CONSUMER STAPLES

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Testing defensive narrative

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COMPANIES

Testing defensive narrative

Home & Personal Care is a credible opportunity offering share gain possibility for top players (~60% share now) and growth longevity led by premiumisation and penetration. Growth buoyancy led by macro tailwinds rests on government capex, MSP hikes, wage & job growth etc., all of which need to perk up else near-term pressure on volumes can sustain longer. At the same time, we remain watchful of rising disruption risks (private labels, D2C, distribution risks) which can put pressure on growth and valuation multiples (none factored yet!). Our preference for Marico>Dabur>HUL is led by company-led growth initiatives in light of its right-to-win, category dynamics, competitive pressures, disruption risk and valuation. Risks: Growth deceleration led by further deterioration in macros and distribution upheaval.

Hoping for macros to act as tailwind for volume growth

India's GDP/capita at USD2,000 seems at an inflection point. China saw 12%/7% GDP/FMCG CAGR over 2006-20 post crossing USD2,000 GDP/capita. Improving macros led by urbanization, favourable median age of working population, widening income pyramid etc. (exhibit 18-22) should set stage for 8% FMCG/capita spends CAGR over FY21-41E. If these get supported by double-digit growth in government capex (state + central), wage and job growth, then rural volume growth can surprise by reverting back to 1.3-1.5x that of urban growth. Absent this triggers, our FMCG/capita CAGR and revenue estimates for HPC companies will be at risk. Watch out for job and wage growth, both of which were key drivers for China's 12% GDP CAGR.

Premiumisation, adjacencies and share gains to be focus areas

Large HPC categories are highly penetrated (>60-65%) with top 3 players having market share of >60%. This means incremental room for penetration-led volume growth is harder. Focus should be on share gain, premiumisation, addressing white spaces and looking at adjacencies, launching functional products, etc. Treading this path could reverse soft revenue trajectory seen for HPC companies (FY16-21, CAGR at 5% vs 15% over FY11-15). Factoring above, we expect HPC companies to clock 11% revenue CAGR over FY21-24E.

Sector susceptible to disruption risk, not otherwise seen before

Three sectoral risks are on the anvil: (i) rise of private labels, (ii) rise of D2C brands, (iii) distribution changes. Each could put at risk either growth longevity, long-term growth rates, margin profile and return ratios, none of which are currently priced into stock prices. Democratisation of distribution channels helps FMCG companies expand their reach but comes at the cost of channel conflict, margins and elevated credit period. While there are limited successful case studies of D2C companies in India, but the way some D2C brands are addressing consumer needs convinces us of their scalability potential as compared to limited competition from regional brands earlier.

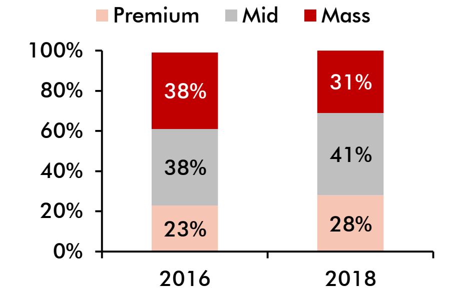
Not just defensive businesses any more

As the above disruption risk will start to get priced into DCF model, current PE multiples (FY24 PE of 38-45x) may get challenged (timing uncertain!). Long term growth opportunities nevertheless prevail, critical is for companies to pursue strategies for market expansion, premiumisation, share gains and capital allocation (invest or acquire for growth). In the near term (FY21-25E), expect all three companies to clock revenue/earnings CAGR of 10-12%/12-14%. Difference in strategies, penetration levels and current valuation makes us favour Marico>Dabur>HUL.

Key Recommendations

Dabur	**BUY**
Target Price: 630	Upside 11%
Hindustan Unilever	**SELL**
Target Price: 2,424	Upside: 1%
Marico	**BUY**
Target Price: 580	Upside: 16%

Premiumisation trend has just begun; ample headroom available



Source: HUL, Ambit Capital research; Note – above is value share

HUL lags in new category foray, Diversification led growth for Dabur, Marico looks well-balanced

	Dabur	HUL	Marico
New category forays	●	◑	◕
Brand positioning	◕	●	◕
Scope of premiumisation	◕	●	◕
Competitive intensity	●	◕	◕
Pricing power	◕	◕	◕
Disruption from pvt label & D2C	◑	◕	◑

Source: Ambit Capital research

Note: ● - Strong; ◕ - Relatively Strong; ◑ - Average; ◔ - Relatively weak

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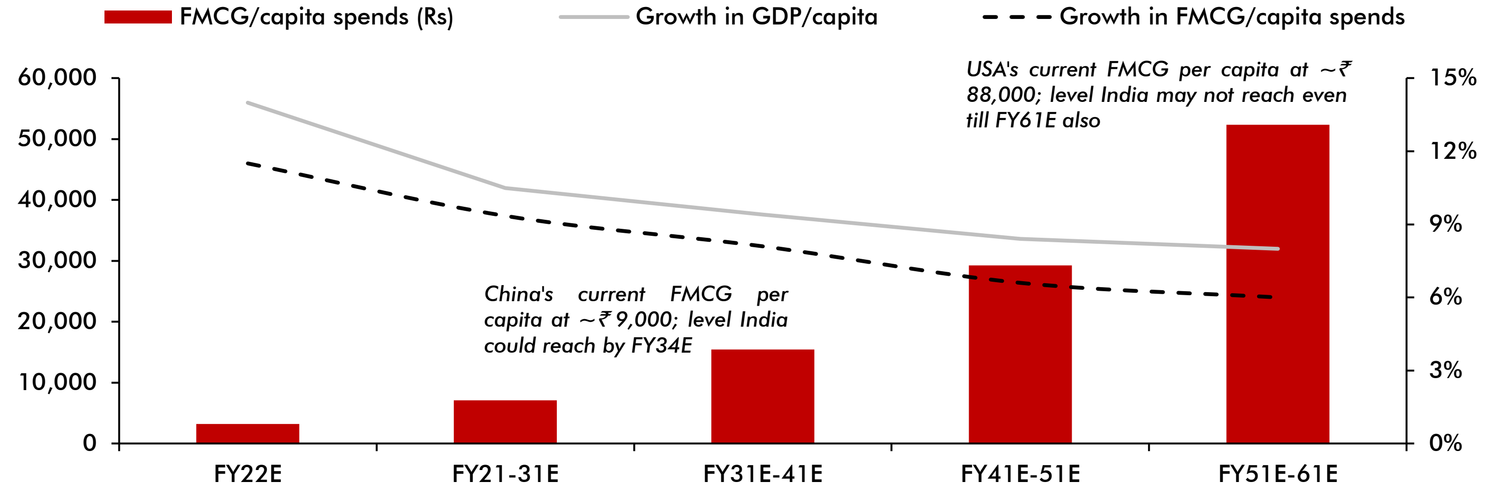
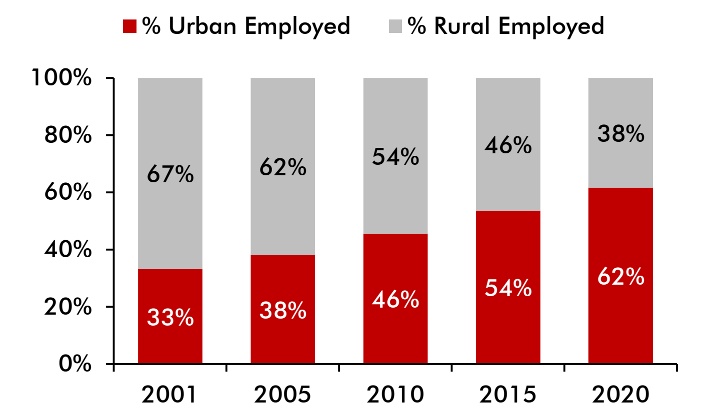
The Narrative in Charts

Exhibit 1: If what happened in China over 2005-20 (12%/7% GDP/FMCG CAGR) were to play out in India, expect India to post GDP/capita & FMCG/capita CAGR of 9.1%/7.4% over the next four decades



Source: IMF, CMIE, Statista, Ambit Capital research

Exhibit 2: Over last two decades, urban employment (ppt) in China almost doubled; India's urbanization too at current levels of ~34%

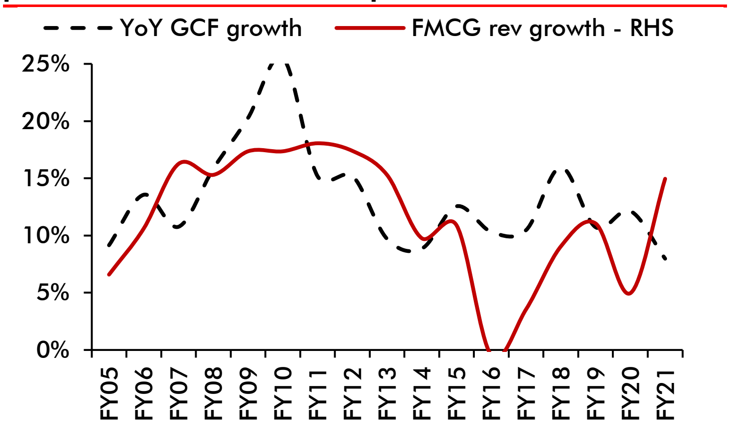


Source: National Bureau of Statistics of China, Ambit Capital research

Exhibit 3: What is required, however, is strong urban wage growth – something seen in China from FY03-20 – to happen in BSE 500 wage cost

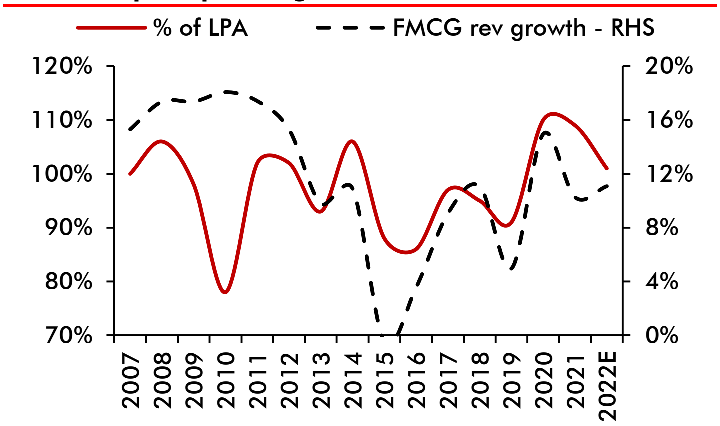
Source: National Bureau of Statistics of China, Ambit Capital research

Exhibit 4: Historical FMCG's volume growth has had positive correlation with GCF spends



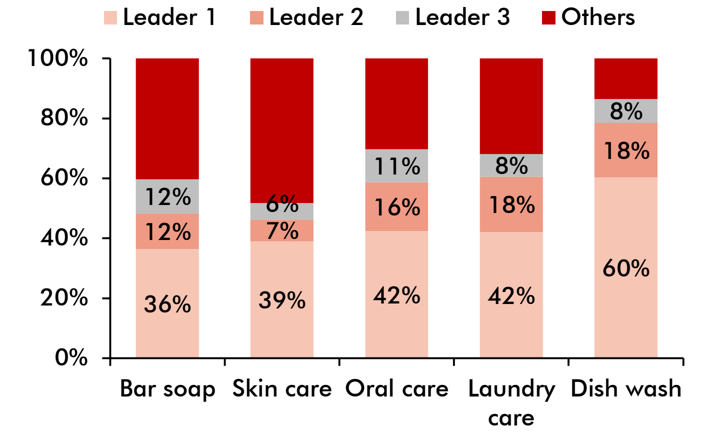
Source: CMIE, Ambit Capital research

Exhibit 5: normal monsoon for the third consecutive year should help keep rural growth resilient



