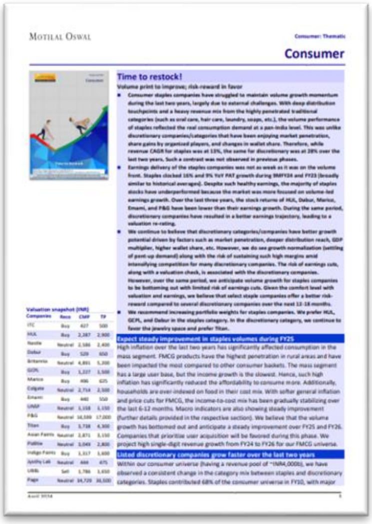
Consumer

Recap, Review, Restore!


Motilal Oswal
Consumer
Time to restock!

- **Recap -** In our last consumer sector thematic published in Apr'24, we highlighted our overweight stance on staple companies owing to favorable risk-reward and expectations of volume recovery in FY25 and FY26. We mentioned that the earnings cut cycle had overly played out in stocks, leading to 15-20% corrections in valuation multiples of staple companies as compared to their own five-year average. Thereby, an improving volume print will also narrow down the valuation gaps. Moreover, we saw positive management commentary during 4QFY24 earnings calls (rural pickup, distribution expansion, new launches, etc.), which defended our expectations of volume recovery. As a result, many FMCG stocks have run up about 5% to 15%, particularly the ones that were corrected the most (Marico, Dabur, HUL, etc).
- **Current rally –** After the election outcome, the rally in consumer stocks has extended further for the last two days, which is mainly attributed to portfolio allocation. We believe this rally in staple stocks is driven by not only its 'defensive sector' tag but also the underlying excitement, which was triggered by strong post-4Q management commentary. Most investors were in sync with us on the risk-reward proposition (noted during our extensive road show on consumer thematic); however, they wanted to see more signs of recovery before buying into the sector. In the last two days, the risk-reward proposition along with sector tailwinds, has quickly gained the required attention.
- **What has not been factored in?** In our estimates, we have estimated high-single-digit volume growth for FY25 and FY26. Although the management of various companies had highlighted the possibility of attaining low-double-digit volume growth for FY25, we have still not upgraded our estimates to factor in this positive commentary. Thereby, any meaningful pickup in volume growth in ensuring quarters can lead to upgrades in our volume growth assumption. Secondly, the recent fall in crude prices can further boost gross margins; we have built marginal GM expansion for FY25-26E. The upside revision is also possible if crude prices remain around the current low levels. We have rather built cost control-led EBITDA margin expansion in FY25. Thirdly, any change in the government's push for consumption (particularly rural) can further fuel volume growth.
- **How do we want to play?** In our initial argument of favorable risk-reward for staple companies, certainly the reward has come quite quickly. But the question arises: has the risk increased due to this stock rally? We believe that as earnings catalysts are in place and stocks are also within our fundamental value, the risk factor is still under control. However, volume performance will be critical to maintaining the stocks' performance. The sector has seen several headwinds in FY23/FY24, we believe the earnings cycle will see an upward trend. An above-normal monsoon, rural pickup, distribution expansion, seasonal benefits (summer/winter portfolio has favourable base) and steady raw material prices provide visibility on the earnings acceleration in FY25.
- **Top picks:** We maintain our over-weight call on the staple sector and continue to prefer **HUL, GCPL and Dabur as our top picks**.

Valuation summary (INR b)

Company	Reco	CMP (INR)
Hind. Unilever	Buy	2,603
ITC	Buy	430
Asian Paints	Neutral	2,960
Nestle India	Neutral	2,509
Pidilite Inds.	Neutral	3,163
Dabur India	Buy	600
Britannia Inds.	Neutral	5,487
Godrej Consumer	Buy	1,427
Marico	Buy	645
United Spirits	Neutral	1,300
Page Industries	Neutral	38,492
P & G Hygiene	Neutral	16,525
Colgate-Palm.	Neutral	2,960
United Breweries	Sell	2,016
Emami	Buy	700
Indigo Paints	Buy	1,353
Jyothy Labs	Neutral	448

Naveen Trivedi – Research Analyst (Naveen.Trivedi@motilaloswal.com
Research Analyst: Pratik Prajapati (pratik.prajapati@motilaloswal.com) | **Tanu Jindal** (Tanu.Jindal@MotilalOswal.com)

