AXIS SECURITIES

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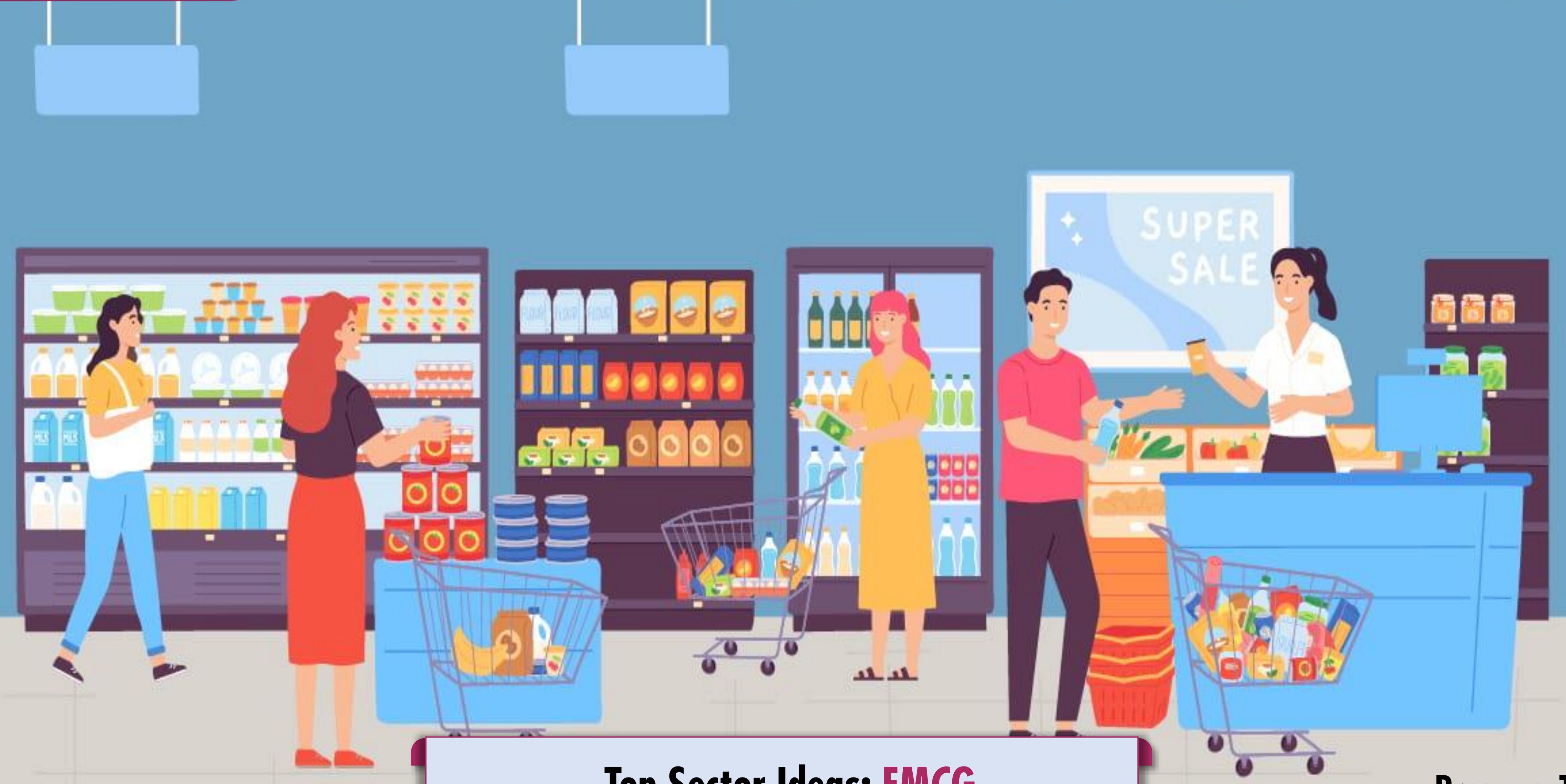

Top Sector Ideas: FMCG

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FMCG Sector: Post Election Result Outlook

Consumption is Likely On A Front Seat?