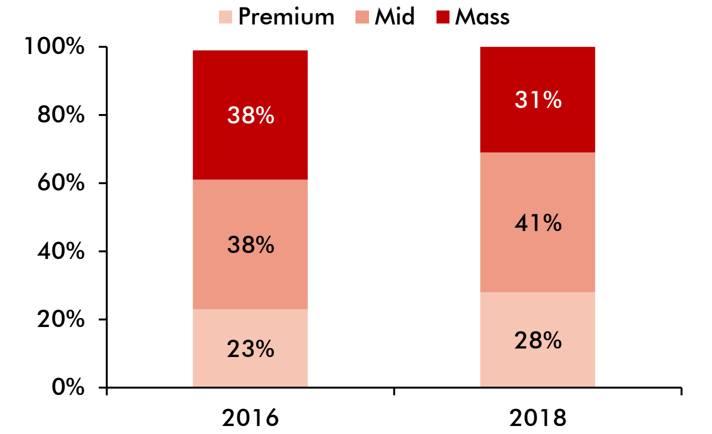
Source: Ambit Capital research; Note – Rainfall LPA is as per CY whereas FMCG's revenue growth is for the succeeding year

Exhibit 6: Top 3 players in large HPC categories corner >60% market share; premiumisation key



Source: Euromonitor International Limited 2021 © All rights reserved, Ambit Capital research

Exhibit 7: Premiumisation trend has begun, huge headroom available



Source: HUL, Ambit Capital research

Exhibit 8: Category playbook suggests HUL is present across HPC categories followed by GCPL, Dabur and then Marico

Categories	DABUR	HUVR	GCPL	MRCO
Beauty & Personal Care				
Bar Soap	×	✓	✓	×
Hair Care (Shampoo, Conditioners, Colorant, etc)	✓	✓	✓	✓
Skin Care	✓	✓	✓	✓
Oral Care	✓	✓	×	×
Men's Grooming (Shavings, Toiletries & Fragrance)	×	✓	✓	✓
Hair oil	✓	✓	×	✓
Colour Cosmetics	×	✓	✓	×
Baby and Child-specific Products	✓	✓	✓	✓
Deodorants	×	✓	✓	✓
Liquid Soap	×	✓	✓	×
Body Powder	×	✓	✓	×
Body Wash/Shower Gel	×	✓	✓	×
Home Care				
Laundry Care	×	✓	✓	✓
Home Insecticides	✓	×	✓	×
Dishwash	×	✓	✓	×
Surface Care	×	✓	✓	×
Toilet Care	✓	✓	✓	×
Air Care	✓	×	✓	×

Source: Companies, Ambit Capital research

Exhibit 9: Changing distribution landscape signifies potential impact on net sales for FMCG companies…

Gross sales/MRP (₹)	Distributor channel	JioMart	Udaan
	100	100	100
Commission & Cost:			
Distributor	5%		
Retailer	10%	22-25%	22-25%
Schemes & incentives	2%		
Logistic cost (approx)	2%		
Total cost	*19%*	*22-25%*	*22-25%*
Net sales (₹)	**81**	**75-78**	**75-78**

Source: Ambit Capital research

Exhibit 10: …apart from sales, impact on margins, WC, return ratios and bargaining power too

Particulars	Impact to:			
	FMCG Co	Distributor	New channel intermediaries	Retailer
Volume/Revenue growth	☺	☹	☺	😐
Scale up of new launches	☹	😐	😐	☹
Margins	☹	☹	☺	☺
Working capital	☹	☹	☺	☺
Bargaining power	☹	☹	☺	😐
Return ratios	☹	☹	☺	☺
Vulnerability	☹	☹	☺	😐

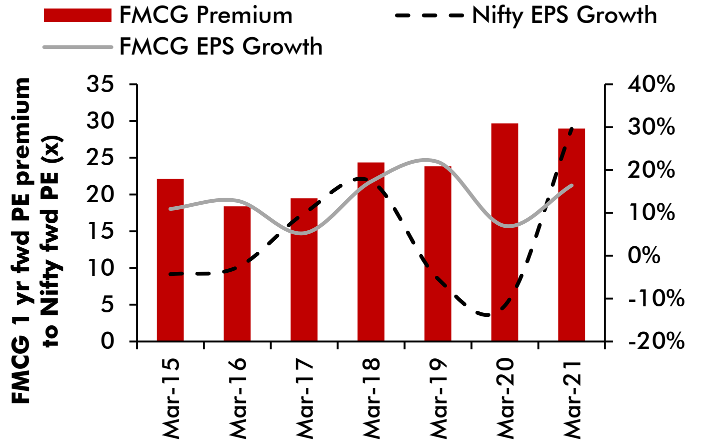
Source: Ambit Capital research

Exhibit 11: HUL fares the best on IBAS followed by Marico and Dabur; only constraining factor for HUL is its slower pace of new launches owing to multiple layers of approval from global head office

Parameters	HUL	Marico	Dabur	Comments
Innovation				
Pace of new launches	2	3	4	While all cos have their R&D cell, HUL is a pioneer in terms of R&D capabilities who also gets benefitted from Parent's R&D programmes.
R&D capability	4	3	3	
Innovation to expand TAM	3	4	4	
Brand				
Market share in core categories	3	3	3	HUL, Dabur and Marico hold leadership positions in most of their core categories.
Ability to take price hikes & charge premium	Yes	Yes	Yes	
Brand Trust	4	4	4	
Architecture				
Ability to attract & retain quality talent	4	3	3	HUL, Dabur and Marico have an ESOP plan to incentivise and retain top talent. Attrition is increasing across FMCG cos
Employee development/ career growth	4	4	4	
Relationship with suppliers	4	4	4	
Strategic Assets				
Distribution reach	8mn+	6.9mn+	5.3mn+	HUL has led from the front in using data analytics and technology. Marico and Dabur have also embraced tech now.
Use of technology & data analytics	4	3	3	
International presence/opportunity	NA	Yes	Yes	

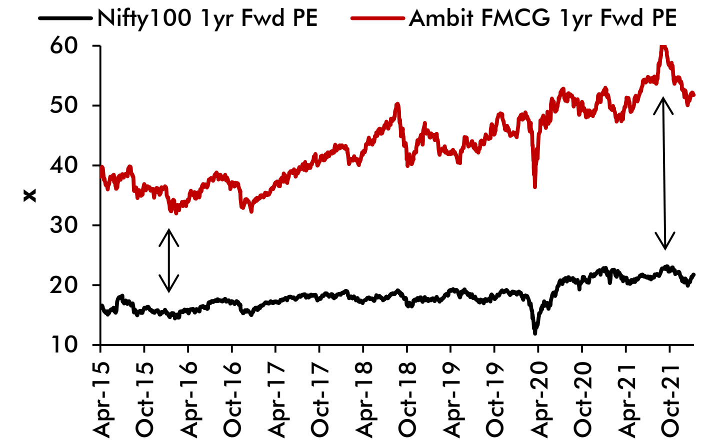
Source: Company, Ambit Capital research

Exhibit 12: 13%/1% EPS CAGR for FMCG/Nifty over FY15-20 led to 33% expansion in FMCG's 1-year fwd P/E...



Source: Ambit Capital research, Bloomberg; Calculation of FMCG EPS growth includes PAT of Dabur, GCPL, HUL, Marico, Nestle, Britannia and Tata Consumer

...and led to gap with Nifty 100 1-year fwd PE to widen; post Covid however the gap has started to narrow



Source: Ambit Capital research, Bloomberg

Exhibit 13: Marico likely to post highest revenue, EBITDA and PAT CAGR followed HUL and Dabur; HUL likely to have highest CFO; Dabur and Marico's CFO impacted by best WC conversion in FY21

Company / metric	Revenue CAGR		EBITDA CAGR		PAT CAGR		CFO CAGR	
	FY16-21	FY21-25E	FY16-21	FY21-25E	FY16-21	FY21-25E	FY16-21	FY21-25E
Dabur	4%	11%	6%	12%	6%	12%	12%	8%
Hindustan Unilever	6%	10%	15%	12%	15%	14%	18%	15%
Marico	6%	12%	9%	13%	10%	14%	12%	0%

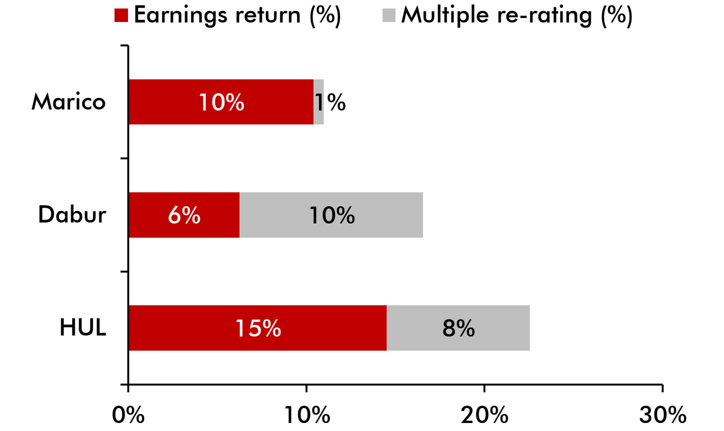
Source: Company, Ambit Capital research; Note – Near term growth rate for HUL is higher owing to benefits of integration of GSK portfolio

Exhibit 14: HUL likely to have best EBITDAM expansion whereas Marico would have highest RoE

Company / metric	EBITDAM				Asset turnover (x)				RoE			
	FY19	FY21	FY23E	FY25E	FY19	FY21	FY23E	FY25E	FY19	FY21	FY23E	FY25E
Dabur	20%	21%	22%	22%	2.7	2.5	2.8	3.1	27%	24%	23%	23%
Hindustan Unilever	23%	25%	26%	27%	6.2	2.3	2.6	2.8	83%	29%	22%	28%
Marico	18%	20%	19%	20%	6.0	5.1	5.2	5.5	41%	38%	40%	47%

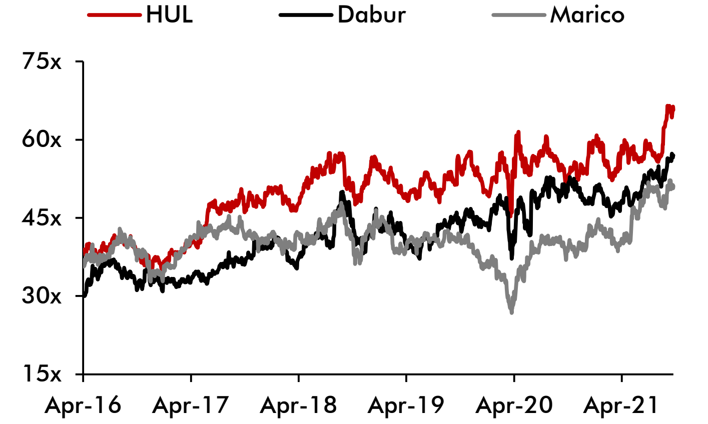
Source: Company, Ambit Capital research

Exhibit 15: P/E multiple has re-rated the most for Dabur and least for Marico over FY16-21