- **HUL**: We expect that volume growth has bottomed out and anticipate a gradual volume recovery in FY25. HUL's wide product basket and presence across price segments should help the company achieve a steady growth recovery. There is scope for a turnaround in part of BPC and F&R; we will monitor the execution in these segments under the new CEO. The valuation at 49x FY26E EPS is reasonable given its last five-year average P/E of 60x on one-year forward earnings.
- **GCPL** is consistently working to expand the total addressable market for its India business through product innovations to drive frequency. Besides, there has been a consistent effort to address the gaps in profitability and growth in its international business. We see margin headroom from the RCCL and Indonesia businesses. The valuation is expensive, but earnings are expected to outperform peers.
- **DABUR**: Recovery in rural markets should support its portfolio, as it is heavily skewed toward rural areas. In the domestic business, we expect healthcare, oral care, and food business to grow faster than others. The distribution drive will further contribute to rural growth. EBITDA margin has remained in the range of 19-20% for the past several years. The margin is expected to improve in the coming years due to a better mix of products (such as higher healthcare offerings) and increased pricing in high market-share brands.

Expect recovery in volume growth

- Growth in the FMCG sector is driven by price hikes in the last two years due to high inflation and slower volume growth.
- Macro headwinds and price hikes have been delaying the recovery in the rural market, which is under pressure due to weak income growth. The mass segment was exposed to inflation; hence, the volume recovery has been delayed. During this period, we have seen down-trading, a higher mix of low unit packs (LUPs), etc.
- With steady improvements in macroeconomics and price cuts by FMCG companies, we anticipate a rebound in volume growth.
- With a prolonged slowdown in rural markets, the government can also be more active in accelerating the volume growth performance. As of now, we do not change our volume growth assumption, but it can also further drive our volume growth assumption.

Exhibit 1: FMCG companies volume growth (%)

Companies	FY05-10	FY10-15	FY15-19	FY19-24	FY24	FY24-26E
HUL	6	7	6	3	2	6
Colgate	9	10	3	1	1	5
Dabur	7	9	5	6	3	7
Emami	10	12	7	3	2	6
Marico	11	11	5	5	3	7
GCPL	11	6	7	6	7	8
Jyothy	16	9	7	6	10	8
Britannia	8	9	8	4	2	7
Nestle	11	5	(1)	6	5	8
ITC-Cig	4	(2)	(1)	4	3	3

Margin profile

The gross margin recovery in FY24 was quite swift, with most companies surpassing their FY19-levels margin. Nestle, Dabur, and GCPL were slightly lower as compared to FY19. In FY24, we saw faster reinvestment of gross margin expansion into higher marketing spending. As of now, we have not built the benefits of the recent softening in RM prices. We modeled a slight improvement in EBITDA margins, largely driven by operating leverage and cost control (A&P spending).

Exhibit 2: Gross and EBITDA margin trajectory

	Gross Margin (%)			Gross Margin Change (bps)			EBITDA margin			EBITDA Margin Change (bps)		
	FY19	FY24	FY26E	FY19-23	FY23-24	FY24-26E	FY19	FY24	FY26E	FY19-23	FY23-24	FY24-26E
ITC	64.0	61.6	62.1	(486)	245	54	38.1	37.0	37.2	(189)	86	20
HUL	53.0	51.9	52.7	(536)	427	73	22.6	23.7	24.2	77	33	47
NESTLE	59.4	56.1	56.0	(522)	197	(10)	24.4	24.2	24.8	(187)	165	61
DABUR	49.6	48.0	49.0	(394)	236	97	20.4	19.4	20.9	(160)	52	155
BRITANNIA	40.6	43.4	44.0	51	224	60	15.7	18.9	19.3	169	154	40
GCPL	55.8	55.2	55.2	(618)	550	1	20.4	21.8	22.4	(133)	271	63
MARICO	45.2	50.8	50.6	(3)	562	(21)	18.1	21.0	21.3	46	245	31
COLGATE	65.1	69.7	68.9	60	400	(78)	27.7	33.5	33.2	190	386	(31)
EMAMI	65.7	67.6	67.5	(101)	284	(7)	27.1	26.5	27.4	(175)	121	89
UNSP	48.8	43.4	44.0	(737)	197	57	14.3	16.0	16.9	(66)	230	88
P&G	58.0	63.0	63.0	(39)	537	-	20.7	26.4	27.0	153	420	60
TITAN	27.2	22.8	23.5	(203)	(238)	69	10.1	10.4	10.9	196	(167)	56
ASIAN PAINT	41.5	43.4	42.7	(280)	474	(67)	19.6	21.4	20.3	(142)	322	(102)
PIDILITE	49.3	51.6	52.2	(661)	888	62	19.3	21.9	22.5	(251)	504	62
INDIGO PAINT	44.3	47.6	46.5	28	309	(113)	10.1	18.2	17.5	681	132	(69)
JYOTHY	46.5	49.1	48.5	(419)	680	(58)	15.5	17.4	17.8	(279)	470	43
UBBL	53.6	42.7	45.5	(1,042)	(40)	278	17.6	8.6	12.8	(936)	35	418
PAGE	58.0	54.5	55.7	(228)	(127)	120	21.6	19.0	20.3	(333)	74	122

