

Godrej Consumer (GCPL IN)

Things are not getting better

INDIA | FMCG | Quarterly Update

29 January 2019

Top takeaways from Q3FY19

- ✓ Results were significantly below our estimates because of: (1) Unfavourable weather conditions in south India affecting performance of high-margin HI (household insecticides) portfolio, (2) subdued performance of soaps & hair colours on an unfavourable base, and (3) lag in taking price hikes to pass on RM inflationary pressure and upfront A&P investments into the international business.
- ✓ **One more disappointing quarter for the domestic business** – Domestic business volume growth at 1% was much below consensus expectations of 5-7%. Household insecticides remained flat yoy due to unfavourable weather conditions and increasing salience of incense sticks from the unorganized sector – management said that in order to combat this, it has test-launched its own more efficacious natural products in AP and Telangana. However, we believe it will be difficult to gain meaningful market share in incense sticks, given that unorganised players have widespread presence, low operating costs, and healthy distribution reach.
- ✓ **International business yet to see any meaningful recovery** – International business saw adjusted (ex-sales of UK business) constant currency (CC) sales growth of only 10% yoy, which we consider disappointing given that it was the festive season and that it had scaled up its wet-care portfolio in Africa. Adjusted EBITDA margins declined 300bps yoy to 15% due to higher RM costs and currency-related pressures.
 - Indonesia (30% of international business) CC sales growth slowed to 7%, after seeing two consecutive quarters of 10%+ growth; margin contracted 160bps yoy to 23% (against moderate margin expansion over the past few quarters) mainly due to RM pressure and higher A&P investments.
 - GAUM (55% of international business) saw the fourth consecutive quarter of subdued growth (+4% CC sales) as weakness in South Africa and Kenya business weighed on operating performance.
 - LatAm business remained under significant pressure due to the poor macro-economic situation.

Things not getting better; downgrade to SELL: We believe that GCPL is likely to face a challenging time in the medium term (FY18-21 revenue/EBITDA/net income CAGR of 9%). Within domestic business, HI (50% of domestic business) is likely to see muted growth in the medium term due to increasing competition from unorganised incense stick players (hurting GCPL in coils) and the government's campaign on cleanliness reducing the prevalence of mosquitoes. Moreover, unfavourable weather conditions (intense rainfall/heat and cold) also lead to volatility in sales and therefore operating performance.

International business (50% of overall sales) has remained erratic due to geopolitical risks and macro-economic instability in key geographies. We do not expect meaningful improvement in the macro situation in the medium term. We are ascribing lower valuation multiple to GCPL to account for the seasonality in its HI business, and geopolitical risks and macro-economic challenges in its international business. After this earnings miss (3Q), we have cut our EPS estimates by 5%/8% for FY20/21. We reduce our target PE to 35x FY21 earnings – from 40x December 2020 EPS earlier – to account for lower ROCE (at 17-18% vs. mid-cap peers' c.25%+). We downgrade to SELL from BUY with revised target of Rs 645 vs. Rs 765 earlier.

SELL (Downgrade)

CMP RS 757

TARGET RS 645 (-15%)

COMPANY DATA

O/S SHARES (MN) :	1022
MARKET CAP (RSBN) :	774
MARKET CAP (USDBN) :	11
52 - WK HI/LO (RS) :	979 / 644
LIQUIDITY 3M (USDMMN) :	10.1
PAR VALUE (RS) :	1

SHARE HOLDING PATTERN, %

	Dec 18	Sep 18	Jun 18
PROMOTERS :	63.3	63.3	63.3
FII / NRI :	27.7	27.9	28.1
FI / MF :	2.3	2.4	2.3
NON PRO :	0.3	1.7	1.5
PUBLIC & OTHERS :	6.4	4.8	4.9

KEY FINANCIALS

Rs mn	FY19	FY20E	FY21E
Net Sales	1,05,303	1,15,430	1,26,244
EBITDA	21,652	24,247	26,661
Net Profit	14,717	16,816	18,850
EPS, Rs	14.4	16.5	18.4
PER, x	52.6	46.0	41.0
EV/EBITDA, x	35.9	32.0	28.9
PBV, x	11.5	10.7	10.0
ROE, %	21.8	23.4	24.4
Debt/Equity (%)	37.4	35.0	32.6