Source: HUL, Ambit Capital research

Exhibit 16: Most of Marico's re-rating happened from April 21 vs steady re-rating for HUL & Dabur over the last 5 years



Source: HUL, Ambit Capital research

Exhibit 17: Limited upside for Dabur & HUL; earnings led upside likely for Marico

Company	FY21-41E			EBIT margin			TP (₹)	CMP	Upside / Downside (%)	Implied FY24 PE (x)
	Revenue	EBIT	FCF	FY21	FY31E	FY41E				
Dabur	10%	11%	9%	22%	25%	26%	630	570	11%	47
Hindustan Unilever	10%	12%	15%	23%	28%	30%	2,424	2,390	1%	47
Marico	11%	12%	9%	19%	21%	22%	580	501	16%	43

Source: Company, Ambit Capital research; Note – Domestic growth for Dabur and Marico is higher than HUL, however owing to ~24%/23% international business portfolio for Dabur/Marico respectively growing at mid to high single digit, company level growth rate for Dabur and Marico for FY21-41E becomes largely the same

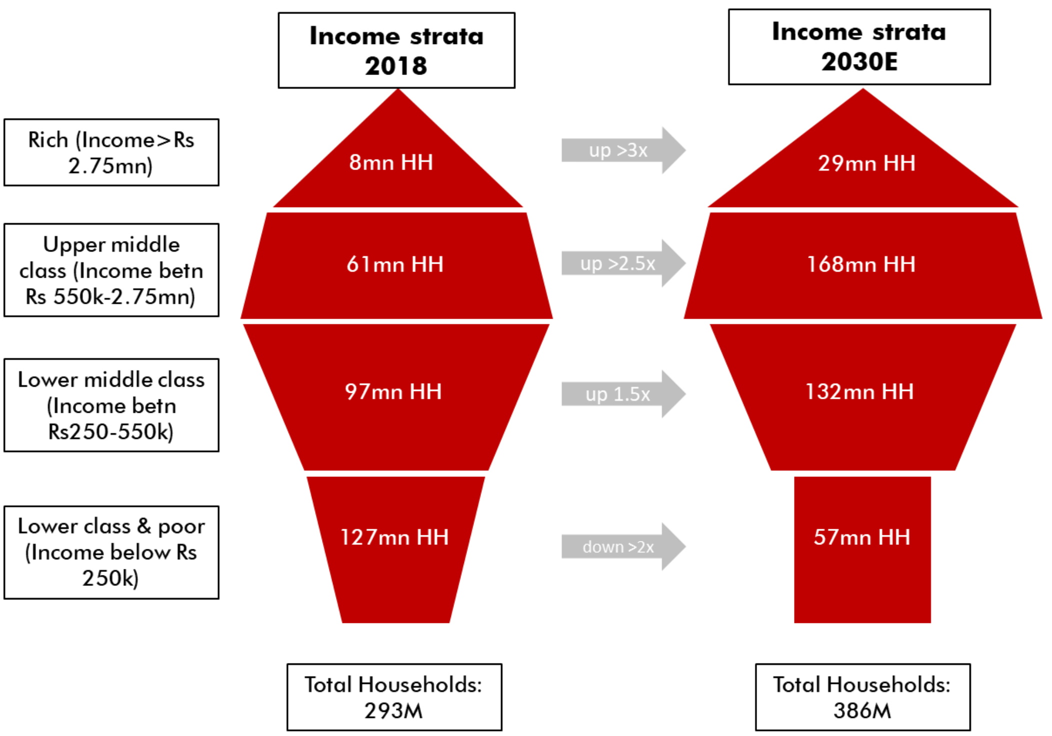
Rosy narratives

The Indian consumer story is a multi-decadal growth narrative riding on macro tailwinds of population dynamics, urbanization, increasing GDP per capita etc to offer penetration and premiumisation-led growth. The crucial factor however is sustenance of a buoyant rural economy, acceleration in urbanization as well as job and wage growth. Rural volume growth is a derivative of: (i) government's capex/fiscal impulse (refer exhibits 24 to 27); (ii) agri wage growth (exhibit 28); (iii) MSP (exhibit 29) and (iv) direct transfers (exhibit 30). Monitoring these parameters offers a view on how rural growth is likely to fare. As governments (central and state) accelerate their capex spending, current softness in rural growth should ebb. Thus, we expect FMCG revenue growth to compound at 11% CAGR over FY21-24E vs 5% clocked over FY16-20 (FY21 excluded owing to Covid).

The great Indian consumer story

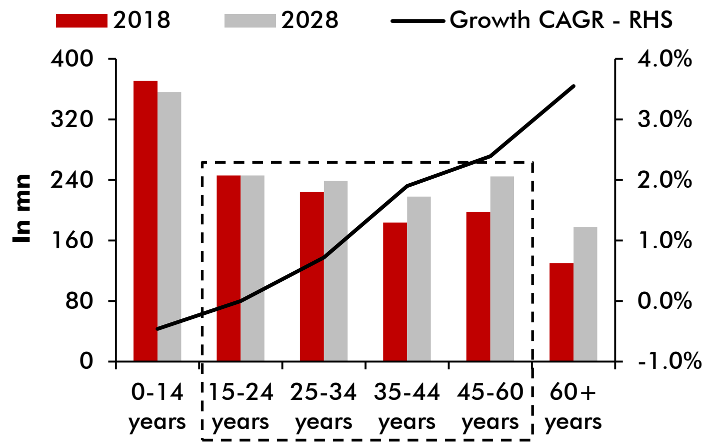
Key ingredients for India's long-term consumer story rests on structural macro tailwinds such as: (i) favourable population dynamics; (ii) improving urbanization as well as rise of middle India; (iii) government fiscal impulses and rural uplift initiatives; (iv) job and wage growth, etc. Add to that: (i) low penetration across multiple categories, opportunity to premiumise in moderate to highly penetrated categories; (ii) increasing frequency, quality and quantity of consumption; and (ii) changing distribution landscape are cornerstones of long-term growth for HPC companies.

Exhibit 18: Next decade would be about improving HH affordability, thereby bolstering quantity and quality of consumption



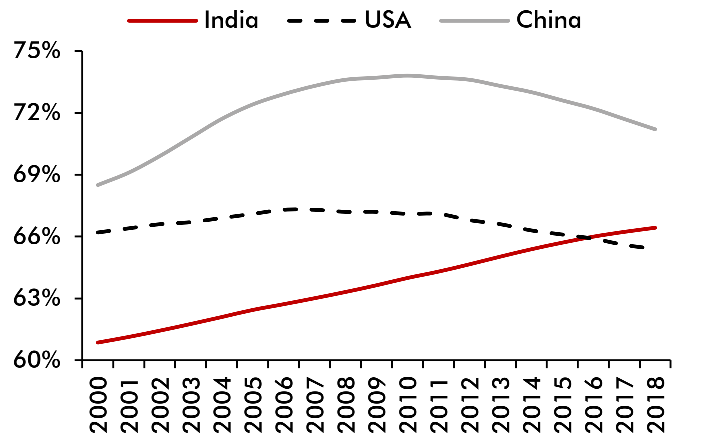
Source: Ambit Capital research

Exhibit 19: 5% addition of consumers in the 15-60 years age bracket over a decade



Source: BCG report, Ambit Capital research

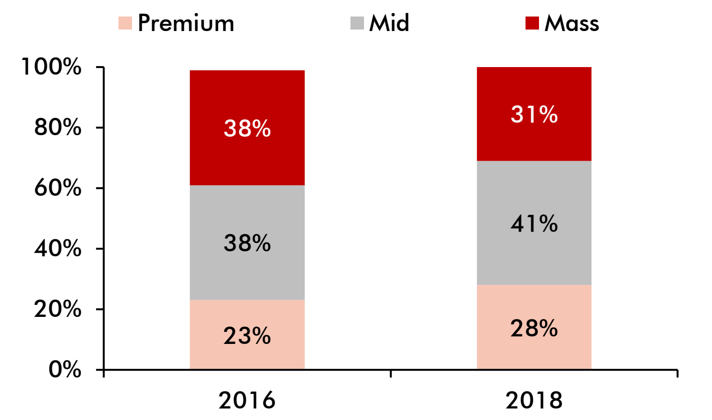
Exhibit 20: India's working population on the rise vs USA and China where the ratio is inversing



Source: WHO, OECD, Ambit Capital research

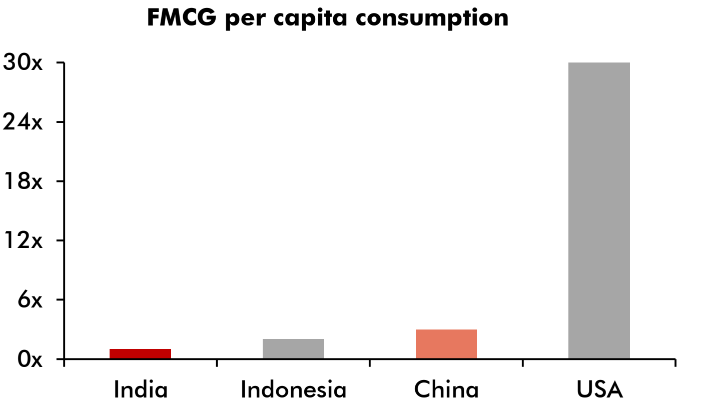
Ideally, the above macro dynamics should help India witness: (i) a multi-decadal consumption story led by improving disposable income; (ii) improving availability and awareness to increase quantity and quality of consumption; (iii) premiumisation as a trend which has just begun should get accelerated (exhibit 21). All these should improve India's per capita FMCG consumption, which is half that of Indonesia and one fourth China's.

Exhibit 21: Improving affordability to further shrink the mass category which will benefit large FMCG



Source: HUL, Ambit Capital research

Exhibit 22: Room to improve PCC which is 1/2 of Indonesia and 1/3 of China; US in different league



Source: HUL, Ambit Capital research

Besides, overall initiatives to uplift rural India (contributes ~60% to volumes but 40% to value) and scope to expand distribution in villages (commentaries from FMCG companies suggest that out of ~0.6mn villages, top FMCG companies barely reach 0.06-0.1mn villages) aid in volume growth longevity.

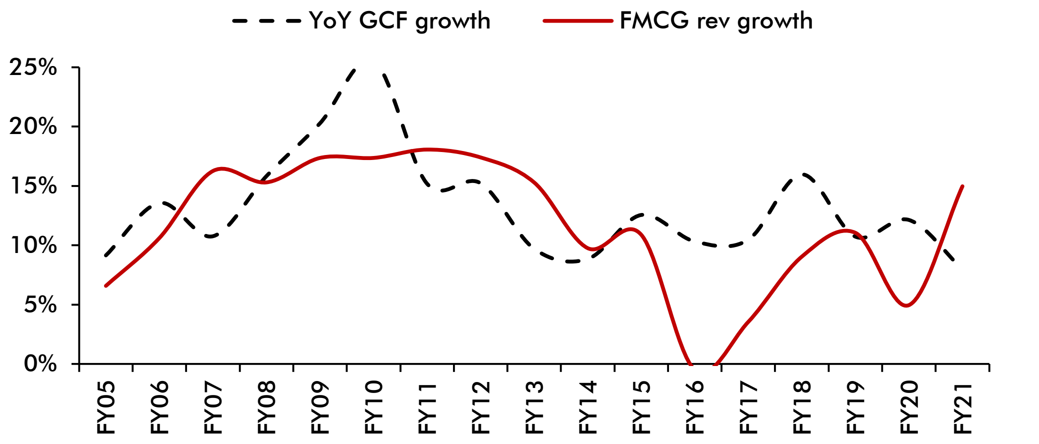
But macros have changed over the last decade

As India navigates from the Covid-driven slowdown, our economist believes that over the medium to long term India's real GDP can grow at ~7% (10-12% nominal GDP growth). This would be an outcome of government policies and reforms, capex and infrastructure spending, jobs and wage creation, agricultural reforms, etc. For HPC companies under our coverage to post 8-12% YoY revenue growth, external macro support is important, besides increase in market size and penetration and distribution expansion. We believe some of the macro parameters that need to be followed closely are government initiatives impacting rural wage growth, MSPs, DBT, gross capital formation, budgetary allocation for rural and social schemes, job & wage growth, etc.