Valuation and view

- The sector's valuation has seen a consistent re-rating over the last 10-15 years. The sector was trading at around 30x P/E during 2014, but it has since undergone a re-rating, with the multiple increasing to more than 40-45x after 2019. However, over the past 2-3 years, the sector’s valuation has remained relatively stagnant. In fact, some stocks have experienced a correction in their valuations during this period.
- The sector (excluding ITC) has largely witnessed a de-rating in valuation over the past two years. Most of the stocks have generated returns below their earnings growth as the quality of earnings (volume-led) was lacking. During the same period, we have observed several new consumer companies in the discretionary sector reporting a high earnings trajectory, resulting in a re-rating of their valuations. Over the last three years, several FMCG stocks (excluding ITC, Tata Consumer and Varun Beverages) have experienced a valuation correction, including Dabur, HUL, Marico, and P&G. Some of the discretionary stocks have also seen corrections recently, such as Asian Paints, Pidilite, etc.
- **The sector has seen several headwinds in FY23/FY24, we believe the earnings cycle will see an upward trend. An above-normal monsoon, rural pickup, distribution expansion, seasonal benefits (summer/winter portfolio has favourable base) and steady raw material prices provide visibility on the earnings acceleration in FY25. We believe that, in line with the earnings uptrend, the valuation will also see rerating and will be close to the last five-year average valuation multiple.**
- **Top picks: We maintain our overweight call on the staple sector and continue to prefer HUL, GCPL and Dabur as our top picks.**

Exhibit 3: Our coverage universe CAGR during FY24-26E

Companies	Revenue	Gross Profit	EBITDA	PAT
ITC	9	9	9	8
HUL	8	9	9	10
NESTLE	10	10	12	12
DABUR	9	10	13	13
BRITANNIA	10	11	11	14
GCPL	10	10	11	17
MARICO	9	9	10	10
COLGATE	7	7	7	7
EMAMI	8	8	10	9
UNSP	9	10	12	9
P&G	10	10	11	12
TITAN	17	19	20	24
ASIAN PAINT	10	10	8	6
PIDILITE	13	14	15	17
INDIGO PAINT	16	14	14	12
JYOTHY	10	9	11	11
UBBL	12	16	37	44
PAGE	13	14	17	20

Exhibit 4: Coverage universe PAT and market cap CAGR over the years

Companies	PAT CAGR (%)			MKT Cap CAGR (%)		
	FY21-24	FY19-24	FY14-24	FY21-24	FY19-24	FY14-24
ITC	16	10	9	25	8	6
HUL	8	11	11	-2	7	15
NESTLE	15	13	10	14	19	18
DABUR	3	4	7	-1	5	11
BRITANNIA	5	13	18	10	10	28
GCPL	5	-0	10	19	12	16
MARICO	8	6	12	7	8	17
COLGATE	9	12	11	20	17	15
EMAMI	6	10	7	-5	1	7
UNSP	44	14	27	27	15	8
P&G	17	14	10	10	9	18
TITAN	56	22	17	34	27	30
ASIAN PAINT	20	20	16	4	14	18
PIDILITE	17	14	15	18	19	26
INDIGO PAINT	28	41	83	-18	N/A	N/A
JYOTHY	19	13	15	46	18	15
UBBL	51	-6	6	12	4	8
PAGE	19	8	14	4	7	18