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(Rs mn)	3QFY19	3QFY18	yoy (%)	1QFY19	qoq (%)	PC est. (yoy %)	Comments
Domestic volume growth (% yoy)	1%	18%		5%			
Net Sales	26,964	26,037	3.6%	26,418	2.1%	10.3%	
EBITDA	6,162	5,987	2.9%	4,865	26.7%	3.0%	
EBITDA margin (%)	22.9	23.0	-14bps	18.4	444bps	-151bps	
Adj. PAT	4,176	4,322	-3.4%	3,180	31.3%	0.1%	

Weak operating performance weighs on 3QFY19 performance

Consolidated (Rs m)	3QFY18	3QFY19	% YoY	Comments
Net sales	26,037	26,964	3.6	
Other operating income	266	255		• Subdued domestic performance, primarily impacted by HI, soaps, and hair colors
Operating Costs	(20,316)	(21,057)	3.6	• Indonesia slowed down in cc terms, while GAUM and seen mixed performance on weakness in South Africa and Kenya businesses.
EBITDA	5,987	6,162	2.9	• Drag on EBITDA margins was due to higher input cost and weak margins performance in international business.
EBITDA Margin (%)	23.0	22.9	-14bps	
Depreciation	(396)	(427)	7.8	
Interest	(386)	(578)	49.6	
Other Income	359	227	-36.9	
Forex loss	(97)	(75)	-22.3	
PBT	5,467	5,309	-2.9	
Provision for Tax	(1,148)	(1,133)	-1.3	
-Tax Rate (%)	21.0	21.3	34bps	
Net profit before minority	4,319	4,176	-3.3	
Minority Interest	-	-		
Share of profit from associate	3	1		
Adj PAT	4,322	4,176	-3.4	
<i>Net Profit Margin</i>	<i>16.6</i>	<i>15.5</i>	<i>-111bps</i>	
EO Items	(23)	59		
Reported PAT	4,299	4,235	-1.5	
EPS	6.3	6.2	-1.5	
Gross Profit	14,774	15,055	1.9	• Higher raw material inflation coupled with weak category mix led to impact on GM.
Gross margins	56.7	55.8	-91bps	

Cost Details	3QFY18	3QFY19	% YoY
Raw Material Consumption	11,263	11,909	5.7
<i>As a % of sales</i>	<i>43.3</i>	<i>44.2</i>	<i>91bps</i>
Employees cost	2,802	2,794	-0.3
<i>As a % of sales</i>	<i>10.8</i>	<i>10.4</i>	<i>-40bps</i>
Ad spends	2,263	2,170	-4.1
<i>As a % of sales</i>	<i>8.7</i>	<i>8.0</i>	<i>-64bps</i>
Other expenditure	3,988	4,184	4.9
<i>As a % of sales</i>	<i>15.3</i>	<i>15.5</i>	<i>20bps</i>

Source: Company, PhillipCapital India Research

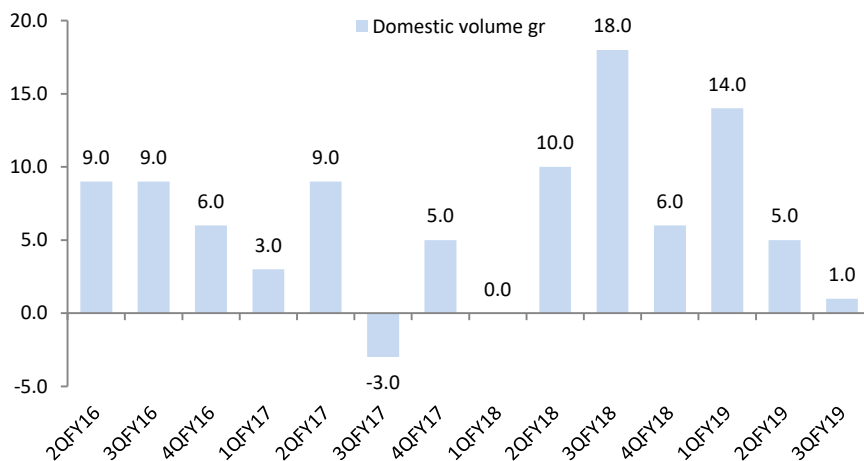
Segment details

India Business (Rs m)	3QFY18	3QFY19	yoy
Soaps	4,260	4,330	2%
Hair care	1,600	1,610	0%
HI	5,970	5,980	0%
Others	2,200	2,750	26%
Exports	780	870	11%
Less: sales promotional	(870)	(810)	-7%
Total	13,940	14,730	6%

International Business (Rs m)	3QFY18	3QFY19	yoy	yoy cc. (%)
Indonesia	3,640	3,950	9%	7%
GAUM	5,980	6,800	14%	4%
Others	2,640	1,660	-3%	41%
Total	12,260	12,410	9%	10%