Influence of government's capital expenditure on FMCG revenue growth

Note that during periods when the government accelerates investment activities/expenditure (gross capital formation, GCF), income effect leads to better volume growth, especially in rural areas, which boosts overall volume/revenue growth for FMCG companies (refer exhibit 23).

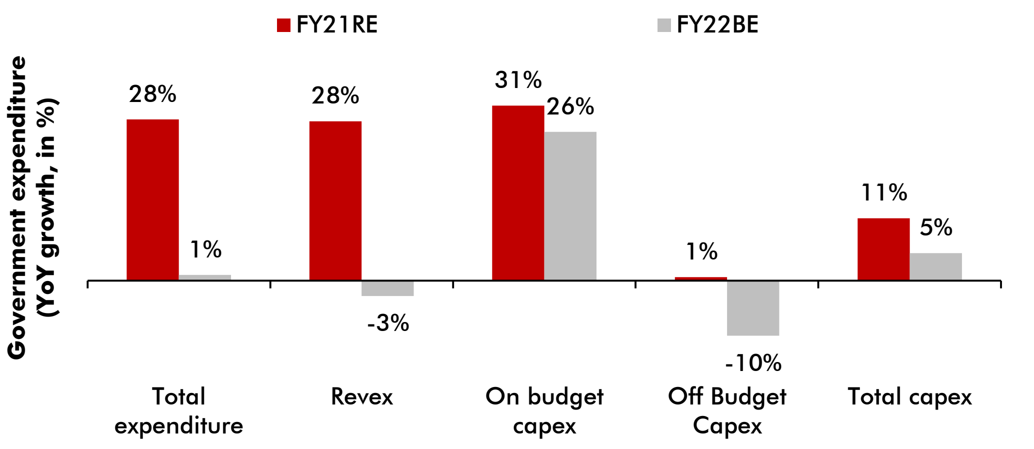
Exhibit 23: Higher spending towards GCF bodes well for FMCG companies' volume and revenue growth, albeit with a lag of 6-9 months



Source: CMIE, Ambit Capital research; Note – FY09 and FY10 revenue growth for HUL has been adjusted to streamline from 15months/12months period to 12months period each; FY16 revenue for FMCG cos is turning negative owing to Maggi ban issue in CY15 (ex-of that issue FMCG revenue growth would be ~3%).

This brings us to take note of the 2021 budget allocation to capex and revex. As per Union Budget 2021, the government's overall support to the economy is likely to scale down in FY22 as overall expenditure is budgeted to clock 1% YoY growth in FY22 on a high base of FY21 (28%). Within this, revenue expenditure is budgeted to contract 3% in FY22, again on a high base of 28% YoY in FY21 and capex is likely to moderate to 5% in FY22 on 11% YoY growth in FY21. For a detailed analysis, please refer our budget note. Thus, while FY22 government spending looks optically soft, the high base needs to be factored in.

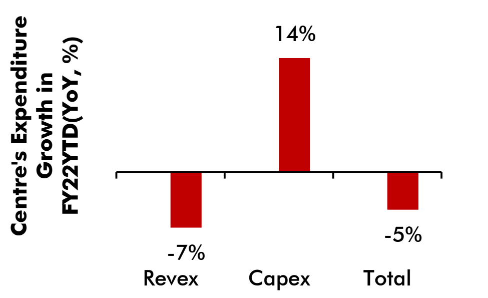
Exhibit 24: Government support to the economy to wane in FY22



Source: Union budget documents, Ambit Capital research

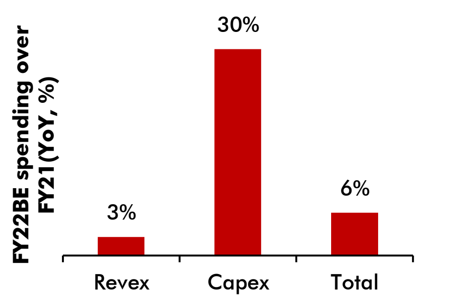
For YTDFY22 (April-July FY22), the government's total expenditure contracted by 5%. But this coupled with the fact that tax revenue growth has been buoyant (net tax revenue up 56% vs FY20) gives the government ample room to accelerate spending in the remaining of the fiscal. Ambit's economist estimates that the government's total expenditure will grow at 12% YoY during Aug-Mar (vs contraction of 5% during Apr-Jul) and will likely remain in double digit in FY23 BE also.

Exhibit 25: Overall expenditure has contracted in FY22YTD due to cutback on revex



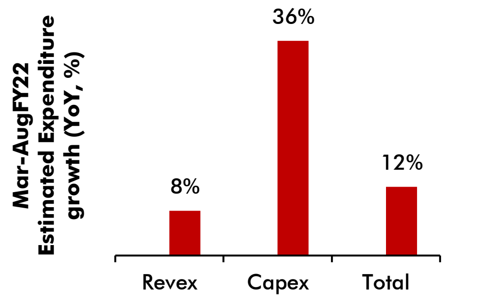
Source: CGA, Ambit Capital research. Note- Revex and total Expenditure for FY21 excludes FCI and fertilisers dues cleared by centre which amounted to ₹2.35trn

Exhibit 26: Despite central government having focused on capex growth in FY22YTD...



Source: CGA, Budget Documents, Ambit capital research. Note-BE: Budgeted Estimates.(2) - Revex and total Expenditure for FY21 excludes FCI and fertilisers dues cleared by centre which amounted to ₹2.35trn

Exhibit 27: ...it will have to increase capex by 36% in the rest of the year to reach its annual target



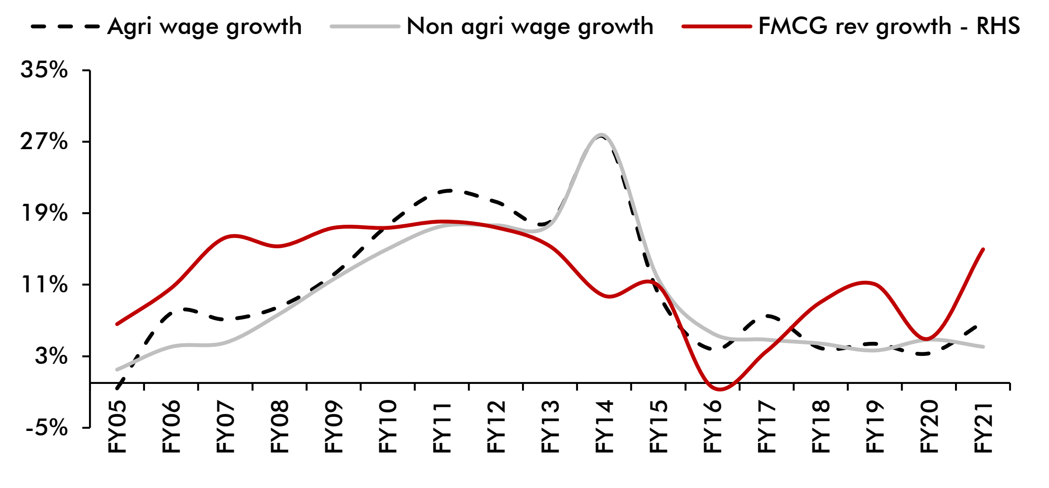
Source: CGA, Budget Documents, Ambit capital research. Note- Estimated growth = (BE-Apr-JulFY22 Actuals)/ (Aug-MarchFY21 Actuals) -1. (2)BE: Budgeted Estimates.(3) - Revex and total Expenditure for FY21 excludes FCI and fertilisers dues cleared by centre which amounted to ₹2.35trn

Considering the fiscal cushion that central governments have in terms of revex and capex spending over August-March 2022, we believe the current softness in rural markets may thus be short-lived. This together with the third sequential year of good monsoons should aid in better crop yield, thereby improving realization for farmers.

Impact of rural wage growth on FMCG companies revenue growth

In below exhibit, we have mapped the historical impact of rural agri wage growth and rural non-agri wage growth on FMCG companies' revenue growth. As seen below, till FY14 rural agri and non-agri wage growth remained healthy in the mid to high teens partially helped FMCG companies post mid-teen revenue growth. However, as rural agri and non-agri wage growth moderated to median 5-6% between FY15-20, the cascading hit on revenue growth was seen at FMCG companies too (average revenue growth moderated to ~7% vs mid-teens in the previous decade). Any increase in rural wage growth will positively help FMCG companies' in their volume growth. In FY21, agri wage growth has barely grown and hence it may take few more months before we see growth pick up in rural market.

Exhibit 28: Deceleration in wage growth has led to moderation in FMCG companies' revenue growth



Source: CMIE, Ambit Capital research; Note – FY09 and FY10 revenue growth for HUL has been adjusted to streamline from 15months/12months period to 12months period each; FY16 revenue for FMCG cos is turning negative owing to Maggi ban issue in CY15 (ex-of that issue FMCG revenue growth would be ~3%). Agri wages are computed taking average per day wage for workers into ploughing, sowing, harvesting, picking, well digging, herdsman, cane crushing, animal husbandry, fishermen, wood cutters, etc. Non agri wages are computed taking average per day wage for workers into carpentry, blacksmith, weavers, cobblers, handicraft, plumbers, electricians, tractor drivers, sweepers, unskilled labour, etc.

Impact of MSP hikes to FMCG cos revenue growth

Another parameter for buoyant rural growth is MSP for key agri commodities. As seen in the below exhibit, periods when MSP hikes were in double digits (i.e. 2004-2014), FMCG revenue growth too was in the range of 12-15%. After FY14, when MSP growth moderated to 4-8%, revenue growth of FMCG too started reducing and settled at ~7%. FY21 saw a divergence in MSP rate hike of average 5% vs FMCG revenue growth of ~15%, which is an outcome of Covid-led demand spike of certain categories vs broader FMCG categories' revenue growth. As post-Covid demand scenario emerges (i.e. demand for health, immunity etc. fades), it would be critical to monitor growth in MSP since higher growth does help rural markets do better.