Source: Company, MOFSL

Exhibit 5: Valuation summary

Company	Reco	CMP	Mkt Cap	EPS (INR)			EPS Growth YoY (%)			P/E (x)			RoE (%)	Div. (%)
		(INR)	(INR B)	FY24	FY25E	FY26E	FY24	FY25E	FY26E	FY24	FY25E	FY26E	FY24	FY24
Hind. Unilever	Buy	2,603	5,864	43.7	48.3	53.1	0.7	10.6	9.9	59.6	53.9	49.0	20.2	1.6
ITC	Buy	430	5,092	16.4	17.3	18.6	9.0	7.0	8.3	26.3	24.9	23.2	28.5	3.2
Asian Paints	Neutral	2,960	2,742	57.9	58.6	64.7	30.9	1.1	10.4	51.1	50.5	45.8	32.0	1.5
Nestle India	Neutral	2,509	2,340	41.0	35.8	40.9	62.5	-12.9	14.2	61.1	70.2	61.4	136.5	1.3
Pidilite Inds.	Neutral	3,163	1,567	35.9	42.7	49.4	42.2	18.9	15.7	88.2	74.1	64.1	23.3	0.5
Dabur India	Buy	600	1,026	10.6	12.2	13.5	9.2	15.5	10.0	56.7	49.1	44.6	19.9	1.1
Britannia Inds.	Neutral	5,487	1,278	88.7	102.8	115.5	10.1	15.9	12.3	61.8	53.4	47.5	57.2	1.3
Godrej Consumer	Buy	1,427	1,378	19.3	22.6	27.4	13.2	17.1	21.0	73.9	63.1	52.1	15.0	0.4
Marico	Buy	645	793	11.5	12.5	13.9	13.7	8.8	11.3	56.2	51.6	46.4	38.8	1.6
United Spirits	Neutral	1,300	875	18.1	19.1	21.4	42.7	5.3	12.1	71.7	68.1	60.7	18.9	0.5
Page Industries	Neutral	38,492	409	510.3	605.0	731.2	-0.4	18.6	20.9	75.4	63.6	52.6	35.6	1.0
P & G Hygiene	Neutral	16,525	526	252.1	283.6	314.7	31.8	12.5	11.0	65.5	58.3	52.5	84.3	1.4
Colgate-Palm.	Neutral	2,960	764	49.2	52.3	56.4	26.8	6.2	7.8	60.2	56.6	52.5	74.5	1.4
United Breweries	Sell	2,016	511	15.5	25.5	32.4	24.7	63.9	27.1	129.7	79.2	62.3	10.1	0.3
Emami	Buy	700	279	18.0	20.7	21.3	17.0	14.9	2.6	38.8	33.7	32.9	33.2	1.4
Indigo Paints	Buy	1,353	62	31.3	34.2	39.3	28.8	9.2	15.2	43.2	39.6	34.4	17.7	0.3
Jyothy Labs	Neutral	448	145	9.8	10.9	12.2	54.8	11.0	11.9	45.7	41.2	36.8	21.5	0.8