- **Fell short of market expectations:** On 4th Jun'24, election results were short of expectation with larger dent seen in Uttar Pradesh and Maharashtra. Though NDA has won 292 seats, the Modi 3.0 government will be coalition government and overall market sentiments is likely to shift towards defensive sector like FMCG. With huge setback, Modi 3.0 is expected to see some populist measures with some reforms or policy allocation to the bottom of the pyramid to address the rural challenges. This could be positive for the consumption sector which has seen muted growth for the last couple of years.
- **Other key tailwinds:** 1) Above-normal rainfall is most likely over the country as a whole during the monsoon season (June to September 2024), 2) Overall headline inflation remained stable at 5.4 % in FY24 vs. 6.7% in the previous year and estimated the FY25 inflation at 4.5%. This is likely to push the much-needed rural growth, 3) Early green shoots have been seen in rural areas across FMCG companies led by easing inflation and higher government spending which will drive rural demand in the coming quarters, 4) Crude is down 16% since Apr'24 peak which is likely to drive margins for the sector.
- ***In this backdrop, we are optimistic on the current development related to FMCG space over medium to long term. Our BUY* ideas pertaining to election results outcome in pecking order are – VBL, Nestle, Jyothy Labs, Britannia, HUL, Dabur.***

Note: The Rating is based on our Q4FY24 Result Update. Most of the stocks have reached their Q4FY24 Result Update. We, however, remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

FMCG Sector: Q4FY24/ FY24 Review

Volume Growth Muted; Competition Intensifies

- **Topline growth remains muted:** Most staple companies has delivered low to mid-single digit revenue growth as increased competitive intensity and anniversarization of price hikes has resulted in muted topline. On a positive front, most of the companies have highlighted early green shoots in the rural areas.
- **Hopeful on demand recovery:** Easing inflation, higher government spending, and higher MSP are expected to drive rural demand in the coming quarters. However, the increasing competitive intensity from smaller and regional players, especially as raw material prices ease off, needs to be closely monitored.
- **Gross margin continues its recovery path; EBITDA margins in 'Wait & Watch':** Gross margins across Staples companies are improving as key raw material prices such as crude, palm, and packaging materials remain stable. However, an increase in advertising spending to regain market share may slow down EBITDA margin expansion in the short term. However, this is expected to benefit in the longer run.

FMCG Sector: Outlook

How Have Companies Performed In Q4FY24?

- **Demand recovery in the coming quarters:** FMCG companies have reported muted performance due to increased competitive intensity, affecting overall volume growth. However, there is optimism for demand recovery in the coming quarters, especially in the rural areas which will be driven by easing inflation, increased government spending, and higher remittances.
- **Full rural recovery will take a few more quarters.**
- Companies have highlighted that **volume growth is likely to pick up gradually.**
- On a gross margins' front, most companies have continued to **deliver sequential recovery** as key raw material prices – crude, packing and palm remained stable.
- Nonetheless, **EBITDA margins have shown slower recovery** as companies increased ad-spends to increase 'Voice of Share' and gain market share. Though this has a short-term negative impact on margins, it will help in the longer run.

FMCG Sector Outlook

What Makes the FMCG Sector a Good Bet?

- **Structural Growth Trajectory:** Indian FMCG companies are experiencing a structural growth trajectory, with several categories, such as shampoos and premium detergents, still under-penetrated and underserved. Additionally, ongoing rural penetration is further contributing to the sector's growth potential.

- **Premiumisation Agenda Driving Overall Growth:** As Indian consumers experience a rise in purchasing power, there is a growing tendency to opt for premium and branded products. This premiumisation trend is expected to be a key driver of overall growth for the FMCG sector.