Exhibit 29: Mid-teen MSP growth from 2004-14 dipped to 6-8% from FY14, which led to moderation in revenue growth for FMCG companies

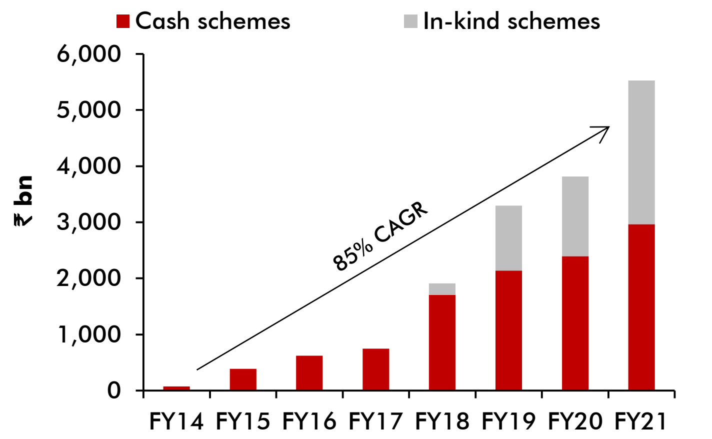
MSP calculating using ₹ per quintal	CAGR				
	2004-2009	2009-2014	2014-2019	2020-2021	2021-2022
Paddy common	10%	8%	6%	3%	4%
Coarse cereals	11%	9%	5%	5%	NA
Wheat	11%	5%	6%	3%	NA
Gram	4%	12%	8%	5%	NA
Arhar (Tur)	8%	17%	6%	3%	5%
Moong	13%	12%	9%	2%	1%
Urad	13%	11%	5%	5%	5%
FMCG cos rev. CAGR	**12%**	**15%**	**7%**	**15%**	**10%**

Source: RBI, Ambit Capital research; Note – FMCG revenue growth for 2021-22 is basis our estimate for companies under coverage and Bloomberg consensus for companies not covered by us

Jump in DBT but no translation to revenue growth

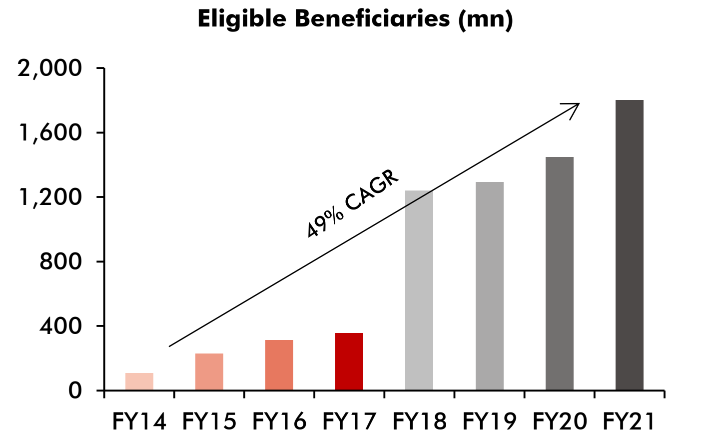
On the one side we have seen a drop in rural wage growth as well as slower increase in MSP hikes but on the other hand we see a sharp jump (85% CAGR over FY14-21) in DBT transfer backed by 49% CAGR in eligible beneficiaries. Despite this, FMCG revenue growth over the same period was ~7%, reflecting only marginal tailwind to volume growth. This could be possibly because DBT is linked to a specific purpose and recipients would have used it for that purpose only rather than for staples and/or discretionary spends.

Exhibit 30: Sharp jump in DBT led by 10x jump in in- kind schemes from FY18



Source: DBT Bharat, Ambit Capital research

Exhibit 31: Despite 49% increase in beneficiaries, translation to FMCG growth has been sub-par

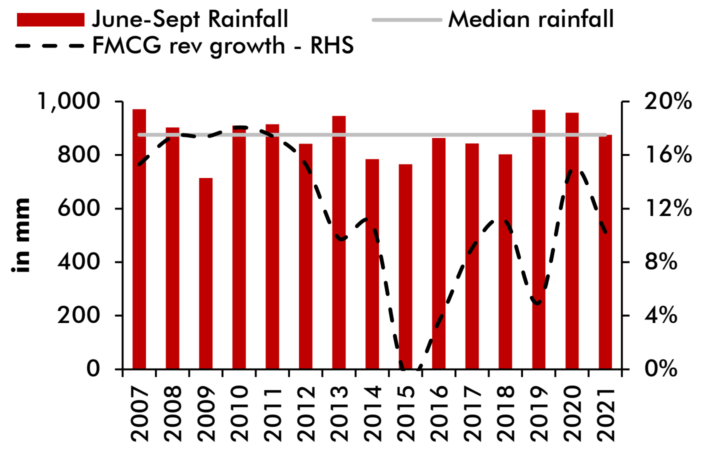


Source: DBT Bharat, Ambit Capital research

Good monsoon brings much needed positivity

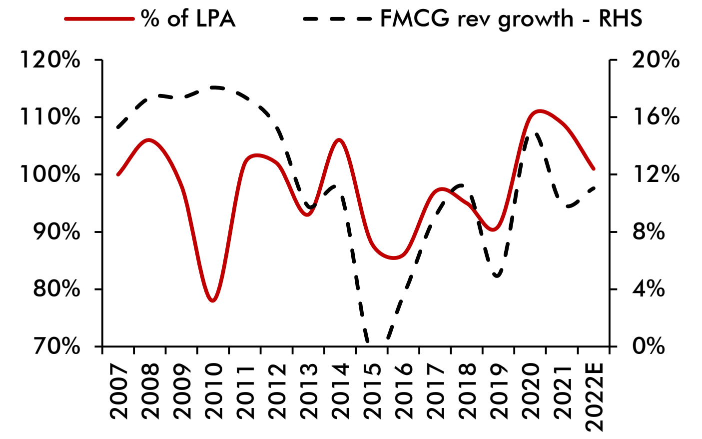
It is a common perception that normal monsoon and more importantly better dispersion of monsoon during June-Sept lead to better agricultural productivity yields and thus improved farm income. To analyse this thesis, we plotted overall monsoon levels (in mm), its YoY growth rate and compared it with FMCG companies' revenue growth. We note that during FY05-13, even if monsoon was lower than LPA, FMCG companies did not see a dip in revenue growth. This could be because during that period rural wage growth, MSP hikes etc. helped rural India overcome weak monsoon/drought, thereby seeing negligible impact on their disposable incomes. However, from FY13, weak monsoon/drought usually led to soft revenue growth for FMCG companies in the subsequent year.

Exhibit 32: Rainfall below median levels has usually led to lower revenue growth for FMCG...



Source: Company, Ambit Capital research; Note – FY09 and FY10 revenue growth for HUL has been adjusted to streamline from 15months/12months period to 12months period each; FY16 revenue for FMCG cos is turning negative owing to Maggi ban issue in CY15 (ex-of that issue FMCG revenue growth would be ~3%). Above chart is as per CY but FMCG revenue growth is as per relevant FY

Exhibit 33: ...with normal rainfall from 2019-21, rural revenue growth expected to be buoyant



Source: Company, Ambit Capital research; Note – LPA is as per CY but FMCG revenue growth is as per relevant FY. For e.g. – rainfall for 2020 whereas sales for FY21 has been considered

Thus, three consecutive normal monsoons (i.e. CY19-21) are likely to improve agricultural yield and improve farm income, both of which should help keep rural distress at bay.

Rural softness transitory; macros favour revival in rural growth

Basis the above macro data points, we expect the current softness in rural markets to not structurally weaken the ability to seize growth potential from rural markets. As state governments' capex and revex spending improves, we expect the last of the pieces to fall in place for rural recovery. Historically, during periods when rural markets have been buoyant (pre-FY14, FY18-19), rural growth has been at ~1.5x that of urban growth. Basis management commentaries, we understand that current rural growth is 0.8-1x and they expect softness in rural growth to be transitory.

The HPC story

Right growth strategy for HPC companies will be through innovation and premiumisation, expanding distribution network (specifically in tier 3 and beyond markets), identifying/addressing product and distribution gaps and addressing those whitespace. Deep dive into HPC categories (refer exhibits 34 and 35) too suggests it to be a prudent strategy. As long as HPC companies are able to tread that path, expect market share gains to sustain. FY16-20 was a period of soft volume growth largely owing to macro headwinds (policy-led, rural softness etc). Despite that, HPC companies saw >500bps EBITDAM expansion led by conscious cost savings, product mix improvement. Leveraging on macro tailwinds (elaborated in the earlier section), we thus expect HPC companies to focus on revenue growth while looking to expand EBITDAM only steadily.

Growth expectation from HPC categories

The FMCG sector can be broken into three broad segments: (i) Home & Personal Care, (ii) Food & Beverages, and (iii) Healthcare. Our thesis on F&B companies is their potential to grow revenue growth faster than HPC companies on account of low penetration across most categories, ample room to gain market share from fragmented unorganized tail (leaders MS<30% in most categories) and distribution headroom (Britannia reaches ~5mn outlets vs HUL/Universe of 8mn+/12mn+ outlets). Unlike F&B categories, large HPC categories have high penetration levels (>60-65%) and hence easy gains emanating from penetration-led volume growth will not be easy. This means focus for most HPC companies would be to:

- Tread the premiumisation path (e.g. bars to liquid soaps in bathing soap and dishwash, regular hair oil to functional hair care product),
- Undertake initiatives to increase frequency & occasions of consumption,
- Further widen the distribution network (increase penetration in Tier 3 and beyond towns and rural areas),
- Identify whitespaces within categories (e.g. expand naturals portfolio), and
- Innovate and launch products basis consumer insights (e.g. taking cue from D2C companies, offer applicator and products like Indulekha hair care),

All these while doable are not easy, and hence clocking double-digit growth across large categories is challenging.

Exhibit 34: Category construct along with market size, shares and 2020-25 expected growth rates; most BPC leaders have lost MS to new-age small brands

Categories	Market Size (₹. Mn)	Historical CAGR (2015-20)	Projected CAGR (2020-25)	Key Players	Key Brands	Company MS (%) - 2020	MS movement over last 5 yrs
Beauty & Personal Care							
Bar Soap	232,071	5.9%	4.2%	Hindustan Unilever	Lifebuoy, Lux, Pears, Dove	36.4%	↓
				Wipro Consumer Care	Santoor	11.8%	↑
				Godrej Consumer Products	Godrej No 1, Cinthol	11.5%	↔
				Reckitt Benckiser	Dettol	9.4%	↑
				ITC	Fiama Di Wills, Vivel	4.6%	↔
Hair Care (Hair oil, Shampoo, Conditioners, Colorant, etc)	231,783	4.9%	7.6%	Marico	Parachute	16.7%	↓
				Hindustan Unilever	Clinic Plus, Dove	16.5%	↔
				Loreal	Loreal, Garnier	9.2%	↔
				Dabur	Vatika	6.7%	↓
				Procter & Gamble	Head & Shoulders, Pantene	6.2%	↓
Skin Care	151,659	8.5%	9.5%	Hindustan Unilever	Fair & Lovely, Ponds, Vaseline	39.0%	↓
				Himalaya Drug	Himalaya Herbals	7.2%	↑
				L'Oréal India	Garnier Skin Naturals	5.6%	↓
				Nivea India	Nivea	3.8%	↔
Oral Care	127,748	5.4%	4.9%	Colgate-Palmolive	Colgate	42.4%	↓
				Hindustan Unilever	Closeup, Pepsodent	16.3%	↓
				Dabur India	Dabur Red, Meswak, Babool	11.0%	↑
				Patanjali	Patanjali	10.2%	↑
Men's Grooming (Shavings, Toiletries & Fragrance)	114,366	7.0%	8.9%	Gillette India	Gillette Vector, Mach3	14.8%	↓
				Vini Cosmetics	Fogg	6.6%	↑
				Hindustan Unilever	Axe/Lynx	6.1%	↓
Colour Cosmetics	88,297	11.8%	13.3%	Hindustan Unilever	Lakme, Elle 18	14.9%	↓
				L'Oréal India	Maybelline New York	8.8%	↔
				Elca Cosmetics	Mac	4.0%	↑
				Colorbar Cosmetics	Colorbar	3.6%	↑
Baby and Child-specific Products	43,706	12.4%	11.9%	Johnson's Baby	Johnson & Johnson	43.4%	↓
				Himalaya Herbals	Himalaya Drug Co	20.9%	↑
				Dabur Lal Tail	Dabur India	4.7%	↔
				Sebamed	Sebapharma	3.3%	↑
Deodorants	39,005	7.7%	9.8%	Vini Cosmetics	Fogg	21.1%	↑
				ITC Ltd	Engage	11.4%	↑
				Hindustan Unilever	Axe/Lynx	8.7%	↓
				Nivea India	Nivea	7.3%	↓
Liquid Soap	15,488	22.9%	14.2%	Reckitt Benckiser	Dettol	48.6%	↔
				Hindustan Unilever	Lifebuoy	25.5%	↔
				Dabur India	Fem	11.7%	↔
				Colgate-Palmolive	Palmolive	2.8%	↔
Body Powder	13,715	-0.2%	-0.9%	Hindustan Unilever	Pond's	49.4%	↓
				Emami Ltd	Navratna	21.3%	↑
				Johnson & Johnson	Johnson's Baby	11.8%	↓
				CavinKare	Spinz	5.8%	↑

