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Top Conviction Ideas: FMCG

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FMCG Sector: Q2FY27 Review

✓ Revenue Growth Remains Healthy; Input Cost Inflation Weighs on Margins

- **Growth stays strong, margins diverge:** The FMCG sector delivered healthy revenue growth in Q2FY27, supported by improving consumption, sustained volume growth and broad-based category performance. Premiumisation, product innovation and distribution expansion further supported topline growth. However, elevated input costs, particularly crude derivatives, palm oil, coffee and packaging, amid West Asia supply disruptions, coupled with higher advertising spends, weighed on margins. Companies relied on calibrated price hikes, cost efficiencies and operational savings to mitigate cost pressures.
- **Demand trends:** Rural markets continued to outperform urban markets, indicating a gradual improvement in consumption demand. The GST rate rationalisation also provided a positive demand impetus, particularly across mass-market and discretionary categories. However, the benefit is expected to play out gradually as companies recalibrate pricing and distribution strategies. Meanwhile, consumers continued to move towards premium and value-added products, supporting realisations and category growth. In distribution expansion, E-commerce, quick commerce and modern trade remained important growth drivers, alongside a recovery in general trade.
- **Margins remain mixed:** Despite healthy topline growth, profitability remained uneven as higher crude derivatives, palm oil, packaging and fuel costs weighed on margins. HUL, Colgate, Jyothy Labs and VBL reported margin contraction amid input cost inflation and higher spending. Companies with stronger pricing power, favourable product mix and cost efficiencies were better positioned to protect margins. Near-term margin recovery is likely to remain gradual, depending on commodity prices and the benefit of recent price hikes.
- **Outlook: Volume recovery to drive growth; margins remain key monitorable:** We remain positive on the FMCG sector's medium-to-long-term outlook, supported by rural recovery, GST-led affordability, premiumisation and distribution expansion. Improving volume growth signals a gradual recovery in underlying demand. However, near-term margins may remain volatile due to elevated input costs and higher brand investments. We expect volume growth to drive earnings, while companies with strong pricing power, premium portfolios and cost efficiencies are better positioned to protect margins.

FMCG Sector: Outlook

✓ How Have Companies Performed in Q2FY27?

- **FMCG companies delivered Healthy Topline Numbers in Q2FY27,** supported by improving consumption trends, sustained volume growth, rural recovery and premiumisation. Growth remained broad-based, although profitability varied across companies amid elevated input costs and higher brand investments. Among key players, HUL reported 15% underlying sales growth with 7% volume growth, while Dabur delivered 11.6% revenue growth and 5.5% India FMCG volume growth. Nestlé reported strong 20.5% revenue growth, supported by double-digit volume expansion, while Britannia grew ~17% with ~13% volume growth, and Colgate sustained double-digit growth of 12.2%. On the profitability front, Nestlé reported strong margin expansion of 190bps each, whereas HUL witnessed a 114bps contraction. Dabur, Colgate and Britannia faced margin moderation amid input cost inflation. Overall, volume recovery remained encouraging, but rising commodity costs and higher advertising spends continued to drive divergence in earnings performance. Furthermore, the paints industry witnessed healthy topline growth in Q2FY27, supported by improved demand, price hikes and industrial coatings performance. Asian Paints reported ~17% revenue growth, with domestic decorative volume growth of 6.4%. However, profitability remained under pressure due to sharp inflation in crude-linked raw materials and supply chain disruptions.

- **Margin performance remained uneven**, as elevated commodity costs and higher advertising spends weighed on profitability. HUL, Dabur, Colgate, Britannia and Asian Paints reported margin contraction, while Nestlé delivered a 190bps expansion, supported by cost efficiencies and favourable product mix. Overall, companies with stronger pricing power and better cost controls were better positioned to protect margins, while sector-wide margin recovery is likely to remain gradual.

FMCG Sector: Outlook

✓ What Makes the FMCG Sector a Good Bet?