- **Best-in-Class Return Ratios (ROCE, ROE):** In a volatile, uncertain, complex, and ambiguous (VUCA) world, the FMCG sector stands out for offering best-in-class returns ratios such as ROCE, ROE, and dividend yield. These factors contribute to safeguarding capital over the long term.

Short & Medium-term Outlook

Short term

Delayed Volume Recovery

Rural slowdown has bottomed out, but yet to fully recover

Delayed Margin Recovery

Gross margins are likely to recover sequentially, but increase in Ad-spends will delay overall EBITDA margin expansion

Domestic consumption play

Better returns in this volatile environment

Rural Demand to Pick Up

Increase in government spending

Consumer price inflation remain stable

RM prices remain stable

Medium Term

Key Monitorables – Rural Recovery; Margins Guidance; Inflation Trajectory; Competitive Intensity

Top Sector Ideas: FMCG

Stock	Reco.	TP*	Recommendation Rationale
Nestle India	BUY	Rs 2,880*	✓ We maintain a positive outlook on Nestle due to its consistent and resilient performance, driven by several key factors: ✓ **Rural Penetration and Market Share Gains:** The RURBAN strategy has bolstered Nestle's rural penetration and market share. ✓ **Continuous Focus on Innovation:** The launch of 125 products in the last seven years has been a significant growth driver. ✓ **Emphasis on Premiumisation:** Nestle's focus on premiumising core categories, such as the Maggi noodles range, and introducing differentiated products supports sustained growth. ✓ **Expansion into Future Categories**: The company's entry into new categories, including Purina Pet Care and Gerber's toddler nutrition, positions it for future growth. ✓ **Direct-to-Consumer (D2C) Platform:** The introduction of a D2C platform enhances consumer engagement. ✓ With these strategies in place, we believe Nestle is well-positioned for long-term growth. We expect the company to deliver healthy Revenue/EBITDA/PAT growth of 13%/18%/18% CAGR over FY23-26E.

Note: The Target price is based on our Q4FY24 Result Update. Most of the stocks have reached their Q4FY24 Result Update Target Prices. We, however, remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

Top Sector Ideas: FMCG

Stock	Reco.	TP*	Recommendation Rationale
Varun Beverages	BUY	Rs 1,750	✓ VBL has consistently outperformed its peers in recent quarters despite the volatile environment ✓ VBL is poised for strong performance driven by several factors: 1) Successful strategic acquisition of the Beverage Company, thereby consolidating its presence in South Africa and DRC, 2) Continued focus on expansion in its distribution reach, mainly in rural areas, 3) commissioning of multiple greenfield and brownfield facilities across geographies, strengthening manufacturing capabilities and extending market reach, thus saving significant transportation costs, and 4) Focus on expanding high-margin Sting energy drink across outlets coupled with increased focus on expansion of value-added dairy, sports drink (Gatorade), and juice segment. We believe these investments are poised to support the company's long-term growth objectives and profitability.

Note: The Target price is based on our Q4FY24 Result Update. Most of the stocks have reached their Q4FY24 Result Update Target Prices. We, however, remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

Top Sector Ideas: FMCG

Stock	Reco.	TP*	Recommendation Rationale
Jyothy Labs	BUY	Rs 500	✓ The company's recent initiatives, implemented over the last couple of years, have begun yielding positive results, and we expect these benefits to extend over the coming years. Notable initiatives include, a) Expanding value offerings through LUPs and promoting premiumisation, primarily in the Detergents and Dishwash segments, b) Diversifying into the larger Body Wash segment (Toilet Soap) as opposed to its previous presence in the niche (natural) segment, creating a broader market for the company in the Soap segment, and, c) The company's commitment to expanding its direct distribution network, with aspirations to increase its current 1.1 Mn outlets. ✓ We expect the company to deliver healthy Revenue/EBITDA/PAT growth of 13%/25%/25% CAGR over FY23-26E and ROE to increase from 15% in FY23 to 21% in FY26

Note: The Target price is based on our Q4FY24 Result Update. Most of the stocks have reached their Q4FY24 Result Update Target Prices. We, however, remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

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