

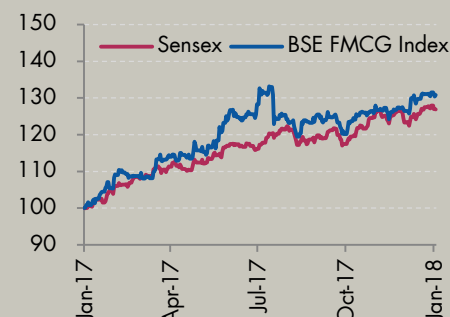
Consumer: FMCG channel check

Supply-chain recovery, rural acceleration, GST-driven shifts to aid demand

Demonetization a year behind and GST-related issues settling down present itself as a vantage point to gauge demand environment and status of supply chain. We conducted a survey, connecting with key players in FMCG supply chain.

The key takeaway is that consumer off-take is likely to improve gradually, as supplies normalize. While organized players have not benefited much from GST-related shift from unorganized, they stand to benefit in long run on recovery in demand. Winter has been good for FMCG companies (Emami and HUL's winter care range is witnessing robust growth). For ITC, cigarette volumes have recovered from pressure of price hikes in Q2FY18. Hindustan Unilever has played out GST pass-through intelligently to drive penetration. Colgate's volumes are improving steadily and it is likely to sustain market share.

Relative performance



Source: Axis Capital

We have conducted a survey, connecting with key players in the FMCG supply chain, including distributors, stockist and wholesalers. To have better analysis we have chosen supply chain partners of HUL, ITC, Colgate, Emami and GSK Consumer. Below is the quick summary of key development in the sector, followed with company specific insights.

Key takeaways from channel checks:

- ♦ **Unorganized segment under huge pressure:** GST has pressured the unorganized segment. By and large, unorganized players are either averse to GST or have issues complying with GST
- ♦ **Organized sector positively placed:** Though unorganized players are under pressure, this has not resulted in any significant benefit to organized players so far, as organized industry was struggling with its supply chain restructuring. As of now unorganized pressure is visible in select categories in select regions (like Tea in North India, Soaps in West India and Detergents in South India). Players that shifted from unorganized are under stress, as they now have to maintain books and file returns. Upcoming introduction of E-way billing can add to pressures
- ♦ **Recovery to be gradual:** According to FMCG companies, the industry is poised for a strong recovery on a low base and rural tailwinds in H2FY18. However, the supply chain highlighted that the recovery has been gradual and is likely to accelerate as GST-related pressure abates
- ♦ **Rural wholesale recovery faster than urban:** While rural wholesale business (relatively small in size) is largely back to normal with regular off-takes, urban wholesale business recovery did not bode well in terms of off-take
- ♦ **General trade margin under pressure after GST:** While modern trade margin has been realigned to GST, it is largely unchanged for general trade. Overall margin contracted from increased taxation (earlier it was only state tax - VAT, but now Central GST and State GST)
- ♦ **Non-cash mode of transaction is on the rise** after GST. Credit days for supply chain remained largely unchanged
- ♦ **Winter offerings are under short supply across companies:** Supply chain highlighted that supplies were short, as there was last year's inventory in the pipeline (demonetization last year had affected sales) and supply chain disruption affected demand forecast

Key takeaways: ITC – (a) Cigarette volume pressure eases with time, (b) expectation of price hike for *Charms* (key mass-end offering in UP and Bihar) and (c) renewed focus on biscuits aiding growth. Hindustan Unilever – (a) Higher rural share to aid, (b) shift from unorganized visible for tea, soap and detergent (though in select pockets as of now) and (d) premium offerings are doing well. Emami – (a) Winter portfolio seeing strong growth, (b) *Kesh King* under pressure and (c) increased promotion to drive volume/ demand. Colgate – (a) volume decline arrested, (b) market share stable and (c) natural pressure countered with new launches. *(Detailed insights in the following pages).*

Feedback specific to companies

ITC

Cigarette business update

- ♦ **Volume recovers after Jul-17 price hike pressure:** After 6-7% price hike in cigarettes in July 2017, Q2 cigarette volume came under pressure, declining by ~6% YoY. Supply chain highlighted that volume loss after any price hikes will be a new normal for the industry. In Q3, ITC has largely recovered volume lost in Q2
- ♦ **Same pricing pan-India a positive:** On pricing side, supply chain is happy with the same pricing pan-India (earlier cigarette pricing was varied given different VAT rate across the states). Distributors in high VAT rate states are quite happy (like in Tamil Nadu and Maharashtra) and clocking high double digit growth
- ♦ **No second price hike in FY18:** As against semi-annual price hikes, this time around, after July price hike, the supply chain has ruled out any price action for the financial year. In select markets like Uttar Pradesh and Bihar, supply chain is expecting a price hike in coming months in mass brand *Capstan*. Supply chain highlighted that when ITC took price hike in Jul-17, competition follow the suit in Dec-17
- ♦ **Efforts to arrest volume pressure:** ITC is looking to arrest volume pressure by launching different flavors across brands (like menthol flavors) and innovations (like ice burst and double burst)