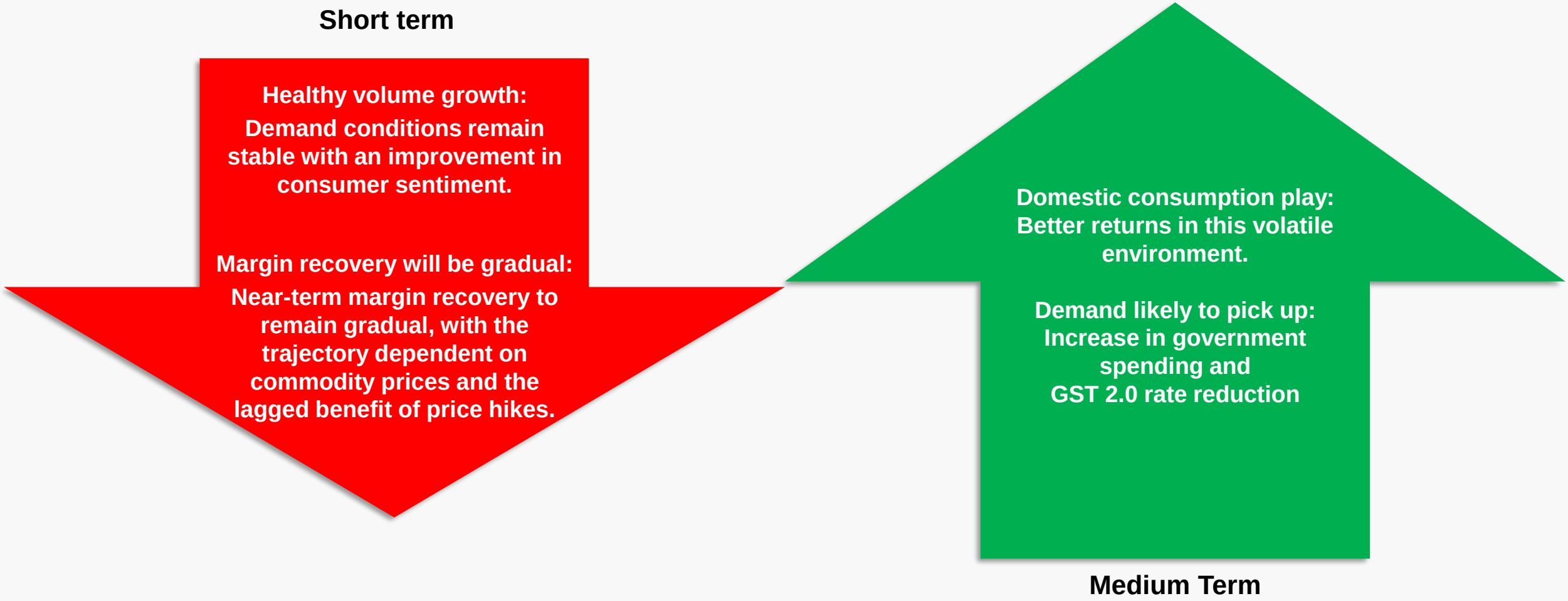
- **Structural growth trajectory:** The Indian FMCG sector offers a strong long-term growth opportunity, with several categories such as shampoos, hair care and premium detergents still underpenetrated, particularly in rural markets. Rising disposable incomes, deeper distribution and improving rural penetration are expected to support sustained consumption growth. Off late, GST rate rationalisation is also likely to improve affordability and boost demand.

- **Premiumisation driving growth:** Rising purchasing power and evolving consumer preferences are driving a gradual shift towards premium and branded products. This trend, along with product innovation and increasing aspirations, is expected to support higher realisations and long-term revenue growth.

- **Best-in-class return ratios (ROCE, ROE):** FMCG companies typically enjoy healthy ROCE, ROE and strong cash flows, supported by established brands, asset-light business models and pricing power. Their ability to generate consistent returns and distribute dividends provides relative earnings resilience amid market volatility, although valuations remain important.

- **Defensive consumption theme:** Essential product demand provides relative stability during economic uncertainty. While potential interest rate hikes could moderate discretionary spending and increase borrowing costs, staples demand is relatively resilient, supporting the sector's defensive characteristics.

Short & Medium-term Outlook



Key Monitorables – Urban recovery; Raw material prices linked to crude oil derivatives; Margins trajectory; Competitive intensity

Top Conviction Ideas

Stock	Reco.	TP*	Recommendation Rationale
Varun Beverages Ltd	BUY	Rs 515*	✓ **Strong Volume-led Growth:** Consolidated revenue grew by 33.2% in Q3CY26, supported by robust volume growth. Consolidated volumes increased 28.7% YoY to 354.4 Mn cases in Q3CY26, driven by growth across markets (22.5% in India and 39.9% in international markets as demand continued its momentum gained since May). Consolidated realisations per case increased 2.2%, supported by a 0.5% increase in India on account of growth in higher-value categories such as dairy beverages. ✓ **Margins:** Remained under pressure due to elevated raw material costs; however, management aims to mitigate the impact through trade spend rationalisation and price-pack interventions. The extended long-term partnership with PepsiCo further strengthens growth visibility. ✓ **Outlook:** VBL is well-positioned to sustain growth, supported by its expanded PepsiCo partnership, deeper distribution and rural penetration, international expansion through Twizza and diversification into snacks and alcoholic beverages. Capacity expansion and growing presence across Africa further strengthen its medium-term growth visibility.

*Note: The Target price is based on our Q2FY27 Result Update Report. We remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

Top Conviction Ideas

Stock	Reco.	TP*	Recommendation Rationale
Hindustan Unilever Ltd	BUY	Rs 2,120*	✓ **Volume-led Double-digit Growth:** HUL reported 15.2% YoY revenue growth in Q2FY27, driven by 7% volume growth and 8% pricing, its strongest growth in 14 quarters. Growth was broad-based across segments, with Home Care and Beauty & Wellbeing delivering strong double-digit growth, supported by robust volume expansion. ✓ **Margins:** HUL's margins continued to face pressure from input cost inflation. The company is adopting calibrated price increases to mitigate cost pressures while protecting volume growth and market share. Further margin recovery will depend on cost-saving initiatives, operational efficiencies and improved A&P productivity. ✓ **Outlook:** HUL's scale, premiumisation strategy and focus on higher-margin categories position it well to benefit from consumption recovery and emerging growth opportunities. While near-term margins remain exposed to input cost inflation, calibrated pricing and cost pass-throughs have helped limit the impact. Management remains confident of stronger FY27 growth, supported by volume recovery and improving rural demand. Following the sharp stock price correction, the risk-reward has turned favourable, despite near-term margin concerns.

*Note: The Target price is based on our Q2FY27 Result Update Report. We remain positive on the stock's long-term prospects and recommend 'BUY on Dips'.

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