Categories	Market Size (₹. Mn)	Historical CAGR (2015-20)	Projected CAGR (2020-25)	Key Players	Key Brands	Company MS (%) - 2020	MS movement over last 5 yrs
Body Wash/Shower Gel	3,818	14.2%	15.7%	Hindustan Unilever	Lux, Dove	32.3%	↓
				Colgate-Palmolive	Palmolive	15.8%	↓
				ITC	Fiama Di Wills, Vivel	5.8%	↑
Home Care							
Laundry Care	293,236	4.1%	5.0%	Hindustan Unilever	Surf, Wheel, Rin	42.1%	↑
				RSPL	Ghari	18.4%	↑
				Procter & Gamble	Tide, Ariel	7.6%	↓
				Nirma Ltd	Nirma	4.6%	↓
Home Insecticides	47,334	4.0%	2.9%	Godrej Consumer Products	Good Knight, Hit	55.0%	↑
				Reckitt Benckiser	Mortein	15.8%	↑
				SC Johnson	All Out, Baygon	11.2%	↓
				Jyothy Labs	Maxo	7.5%	↓
Dishwashing	36,625	7.4%	4.6%	Hindustan Unilever	Vim, Cif	60.3%	↔
				Jyothy Labs	Exo, Pril	18.2%	↔
				RSPL	Xpert	8.0%	↑
				Pitambari	Pitambari Products	3.0%	↑
Surface Care	22,586	11.8%	9.9%	Reckitt Benckiser	Dettol, Lysol, Colin	70.2%	↔
				LOC, Pursue	Amway India	4.0%	↓
				Hindustan Unilever	Domex	3.0%	↓
				SC Johnson	Kiwi	0.5%	↓
Toilet Care	13,332	12.3%	9.3%	Reckitt Benckiser	Harpic	74.5%	↓
				Hindustan Unilever	Domex	4.4%	↓
				Dabur India	Sani Fresh	4.2%	↓
Air Care	9,987	11.0%	6.2%	Dabur India	Odonil	26.0%	↓
				Godrej Consumer Products	AER	12.0%	↑
				Procter & Gamble	Ambi-Pur	9.0%	↓
				Reckitt Benckiser	Air Wick	7.0%	↑

Source: Euromonitor International Limited 2021 © All rights reserved, Ambit Capital research; Note – 2015-2020 category growth CAGR for hair care, skin care, oral care, men's grooming, color cosmetics, body powder, air care is lower by ~150-200bps owing to soft CY2020 on account of Covid led lockdown

In the backdrop of market size, expected growth rate and competitive landscape, the below exhibit summarises our view on drivers of category growth and whether the market leader will be able to retain share in the context of company-specific strategic initiatives as well as emerging competitive dynamics (product-wise as well as distribution wise). We conclude that of the 18 HPC categories captured below, penetration-led growth seems to be possible in only ~30% of categories but >60% of the categories offer premiumisation-led growth.

Exhibit 35: More HPC categories show scope to premiumise/innovate/disrupt vs scope to penetrate

Categories	Category size in ppt	Scope of penetration increase	Scope to premiumise	Scope to innovate/disrupt	Likelihood of MS loss by leader
Beauty & Personal Care					
Bar Soap	16%	Relatively weak	Relatively Strong	Relatively weak	Relatively weak
Hair Care (Shampoo, Conditioners, Colorant, etc)	16%	Strong	Strong	Relatively Strong	Relatively Strong
Skin Care	10%	Strong	Relatively Strong	Relatively Strong	Strong
Oral Care	9%	Average	Average	Average	Relatively Strong
Men's Grooming (Shavings, Toiletries & Fragrance)	8%	Strong	Relatively Strong	Relatively Strong	Strong
Colour Cosmetics	6%	Relatively Strong	Relatively Strong	Relatively Strong	Relatively Strong
Baby and Child-specific Products	3%	Average	Relatively Strong	Strong	Relatively Strong
Deodorants	2%	Average	Average	Average	Relatively weak
Liquid Soap	1%	Relatively Strong	Relatively Strong	Relatively Strong	Relatively weak
Body Powder	1%	Relatively weak	Relatively weak	Average	Average
Body Wash/Shower Gel	0.5%	Average	Relatively Strong	Relatively Strong	Average
Home Care					
Laundry Care	20%	Average	Relatively Strong	Average	Relatively weak
Home Insecticides	3%	Average	Average	Relatively Strong	Average
Dishwash	2%	Average	Relatively Strong	Average	Relatively weak
Surface Care	1%	Average	Relatively weak	Average	Average
Toilet Care	1%	Average	Relatively weak	Average	Average
Air Care	0.5%	Relatively Strong	Average	Average	Relatively weak

Source: Ambit Capital research Note: - Strong; - Relatively Strong; - Average; - Relatively weak

We expect HPC categories to post 8-10% revenue CAGR over FY21-26E with beauty, discretionary and functional categories posting 12-15% growth and high-penetrated HPC categories (hair oil, bar soap etc) clocking 6-8% growth

Reflecting upon macro factors, category nuances and its growth drivers, we expect HPC categories to post 8-10% revenue CAGR over FY21-26E with beauty, discretionary and functional categories posting 12-15% growth and high-penetrated HPC categories (hair oil, bar soap etc) clocking 6-8% growth.

HPC companies playbook

The below exhibit reflects the portfolio play of different HPC companies across categories. As seen in the below exhibit, HUVR is present across HPC categories except home insecticides and air care. GCPL on the other hand is present in multiple HPC categories, however the scale is small. Dabur on the other hand has 45-50% of revenues coming from HPC (largely oral care and hair care) followed by healthcare (35-40%) and foods (15-20%). Marico, like Dabur, is focused on limited HPC categories (60% of domestic revenues from hair care, ~30% from edible oil and food and balance from male grooming, etc).

Exhibit 36: Category playbook suggests HUL is present across HPC categories followed by GCPL, Dabur and Marico

Categories	DABUR	HUVR	GCPL	MRCO
Beauty & Personal Care				
Bar Soap	×	✓	✓	×
Hair Care (Shampoo, Conditioners, Colorant, etc)	✓	✓	✓	✓
Skin Care	✓	✓	✓	✓
Oral Care	✓	✓	×	×
Men's Grooming (Shavings, Toiletries & Fragrance)	×	✓	✓	✓
Hair oil	✓	✓	×	✓
Colour Cosmetics	×	✓	✓	×
Baby and Child-specific Products	✓	✓	✓	✓
Deodorants	×	✓	✓	✓
Liquid Soap	×	✓	✓	×
Body Powder	×	✓	✓	×
Body Wash/Shower Gel	×	✓	✓	×
Home Care				
Laundry Care	×	✓	✓	✓
Home Insecticides	✓	×	✓	×
Dishwash	×	✓	✓	×
Surface Care	×	✓	✓	×
Toilet Care	✓	✓	✓	×
Air Care	✓	×	✓	×

Source: Companies, Ambit Capital research

What growth strategies are we betting on?

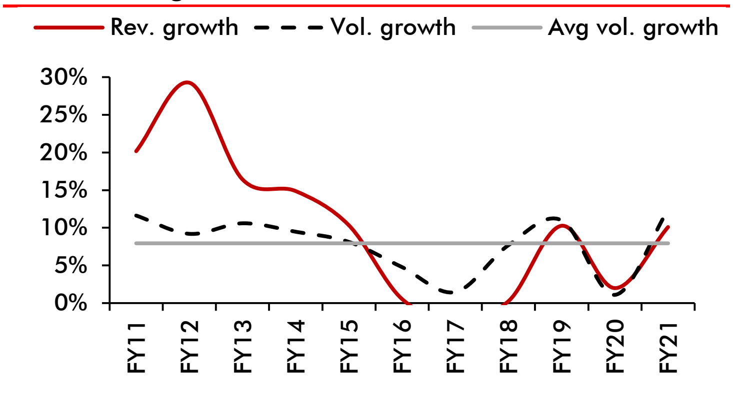
Our bet would be on companies expanding their positioning in existing large categories and slowly pivoting towards niche HPC categories which offer scalability rather than attempting to make a meaningful presence in other large HPC categories where right to win could be limited. Another under-appreciated growth factor for existing HPC companies is the power of existing distribution reach. Using this, incumbent HPC companies are able to place their new launches across 0.5-1mn outlets right in year 1 and achieve size of ₹150-300mn. Assuming companies were looking at 4-5 launches p.a., these itself would lend 1-1.5% additional delta to annual revenue growth. Going ahead, as HPC companies strengthen their innovation funnel, launch more e-com only brands, and establish own D2C platforms, all these will structurally lead to higher-than-industry growth rates for large HPC companies.

Scale-up progression of incumbent HPC companies

Considering the macro environment, category-level nuances and the competitive landscape, the below list summarises historic scale-up of HPC companies.