Source: Company, MOFSL

Exhibit 6: Valuation changes vs. historical averages

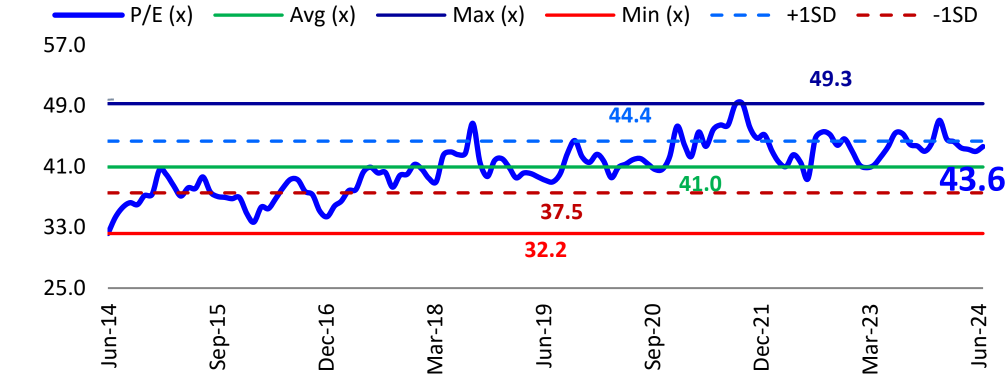
Companies	Current P/E (x)	Average P/E (x)			Prem / Disc P/E (x) vs.		
		15 YR	10 YR	5 YR	15 YR	10 YR	5 YR
Consumer	**43.6**	**36.6**	**41.0**	**43.3**	**19.2**	**6.6**	**0.8**
Consumer Ex ITC	**53.2**	**36.6**	**50.7**	**55.8**	**45.5**	**5.0**	**-4.6**
Asian Paints	47.6	45.6	54.1	61.1	4.2	-12.0	-22.1
Britannia Inds.	50.2	38.0	45.4	48.1	31.9	10.6	4.3
Colgate-Palm.	52.7	32.2	39.4	39.4	63.5	33.7	33.5
Dabur India	46.2	38.7	44.8	51.3	19.3	3.2	-10.1
Emami	30.1	22.1	27.3	25.7	35.9	10.1	16.9
Godrej Consumer	56.6	38.8	44.0	46.7	46.0	28.9	21.2
Hind. Unilever	50.4	44.4	51.9	57.6	13.4	-2.9	-12.6
Indigo Paints	36.8	68.6	68.6	68.6	-46.3	-46.3	-46.3
ITC	23.6	24.2	24.0	20.3	-2.3	-1.6	16.3
Jyothy Lab.	35.3	33.8	33.8	28.6	4.3	4.2	23.2
Marico	47.8	33.4	41.6	44.9	43.3	15.1	6.5
Nestle India	65.5	48.1	58.3	66.9	36.1	12.4	-2.0
P & G Hygiene	55.6	52.7	62.9	66.5	5.6	-11.6	-16.4
Page Industries	57.6	51.9	65.5	70.0	11.0	-12.0	-17.7
Pidilite Inds.	68.9	46.0	57.5	73.6	49.8	19.8	-6.3
Tata Consumer	59.1	40.9	46.6	55.4	44.4	26.8	6.6
United Breweries	71.0	84.4	91.9	111.8	-15.8	-22.7	-36.5
United Spirits	61.3	NA	61.9	60.4	-99.2	-1.0	1.5
Varun Beverages	62.8	43.5	43.5	44.9	44.6	44.6	40.1

Source: Bloomberg, MOFSL

The sector was trading at around 30x P/E during 2014, but it has since undergone a re-rating, with multiples increasing to 40-45x since 2019.

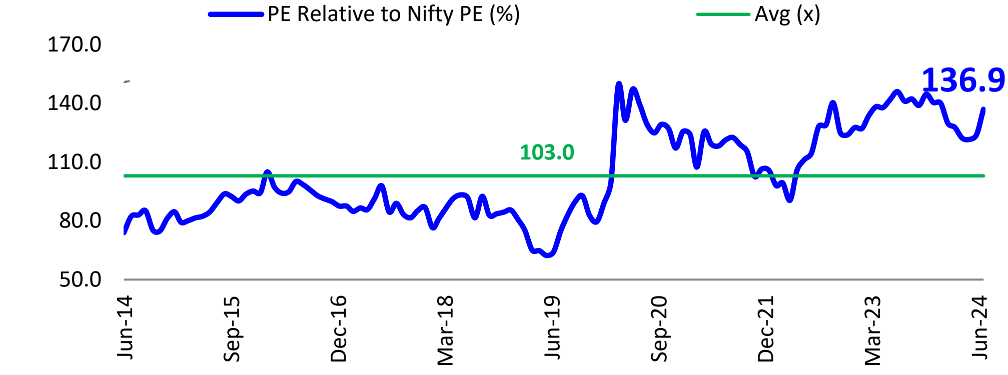
Sector charts: The sector's valuation has seen a consistent re-rating over the last 10-15 years. The sector was trading at around 30x P/E during 2014, but it has since undergone a re-rating, with the multiple increasing to 40-45x after 2019. However, over the last 2-3 years, the sector's valuation has de-rated.