International business margin	3QFY18	3QFY19	yoy
Indonesia	25.0	24.0	(160)bps
GAUM	14.0	9.0	(80)bps
Others	14.7	8.0	(1520)bps

Source: Company, PhillipCapital India Research

Domestic volume growth (%)


Source: Company, PhillipCapital India Research

Con-call takeaways

- Domestic business saw subdued volume growth of 1% (realization growth c.5%) because of weak performance in HI (unfavorable weather conditions) and soaps & hair colors (higher base).
- GCPL expects price-led growth to come down in coming quarters as it passed on most of the benefits (after crude price reducing) to consumer in the form of offers.
- Rural continues to grow faster than urban.

Household Insecticides

- Deficit rainfall (44% below normal) in south India and increased salience of illegal incense sticks players in east India dented overall HI business. South contributes 35% of the HI business.
- Increase competition from the unorganized/illegal incense sticks players has taken away 4-5% annual growth from GCPL's HI category; GCPL has said that the competition from illegal players is likely to come down as HICA (HI Industry body Association) takes required legal action to control this menace. To combat this competition, GCPL has launched more efficacious 'natural neem-based' incense stick in Andhra Pradesh and Telangana priced at Rs 15 (still at a 50% premium to unorganized players).
- GCPL is creating awareness on dengue to increase the usage of insecticides during day.
- Non- HI products contribution to HI sales stands at low double digit
- Newly launched *Good Knight Fabric Roll On* and *ACTIVE PLUS* are seeing good traction.

Hair colors

- Has cut prices temporarily in the 'hair crème' segment from 1st January 2019 to drive penetration into rural areas and to upgrade users from powder to crème-based hair colors.

Indonesia (30% of international business)

- EBITDA margin declined 160bps yoy to 24% due to higher A&P investments and inflationary pressure in raw materials. Management expects margins to improve from 4QFY19 despite four new products launches (expected) in 4QFY19 – driven by cost savings and distribution expansion programmes.
- HI is seeing good traction on market-share gains and new product launches. GCPL has cross-pollinated HIT anti-roach spray from India into Indonesian markets. It said that ex-HI growth has also been very strong.

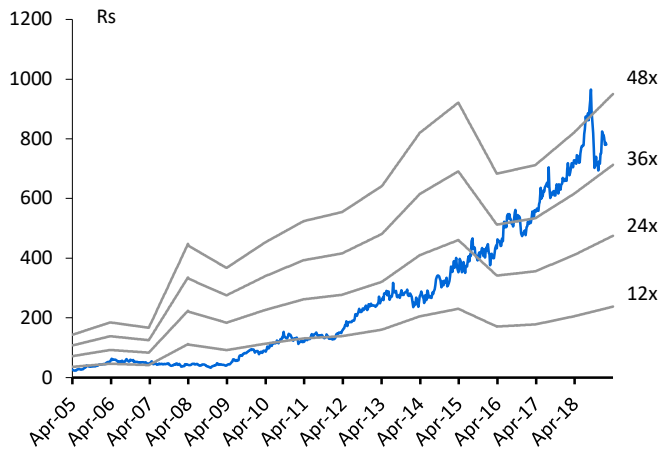
GAUM (50% of international business)

- It saw constant currency sales growth of only 4% yoy due to weakness in South Africa and gradual recovery seen in the Kenya business.
- Darling re-launch: It has been already re-launched in Nigeria/Kenya markets and management plans to re-launch it in South Africa as some green shoots are visible.
- HI launch: Registration is work in progress. It has not shelved its plan of launching HI in African markets.
- Margin recovery: Expects margins to recover once it fully scales up the launch of wet-care products (as they have higher gross margin vs. dry hair care products – which has been its mainstay so far).

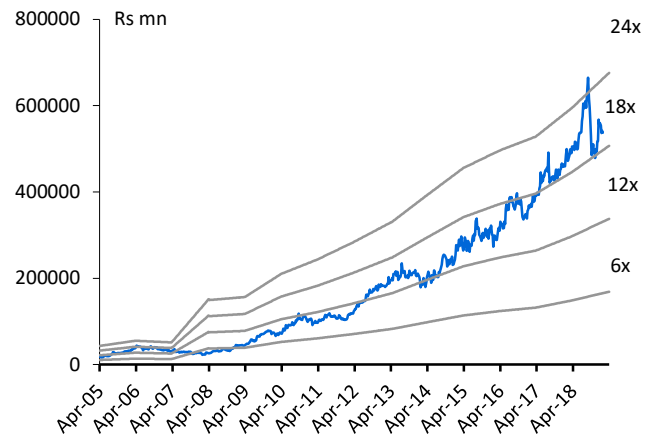
Others (20% of international business)

- LatAm continued to remain under tremendous pressure due to hyper-inflation. The management does not expect any meaningful improvement in coming quarters.

