
Market Cap.(Rs.Cr)	545,397
Shares Outstanding (Cr)	248.2

(InRs.Cr)	FY16	FY17	FY18	FY19
NetSales	17,118	16,312	19,411	22,921
SalesGrowth	15.6%	-4.7%	19.0%	18.1%
EBITDA	2,399	2,309	3,021	3,243
EBITDAMargin	14.0%	14.2%	15.6%	14.1%
PAT	1,203	1,200	1,611	1,754
NPM%	7.0%	7.4%	8.3%	7.7%
Adj.EPS(Rs.)	5.0	5.0	6.7	7.1

	FY16	FY17	FY18	FY19
P/E(x)	453.4	454.7	338.6	310.9
P/B(x)	113.6	89.9	71.6	49.4
EV/Sales(x)	31.8	33.4	28.1	23.8
EV/EBITDA(x)	227.1	236.0	180.4	168.0
ROCE(%)	30.3%	25.7%	29.7%	25.8%
ROE(%)	28.4%	22.1%	23.6%	18.9%

Source: Ace equity, CARE, IBEF

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