- **Dabur – Awakened to seize the most of consumer's preference**

Exhibit 37: Decadal average volume growth was 8%; aggression in healthcare and foods can help Dabur sustain 7-8% volume growth



Source: Company, Ambit Capital research

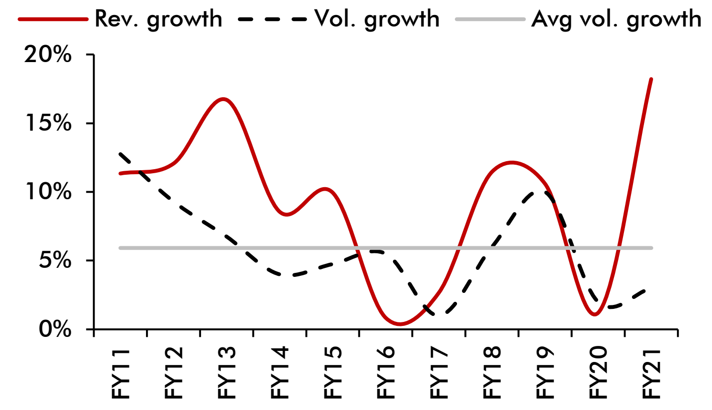
Exhibit 38: Dabur is now aggressive in new launches; focus should be to expand presence in must-win categories rather than all categories

Period	Remarks
FY11-15	▪ Average volume growth of ~10%; ▪ Secular growth from rural as well as urban markets
FY16-18	▪ Average volume dropped to 5% ▪ Dabur started to feel the heat of Patanjali's aggression ▪ DeMon, GST and Govt's policies led to soft rural growth
FY19-21	▪ Average volume growth again picked up to 8% ▪ Change in management led to more agility within organisation; aggression seen across departments: innovation, S&D, supply chain, marketing, etc. ▪ Management truly displayed their might in healthcare by launching relevant consumer products

Source: Company, Ambit Capital research

HUL – Leveraging the use of data & technology to the fullest

Exhibit 39: Decadal average volume growth was 6%; pick-up in BPC and HFD portfolios can lead to 6-8% volume growth in the next decade



Source: Company, Ambit Capital research

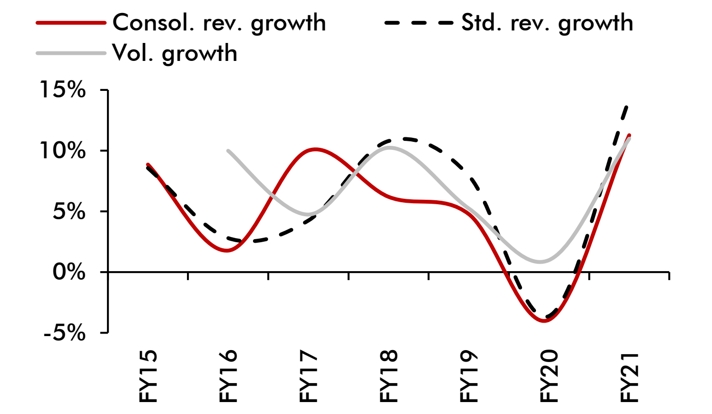
Exhibit 40: HUL is pioneer in using tech and data; critical is improvement in the broader economy for premiumisation benefits to flow in

Period	Remarks
FY11-13	▪ Average volume growth of ~10% ▪ Company rode on distribution expansion and penetration increase
FY14-17	▪ Average volume dropped to 5% ▪ Realising fading benefits of distribution expansion, company initiated WiMi strategy ▪ Competition from Patanjali and DeMon impacted growth in volume across few categories
FY18-21	▪ Benefitting from results of WiMi strategy, FY18/19 saw volume growth of 6%/10%, respectively ▪ However, FY20 volume growth was marred by soft growth in rural markets; FY21 got impacted with decline in volume growth in discretionary portfolio

Source: Company, Ambit Capital research

Godrej Consumer Products – Earnings volatility needs to end

Exhibit 41: Domestic and IB business languished from FY18-20; can new CEO and GAUM head reverse the underperformance?



Source: Company, Ambit Capital research; Note – Revenue growth for FY15 has been captured since prior to that GCPL undertook few acquisitions which led to growth rates (organic + inorganic) in the range of 35-80% which is not appropriate

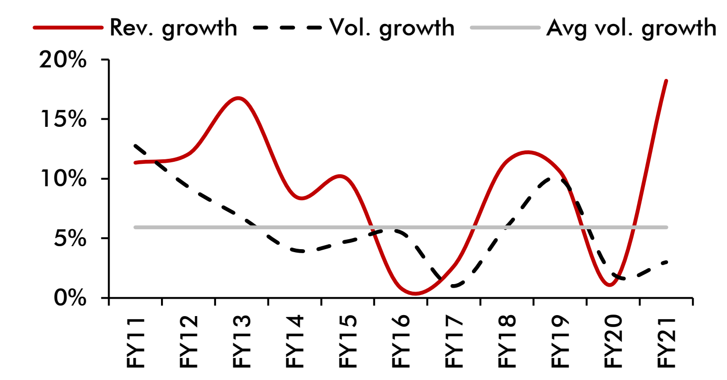
Exhibit 42: Improved supply chain & distribution and foray into new categories can help GCPL inch back to ~8% volume growth trajectory

Period	Remarks
FY15-18	▪ Average volume growth of ~8%; ▪ Domestic business was on relatively better footing; IB started to falter by end of this phase
FY19-21	▪ Average volume dropped to 6% ▪ Domestic business lacked growth predictability in core category of HI; Despite being market leader, company was caught napping when incense stick gained share ▪ Amongst IB, GAUM cluster growth slowed in terms of top line as well as margins ▪ By FY21 exit, GCPL seems to have been more agile, used Covid as an opportunity to expand portfolio in wider HPC categories ▪ Question is can the new MD & CEO (appointment w.e.f. October 2021) and GAUM CEO potentially lead to turnaround for GCPL

Source: Company, Ambit Capital research

Marico – TAM expansion a right move

Exhibit 43: Decadal average volume growth was 8%; can sustain ~8% volume growth subject to scale-up of foods portfolio



Source: Company, Ambit Capital research

Exhibit 44: Marico's aggression in innovation and GTM strategy reflects in performance from FY20

Period	Remarks
FY11-13	▪ Average volume growth of ~13%; ▪ Company rode on distribution expansion, NPDs and penetration increase
FY14-20	▪ Average volume dropped to 5% ▪ Marico's performance in VAHO was softer than its own estimates ▪ Saffola edible oil lost consumer connect of being healthy variant ▪ Pick up in overall foods category was disappointing
FY21	▪ Witnessed pick up across all categories; gained market share too in all categories ▪ Play in healthy foods category looks exciting

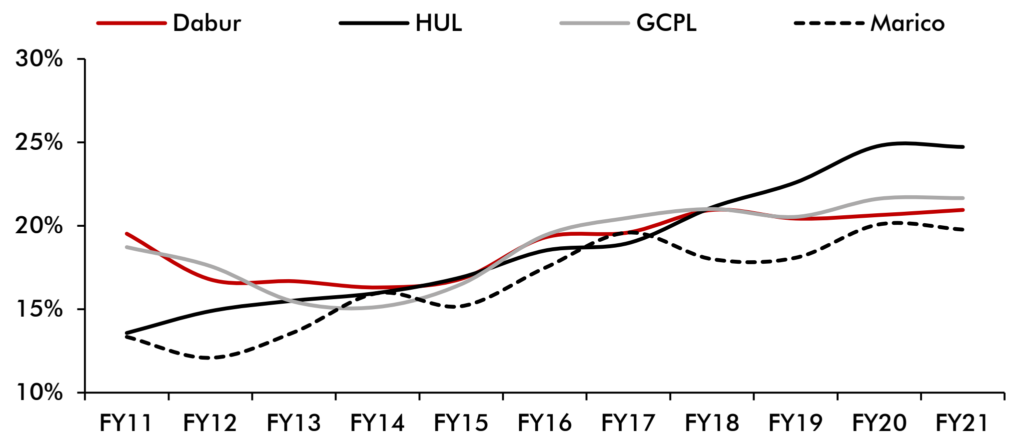
Source: Company, Ambit Capital research

Focus shifts to volume/revenue growth over margin expansion

We expect HPC companies to focus on volume and revenue growth over margins for the next 5 years since HPC companies: (i) have already posted >500bps EBITDAM expansion over the last decade; (ii) posted subdued volume growth from FY16-20, owing to macro challenges; but as macro tailwinds start to play out, companies should look to leverage those by accelerating growth vs focusing on margins; (iii) should look to expand distribution, focus on emerging distribution platforms such as D2C, e-com etc and press pedal on ad spends to create better brand awareness pan-India. All these will ensure expansion of TAM and stable to improving market share trajectory. This will also ensure that threat from startups, D2C brands, private labels, etc can be tackled effectively. As that plays out, we expect HPC companies to be in a much better competitive position.

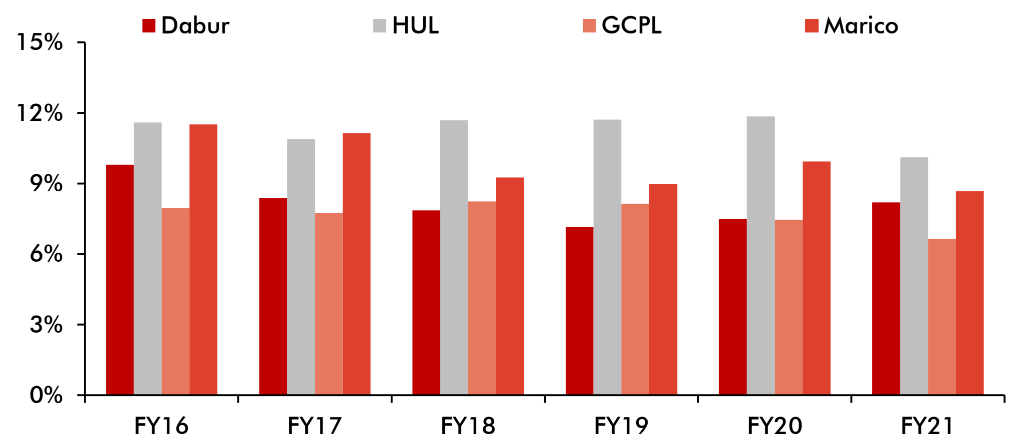
Further, we are expecting only a modest EBITDAM expansion since ability to reduce cost through company specific initiatives, operating leverage benefits and product mix led GM expansion scope persists.

Exhibit 45: Limited incremental EBITDAM expansion scope; expect 50-200bps EBITDAM expansion over FY21-25E



Source: Companies, Ambit Capital research

Exhibit 46: Ad spends have moderated by 100-300bps over FY16-21; incremental reduction may weigh on potential to scale up new launches



Source: Companies, Ambit Capital research

Thus, structurally we expect large HPC categories to post 7-9% volume growth (post high inflationary scenario fades); company-specific growth rates may vary depending on the category in which they are present and share gain dynamics.

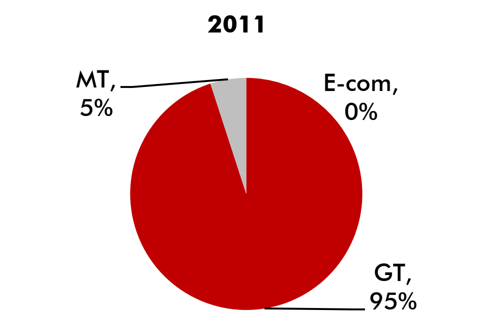
Changes on the horizon

There are some startling underrated changes on the horizon within FMCG like the rise of: (i) emerging distribution channels (JioMart, Udaan etc); (ii) D2C companies and (iii) private labels. These little macro changes can potentially have a lasting impact on financials of consumer staple companies. As share of emerging distribution channels increase, it may lead to companies offering higher margins and/or credit thereby impacting FMCG companies' EBITDAM and RoCE. Increasing count of D2C companies coupled with their scale-up and increasing mind-share will mean as consumers premiumise there are higher changes of them shifting to products of D2C companies vs sticking with incumbent brands. Lastly, as share of private labels increase, incumbents' ability to price their brands and categories profit pool may slowly come down. Impact of these changes could be limited in the near-term but as these changes starts to gain momentum, it can lead to structural impact on earnings profile and hence valuation multiples of FMCG cos.