One-year forward P/E band



EV/EBITDA band



Source: PhillipCapital India Research Estimate

Financials

Income Statement

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Net sales	97,680	1,05,303	1,15,430	1,26,244
Growth, %	5.7	7.8	9.6	9.4
Other operating income	251	753	1,054	1,159
Raw material expenses	-42,744	-47,445	-51,715	-56,370
Employee expenses	-10,574	-11,209	-12,329	-13,686
Other Operating expenses	-24,444	-26,050	-28,297	-30,802
EBITDA (Core)	20,671	21,652	24,247	26,661
Growth, %	8.9	4.7	12.0	10.0
Margin, %	21.2	20.6	21.0	21.1
Depreciation	-1,557	-1,716	-1,904	-2,038
EBIT	19,114	19,936	22,343	24,623
Growth, %	8.8	4.3	12.1	10.2
Margin, %	19.6	18.9	19.4	19.5
Interest paid	-1,607	-2,250	-2,025	-1,823
Other Income	1,076	1,129	1,242	1,366
Non-recurring Items	1,796	0	0	0
Pre-tax profit	20,389	18,815	21,559	24,167
Tax provided	-4,047	-4,098	-4,743	-5,317
Profit after tax	16,342	14,717	16,816	18,850
Net Profit	16,342	14,717	16,816	18,850
Growth, %	11.2	1.2	14.3	12.1
Net Profit (adjusted)	14,546	14,717	16,816	18,850
Unadj. shares (m)	1,022	1,022	1,022	1,022
Wtd avg shares (m)	1,022	1,022	1,022	1,022

Balance Sheet

Y/E Mar, Rs mn	FY18E	FY19E	FY20E	FY21E
Cash & bank	9,602	12,232	14,869	18,711
Marketable securities at cost	8,558	8,558	8,558	8,558
Debtors	12,455	13,427	14,718	16,097
Inventory	15,777	17,008	18,644	20,391
Loans & advances	29	29	29	29
Other current assets	5,256	5,256	5,256	5,256
Total current assets	51,677	56,510	62,074	69,041
Investments	1,052	1,052	1,052	1,052
Gross fixed assets	86,738	90,338	93,638	96,638
Less: Depreciation	-3,588	-5,303	-7,207	-9,245
Add: Capital WIP	839	839	839	839
Net fixed assets	83,989	85,873	87,269	88,231
Non-current assets	1,546	1,546	1,546	1,546
Total assets	1,39,627	1,46,344	1,53,304	1,61,234
Current liabilities	41,648	43,487	45,931	48,540
Provisions	982	982	982	982
Total current liabilities	42,630	44,470	46,913	49,522
Non-current liabilities	34,414	34,414	34,414	34,414
Total liabilities	77,044	78,883	81,327	83,936
Paid-up capital	681	681	681	681
Reserves & surplus	61,902	66,779	71,296	76,617
Shareholders' equity	62,583	67,461	71,978	77,298
Total equity & liabilities	1,39,627	1,46,344	1,53,304	1,61,234