Exhibit 7: Consumer sector's P/E band (x)



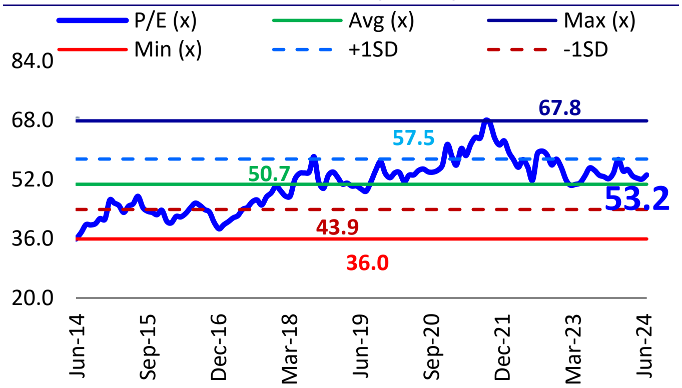
Source: Bloomberg, MOFSL

Exhibit 8: Consumer sector's P/E relative to the Nifty P/E (%)



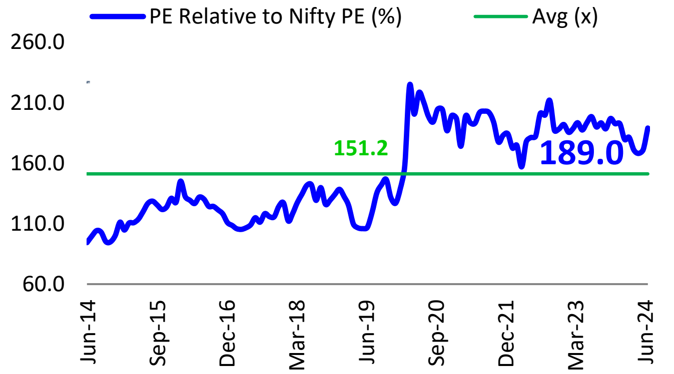
Source: Bloomberg, MOFSL

Exhibit 9: Consumer sector – P/E (Ex-ITC)



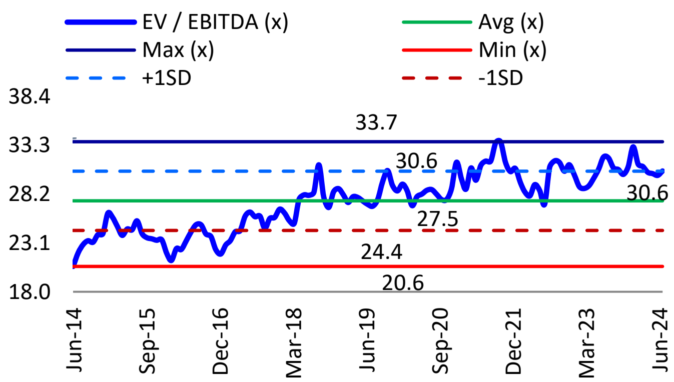
Source: Bloomberg, MOFSL

Exhibit 10: Consumer P/E relative to Nifty P/E (%) (Ex- ITC)



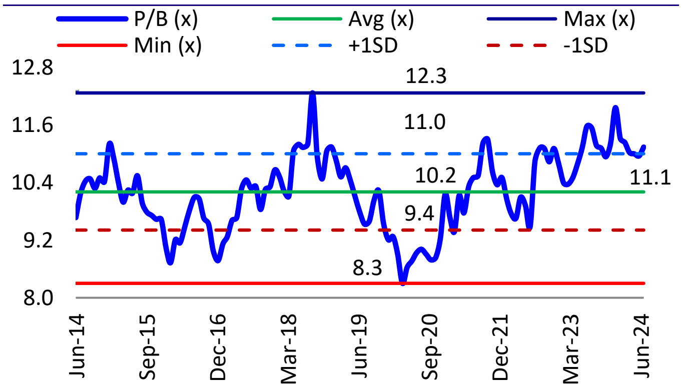
Source: Bloomberg, MOFSL

Exhibit 11: Consumer sector – EV/EBITDA (x)



Source: Bloomberg, MOFSL

Exhibit 12: Consumer sector – P/B (x)



Source: Bloomberg, MOFSL

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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Nainesh Rajani
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Grievance Redressal Cell:

Contact Person	Contact No.	Email ID
Ms. Hemangi Date	022 40548000 / 022 67490600	query@motilaloswal.com
Ms. Kumud Upadhyay	022 40548082	servicehead@motilaloswal.com
Mr. Ajay Menon	022 40548083	am@motilaloswal.com

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