Price hike: In select markets like Uttar Pradesh and Bihar, supply chain is expecting a price hike in coming months in mass brand *Capstan*.

Other FMCG

Sales growth in high single digits to low teens. Post GST, contrary to expectation, growth has been good. Here are brand- and category-wise updates:

- ♦ In **biscuits**, ITC's passive approach (in last three years) has led to market share loss in biscuits in key market in south India. But now, amid benign input costs and management's renewed focus on other FMCG business, ITC has turned aggressive with competitive pricing and expanding its distribution network. The company has started gaining share, with noteworthy share gain in cookies sub-segment. In South India, ITC's effort to enter milk biscuit segment, where Britannia is a leader with no major competition, through *NaatMaad Paal* does not bode well. The company has recently launched new smaller SKU of *Dark Fantasy*, which has seen overwhelming response. ITC's latest launch in the biscuits is '*Farm lite digestive active protein*' priced at Rs 25 for 100 gm SKU
- ♦ **Atta** has no large competition and has been growing in high single digits
- ♦ In **Noodles**, post Maggi issue *Yipee* has cornered market share and is growing with industry growth rate.
- ♦ New launch under **Bingo – No rules** has received excellent market response. The company has gained share from DFM food and Prataap Snacks in the respective markets. Supply chain is very happy with the launch where it has matched competition price of Rs 5 with free gift inside
- ♦ **Recent introduction of Ghee** has seen muted response
- ♦ Engage **deodorant** has posted good growth. Pocket deos is an interesting innovation

Hindustan Unilever

Growth momentum picks up

Supply chain is happy with the business and able to meet targets largely (generally set in high single digits). Winter care range growing in low teens. Detergents growth is in high single digits (benefits from unorganized segment is visible in select markets like Maharashtra). Food business is seeing strong growth, as GST created pressure on unorganized counterpart (huge pressure on loose tea counterparts in cities like Allahabad in Uttar Pradesh).

GST benefits pass through smartly

Post GST rate reduction effective 15 November, company has passed on the benefit through price cut in select SKUs for select variants and offering extra schemes. Noteworthy price changes in detergents (Wheel cut of 9%; Rin cut of 12%) and cosmetic products. In shampoo, the company has increased secondary schemes with no change in MRP as of now (key competitor P&G has reduced prices by 13-17%).

Brand- and category-wise update

- ♦ Recent foray into natural / herbal segment under **Ayush** range is doing well in select pockets like in Uttar Pradesh and South India. Region-wise: In North India, face wash and soaps range are doing better while toothpaste has drawn muted response. In South India, toothpaste is drawing better response. In Western India, Ayush range has drawn good response in the modern trade, but limited response in general trade
- ♦ **Indulekha** premium hair oil with strong media spend is having better-than-expected growth
- ♦ **Citra** skin care range has seen decent off-take in urban market; rural off-take is very weak
- ♦ **Surf excel liquid** has drawn good response. In the premium end, HUL is very well placed, according to the supply chain. Price cuts in the mass offerings under *Wheel* and *Rin* to aid market share
- ♦ **Comfort**, fabric conditioner, penetration remained limited. Supply chain highlighted brand sales only in urban, where it is present in limited general trade outlets
- ♦ **Pepsodent** brand has been under pressure. The company has increased schemes but no material response is visible
- ♦ In rural side, the company is looking forward to route supplies to Shakti network via non-cash mode (on-line transfer route is been explored)
- ♦ With increased regulatory pressure on unorganized counterparts, supply chain is hopeful of benefit in categories like soaps, detergents and tea (specifically)

Emami

Q3 to strong growth

On weak base and early onset of winter, Q3 looks better than market expectations (company had guided for 16-17% growth in H2). Supply chain highlighted that Emami's winter care range is clocking 20-25% growth YoY. The company is running bundled product promotions across offerings (like cream comes free with a body lotion).