Cash Flow

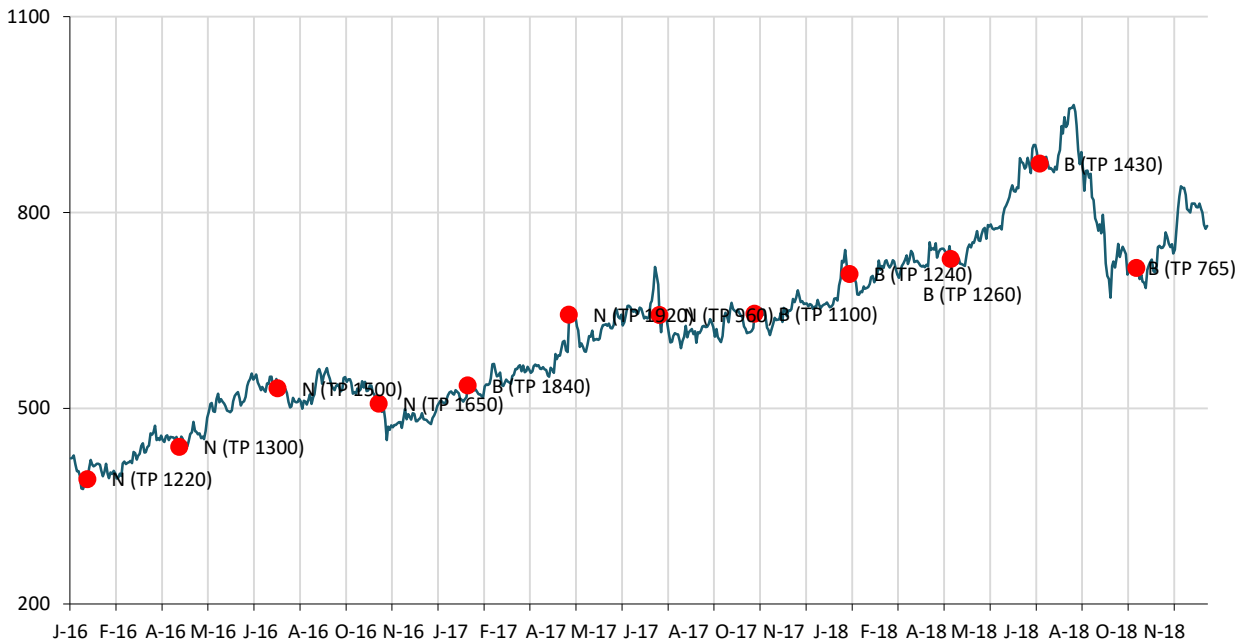
Y/E Mar, Rs mn	FY18E	FY19E	FY20E	FY21E
Pre-tax profit	20,389	18,815	21,559	24,167
Depreciation	1,557	1,716	1,904	2,038
Chg in working capital	866	-364	-484	-516
Total tax paid	-3,899	-4,098	-4,743	-5,317
Cash flow from operating activities	18,913	16,069	18,237	20,372
Capital expenditure	-3,742	-3,600	-3,300	-3,000
Chg in investments	1,113	0	0	0
Chg in marketable securities	-1,740	0	0	0
Cash flow from investing activities	-4,369	-3,600	-3,300	-3,000
Free cash flow	14,544	12,469	14,937	17,372
Equity raised/(repaid)	476	0	0	0
Debt raised/(repaid)	-7,279	0	0	0
Dividend (incl. tax)	-7,379	-9,840	-12,300	-13,530
Cash flow from financing activities	-14,183	-9,840	-12,300	-13,530
Net chg in cash	361	2,630	2,637	3,842

Valuation Ratios

	FY18E	FY19E	FY20E	FY21E
Per Share data				
EPS (INR)	16.0	14.4	16.5	18.4
Growth, %	(25.9)	1.2	14.3	12.1
Book NAV/share (INR)	61.2	66.0	70.4	75.6
FDEPS (INR)	14.2	14.4	16.5	18.4
CEPS (INR)	14.0	16.1	18.3	20.4
CFPS (INR)	18.5	14.6	16.6	18.6
DPS (INR)	6.0	8.0	10.0	11.0
Return ratios				
Return on assets (%)	13.3	11.9	12.6	13.1
Return on equity (%)	23.2	21.8	23.4	24.4
Return on capital employed (%)	18.4	16.9	17.9	18.8
Turnover ratios				
Asset turnover (x)	1.4	1.5	1.6	1.7
Sales/Total assets (x)	0.7	0.7	0.8	0.8
Sales/Net FA (x)	1.2	1.2	1.3	1.4
Working capital/Sales (x)	(0.1)	(0.1)	(0.1)	(0.1)
Receivable days	46.5	46.5	46.5	46.5
Inventory days	59.0	59.0	59.0	59.0
Payable days	110.6	109.5	110.1	110.2
Working capital days	(30.4)	(26.9)	(23.0)	(19.6)
Liquidity ratios				
Current ratio (x)	1.2	1.3	1.4	1.4
Quick ratio (x)	0.9	0.9	0.9	1.0
Interest cover (x)	11.9	8.9	11.0	13.5
Total debt/Equity (%)	40.3	37.4	35.0	32.6
Net debt/Equity (%)	24.9	19.2	14.4	8.4
Valuation				
PER (x)	53.2	52.6	46.0	41.0
PEG (x) - y-o-y growth	(2.1)	44.6	3.2	3.4
Price/Book (x)	12.4	11.5	10.7	10.0
EV/Net sales (x)	8.0	7.4	6.7	6.1
EV/EBITDA (x)	37.8	35.9	32.0	28.9
EV/EBIT (x)	40.8	39.0	34.7	31.3

Source: Company, PhillipCapital India Research Estimates

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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