



**Top Sector Ideas: FMCG**

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### Volume Growth Muted; Competition Intensify

- **Topline growth remains muted:** Most staple companies under our coverage have indicated a subdued demand environment, particularly in the mass end of the segment, as rural areas continue to face pressure. Moreover, increased competitive intensity has further hampered volume growth. Anniversarization of price hikes and price cuts has resulted in muted topline growth.
- **Hopeful for demand recovery:** Easing inflation, higher government spending, and increased urban remittances 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, will 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, but is expected to benefit in the longer run.

## How Have Companies Performed In Q3FY24?

- **Demand recovery in the coming quarters:** FMCG companies have reported muted performance due to sluggish rural demand and increased competitive intensity, affecting overall volume growth. However, there is optimism for demand recovery in the coming quarters, 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 **delivered 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.

## 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 being under-penetrated and underserved. Additionally, rural penetration is ongoing, further contributing to the growth potential of the sector.
- **Premiumisation agenda to drive the 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 returns ratios (ROCE, ROE):** In the volatile, uncertain, complex, and ambiguous (VUCA) world, the FMCG sector stands out for offering best-in-class returns ratios such as ROCE, ROE, and dividends 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 and urban remittances

Consumer price inflation to start receding eventually

RM prices remain stable

## Medium Term

**Key Monitorables – Rural recovery; Margins Guidance; Inflation Trajectory; Competitive Intensity**

Stock	Reco.	TP*	Recommendation Rationale
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**Nestle India**

**BUY**

**Rs 2,800**

- ✓ We maintain a positive outlook on Nestle due to its consistent and resilient performance, driven by several key factors: 1) Rural penetration and market share gains through the RURBAN strategy; 2) Continuous focus on innovation, with the launch of 125 products in the last seven years, driving growth; 3) Emphasis on premiumisation in core categories like the Maggi noodles range and introduction of differentiated products; 4) Expansion into new categories of the future such as Purina Pet Care and Gerber's for toddler nutrition, and 5) Introduction of a Direct-to-Consumer (D2C) platform to enhance 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 Q3FY24 Result Update. Most of the stocks have reached their Q3FY24 Result Update Target Prices. We, however, remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

Stock	Reco.	TP*	Recommendation Rationale
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**Varun Beverages**

**BUY**

**Rs 1,430**

- ✓ VBL has consistently outperformed its peers in recent quarters despite the volatile environment
- ✓ Looking ahead, VBL is poised for strong performance driven by several factors: 1) Normalization of operations and market share gains in newly-acquired territories post the COVID-19 disruptions; 2) Continued emphasis on efficient go-to-market execution, exemplified by the successful commissioning of the Bihar facility and subsequent market share gains; 3) Expansion of distribution reach to 3.5 million outlets by CY23, up from the current 3 million; 4) Strategic focus on expanding high-margin products like Sting energy drink, along with value-added dairy, sports drink (Gatorade), and juice segments, and 5) Anticipated robust growth in international regions. With these strategies in place, VBL is well-positioned to drive growth and enhance its market presence in the coming periods.

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Stock	Reco.	TP*	Recommendation Rationale
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**Jyothy Labs**

**BUY**

**Rs 565**

- ✓ 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



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