Schemes and incentives increased to push volume

To revive growth, the company has started schemes on a monthly basis vis-à-vis once in three months earlier. Schemes/ incentives for retailers increased to ~7% from 3-4% in the past (mainly where GST rates have increased and new launches).

Brand- and category-wise update

- ◆ *Boroplus* range is registering good growth this winter. On positive side, newly-launched Rs 10 SKU of Boroplus cream in tub format and 500 ml SKU of Boroplus lotion is in huge demand (market is under-serviced; SKU launched for modern trade but has received overwhelming response in general trade). On the other hand, existing 300 ml SKU of Boroplus lotion is posting steady sales. On negative side, recently-launched Boroplus Perfect Touch has drawn muted response (no movement in Rs 10 SKU; only large formats have done well)
- ◆ *Vasocare* petroleum gel priced at Rs 10 has drawn excellent response; always on short supply due to huge demand. Demand for large pack is also high (highest pack is of 50 gm). Supply chain highlighted that the market for family pack (100 gm and above) is huge, which is currently not addressed by Emami (area to improve)
- ◆ In Balms, base *Zandu* offering is doing well, while new launches have drawn muted response (spray has drawn better response). Supply chain highlighted that off-take has improved with change in case size from 96 pcs per case to 36 per case. *Mentho Plus* (last inventory cleared through Buy One Get One free) is a defocused brand for the company. Fast Relief is posting decent growth (aided by reduction in case size)
- ◆ Hair Color launched in Q2 is drawing good response from rural market. Supply chain highlighted that the salience of the offering will boost if the company shifts the format from single pouch to sachet strip (better display on the shelf to drive growth). In urban market, it is still working on push model due to high competition from Godrej Consumer Products Ltd
- ◆ *Chyawanprash* is posting decent growth in the winter season. *Keshri Zivan* posted noteworthy improvement (launched new variant fit for diabetic). Introduction of consumer offer for smaller SKU of 500 gm is driving off-take of *Sona Chandi*
- ◆ *He Waterless Facewash* posted good off-take on launch. But as the company has reduced investment behind the brand (A&P), off-take has dropped gradually. Premium markets witnessing repeat buying, but off-take in rural market has been lukewarm.
- ◆ *7 Oil-in-1* posting good growth and witnessing repeat orders
- ◆ *Kesh King* is witnessing gradual recovery in demand. Company has increased advertising, which has revived growth. Shampoo has miniscule share and growth is muted

- ♦ *Fair and handsome* is witnessing decent growth. *Fair and Handsome winter solution* is doing well with stepped up media promotions. New launch *Fair and Handsome Laser 12* has drawn muted response as of now. The company is aggressively marketing the brand
- ♦ *Navratna Almond oil* for women (launched in summer) has drawn muted response

Colgate

- ♦ **Volumes recovering:** Price cut (8-10%) after GST aided gradual volume recovery for the company. Overall market share is likely to remain stable in Q3
- ♦ **QoQ targets largely met:** Growth across different supply chain partners range in mid-to-high single digits. Supply chain is on track achieving QoQ targets
- ♦ **'Natural' segment pressure eases a bit:** Pressure on 'Natural' segment is easing out. The company has launched two offerings under Naturals – '*Ved Shakti*' and '*Swarna Vedshakti*'. Both variants have drawn good response. Not much pressure seen from HUL's *Ayush* range
- ♦ **Trade margin:** The company has increased distributor margin by 1% after price cuts post GST (Colgate is the only exception to have done so)

GSK Consumer

- ♦ **West India yet to see introduction of new launches:** Supplies of new launches like *Horlicks Growth+* and *Cardia+* is yet to reach western market. The company is struggling with distribution network in key Mumbai market, distributor changes happening every two month, as per the retailers
- ♦ **CSD cut down aided general trade:** With pressure on supplies to Canteen Store Department (CSD), demand migration to general trade is aiding growth for distributors. In select markets, supply chain highlighted demand assessment from the company is weak, which is reflected in short supply of *Horlicks*
- ♦ Despite GST rate reduction effective 15 November; the company is yet to pass on the benefit. Rather company has increased schemes on the products
- ♦ **Growth targets:** The company is aiming for low-double digit to mid-teen growth, which is been achieved by supply chain. In select markets, general trade growth is 20-25%, primarily in markets where CSD off-take has reduced
- ♦ The company has notified introduction of OTC offering from Novartis (part of business auxiliary income)

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Research Team

Sr. No	Name	Designation	E-mail
1	Pankaj Bobade	Research Analyst	pankaj.bobade@axissecurities.in
2	Kiran Gawle	Associate	kiran.gawle@axissecurities.in

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