



**Top Conviction Ideas: FMCG**

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### Volume Growth Muted as Urban Reels Under Pressure

- **Topline growth remains muted:** Staple companies have reported muted topline growth due to weak urban consumer demand, heavy rainfall across major parts of the country, and heightened competitive intensity. On a positive note, rural demand continues to show signs of revival and remains resilient.
- **Urban weakness was a surprising element:** Urban which accounts for 50-60% of FMCG sales came under pressure as highlighted by most of the consumer companies owing to – 1) Slowdown in discretionary spends, 2) Muted wage growth, 3) Higher interest rate coupled with increase in rentals and EMIs, 3) Higher competitive intensity from other D2C brands as Q-commerce penetration increase in the recent time leading to overall weakness in overall urban.
- **Rural demand recovery sustains:** Easing rural inflation (with minimal impact from food inflation), higher government spending, normal monsoons, better harvests, and higher MSP are expected to drive rural demand in the coming quarters.
- **Gross margin under pressure; EBITDA Margins in 'Wait & Watch':** Gross margins across staple companies have been under pressure due to a surge in key raw material prices (such as palm oil and other food commodities) and higher packaging costs, which have impacted overall margin performance. With subdued volume growth and elevated raw material prices, EBITDA margin expansion is likely to remain constrained in H2FY25.

### How Have Companies Performed In Q2FY25?

- **Demand recovery likely to be delayed:** FMCG companies have reported muted performance due to weakness in the urban market owing to increased competitive intensity and higher rainfall across India. However, rural recovery continues owing to easing inflation, increased government spending, and higher MSP.
- Companies have highlighted that **volume growth is likely to pick up gradually in H2 owing to the festive season.**
- On the **Gross Margins front**, most companies reported subdued performance as key raw material prices – packing and palm saw an inflationary trend.

## 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

Urban slowdown is likely to play spoilsport

#### Delayed Margin Recovery

Gross and EBITDA margins are likely to remain under pressure owing to subdued top line and increase in RM

Domestic Consumption Play  
Better returns in this volatile environment


#### Rural Demand to Pick Up

Increase in government spending;  
Consumer price inflation remains stable

### Medium Term


**Key Monitorables – Urban Recovery; Margins Trajectory; Competitive Intensity**

# Top Conviction Ideas

Stock	Reco.	TP*	Recommendation Rationale
 <p><b>Varun Beverages</b></p>	<b>BUY</b>	<b>Rs 700*</b>	<ul style="list-style-type: none"> <li>✓ VBL has consistently outperformed its peers in recent quarters despite the volatile environment</li> <li>✓ VBL is expected to maintain its strong growth momentum driven by several key factors: 1) The successful strategic acquisition of the BevCo, which consolidates its presence in South Africa and DRC; 2) Expansion of its snacks portfolio outside India, particularly in Zimbabwe and Zambia; 3) Continued focus on increasing distribution reach, especially in rural areas; 4) The commissioning of multiple greenfield and brownfield facilities, enhancing manufacturing capabilities and market reach while reducing transportation costs; and 5) Expansion of the high-margin Sting energy drink, along with increased emphasis on value-added dairy, sports drinks (Gatorade), and juice segments. These investments are expected to support the company's long-term growth and profitability.</li> </ul>

Note: The Target price is based on our Q2FY25 Result Update. We remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

# Top Conviction Ideas

Stock	Reco.	TP*	Recommendation Rationale
 <p><b>DOMS Industries</b></p>	<b>BUY</b>	<b>Rs 3120*</b>	<p>✓ The company has been implementing strategic initiatives over the last couple of years, and these are expected to bear fruit in the coming years. A few notable initiatives are: 1) Managing entire end-to-end operations, driving operating efficiency while maintaining high-quality standards. The new 44-acre greenfield facility will further boost growth; 2) The company's continued focus on launching new products and expanding into the larger pens category, as opposed to its earlier presence in the small pencil segment, which will broaden its product portfolio. Additionally, entering the fast-growing bags, toys, and diaper segments will further boost growth; 3) There is significant potential for distribution expansion, with DOMS currently reaching 135,000 outlets. The company has the potential to expand its reach to ~300,000-350,000 outlets, as there is still untapped potential in the east and south markets as well as smaller towns in India; and 4) The strategic partnership with FILA, which enables DOMS to expand its global reach while leveraging FILA's R&amp;D capabilities, providing a long-term advantage.</p>

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