Emerging distribution channels, a force to reckon with

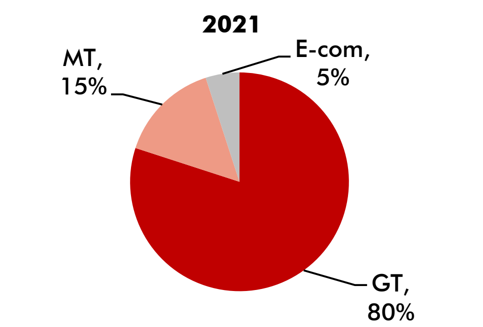
Over the last few decades, distribution in the FMCG sector has not seen any major upheaval. Most of the FMCG companies have adopted technology largely to: (i) track primary and secondary sales on a real-time basis; (ii) track inventory and logistics; and (iii) digitize order seeking and fulfilment. However, no major innovation has happened on the distribution model (except what HUL has done). Parallel to this, over the last few years, the share of MT and e-com has been steadily increasing but that did not materially impact distributors/retailers growth.

Exhibit 47: From a mere share of 5%/0% of MT/e-com…



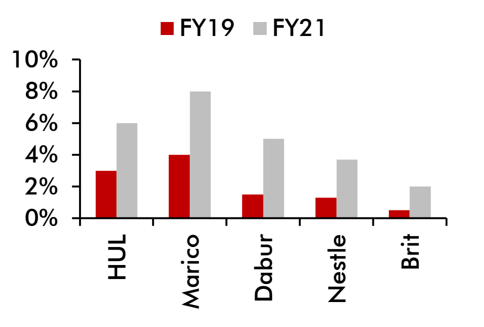
Source: Company, Ambit Capital research

Exhibit 48: …overall contribution has gone up to ~20% and…



Source: Company, Ambit Capital research

Exhibit 49: …Covid has accelerated the push to e-com



Source: Company, Ambit Capital research

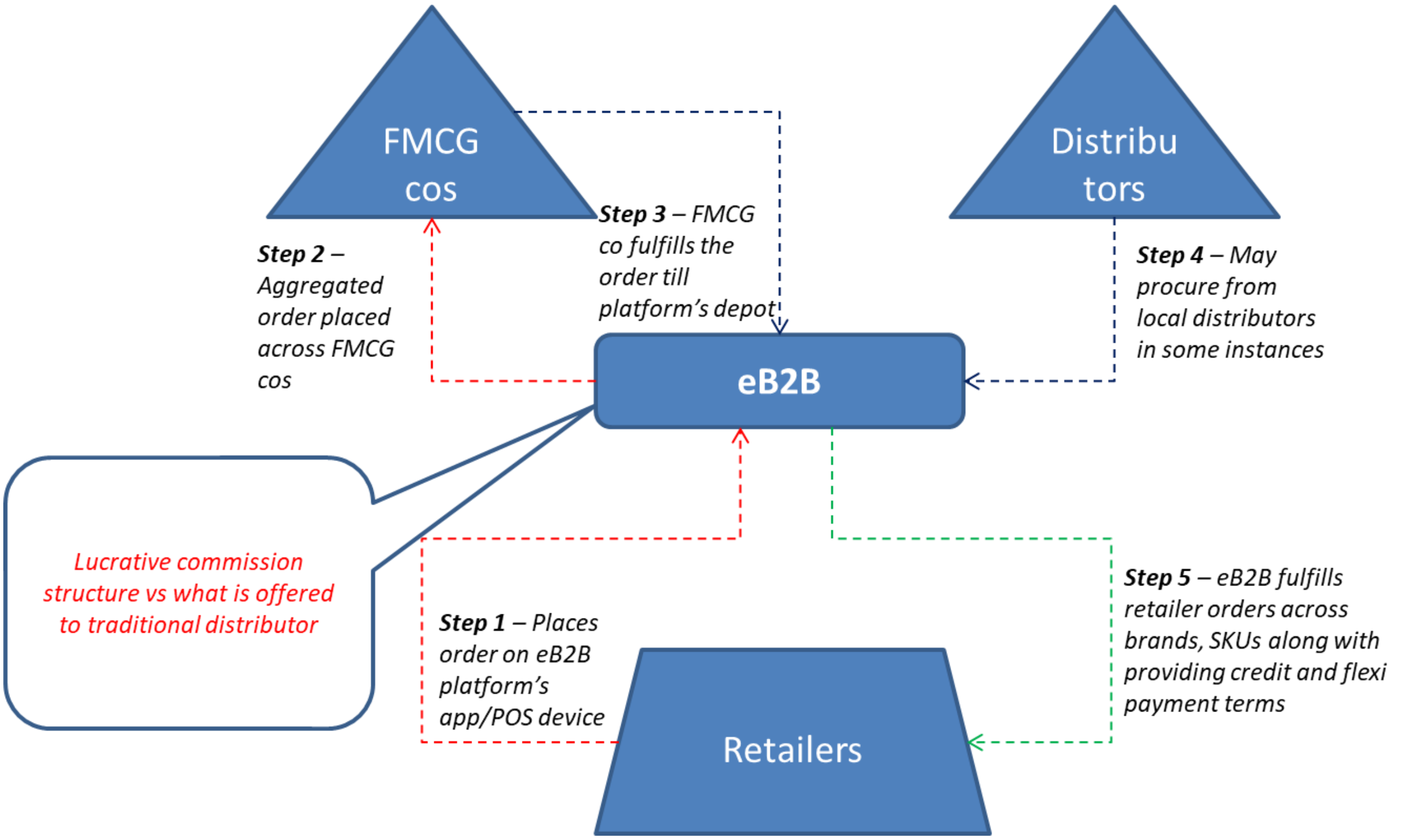
What is changing now?

Over the last 24 months, technology-enabled eB2B platforms have started to scale up trying to connect FMCG companies directly with retailers while handling distribution, logistics and warehousing. Some pure eB2B marketplace platforms are Udaan, Shopkirana, StoreKing, ElasticRun etc. and eB2B2C platforms are JioMart, Amazon, Flipkart etc. While the share of these intermediaries as a % of FMCG revenues is not known yet, suffice to say that their saliency is surely growing at a rapid clip.

Modus operandi for eB2B platforms

Keeping technology as the backbone, eB2B marketplace operators cater to consumption categories such as FMCG, staples, apparels, electronics etc. Together with this, it provides ancillary services such as logistics and credit to retailers and warehousing and marketing to brands.

Exhibit 50: How are eB2B operators revamping distribution architecture between the company and retailer?



Source: Ambit Capital research

Why these platforms are becoming relevant

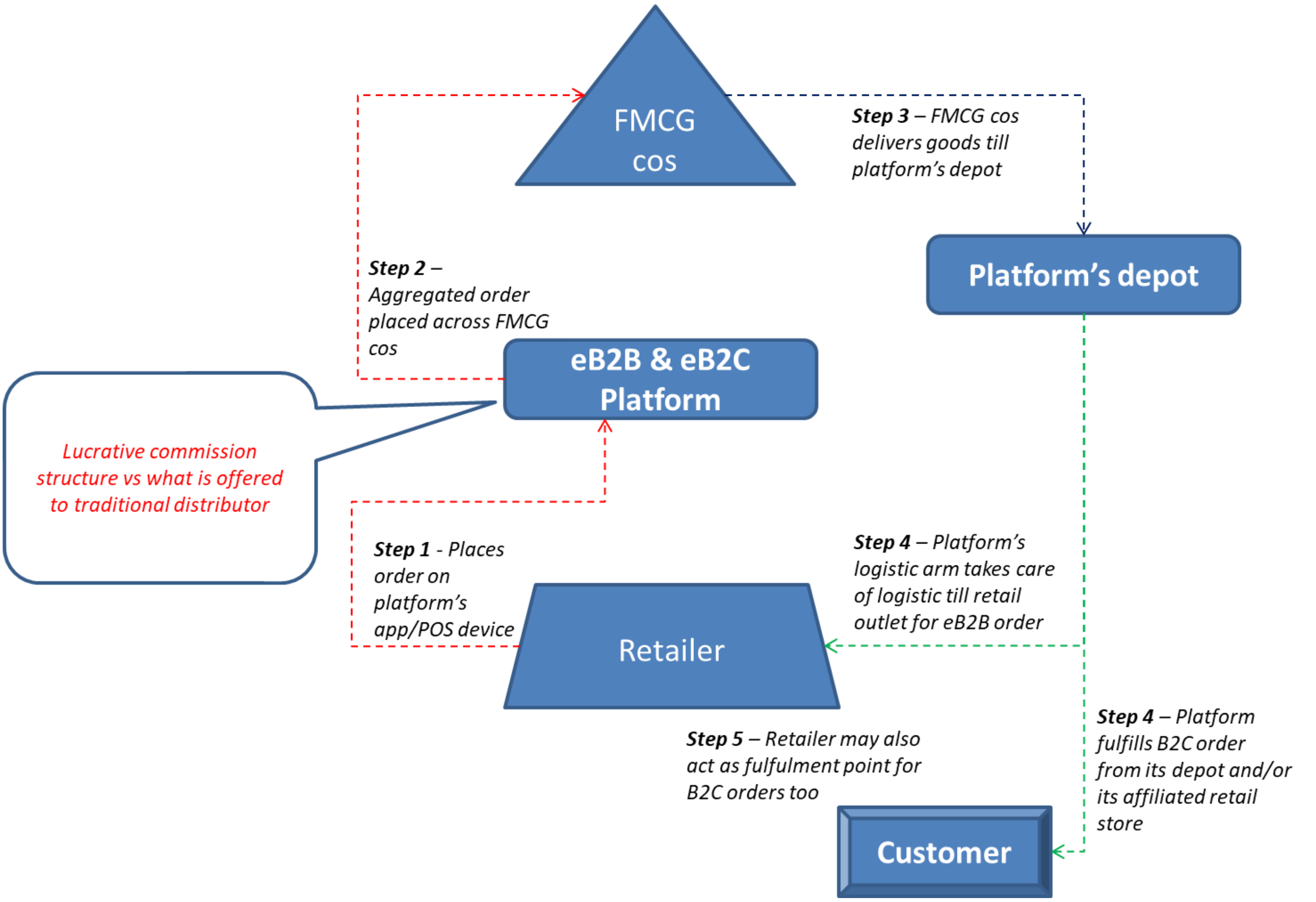
Large FMCG companies are looking to expand their distribution in the underserved geographies of tier 3-6 cities and rural markets. For FMCG companies to achieve this, they will need to (i) appoint new distributors/wholesalers in those markets (interacting with experts is difficult) or (ii) appoint more feet on street that can reach out to those markets to serve retailers (difficult but not impossible) or (iii) incur high logistics and distribution cost, making distribution to those markets unviable from a cost and margin perspective. Thus, FMCG companies are possibly looking to work closely with these eB2B platforms. However, there is a flip side to it. While eB2B platforms are striving to reach newer markets where there is no existing distribution ecosystem, some have chosen to operate in markets where the distribution ecosystem is well-established, leading to channel conflict. If this channel conflict is not curtailed, it can lead to some long lasting repercussions for FMCG companies (refer exhibit 53).

"We are not supplying to Udaan. We have 10,000 distributors who create employment for 1 lakh people. We have worked with them for 6-7 decades. We don't want to sacrifice distribution. We have an Amul cart app that can do the same." – GCMMF MD RS Sodhi

Modus operandi for eB2B and eB2C, e.g. JioMart

On the distribution side, there are a few other players who are looking to scale up their B2B as well as B2C platforms. For such players, their B2C model is akin to DMart and their B2B model involves digitizing the GT by offering PoS machines, undertaking inventory management, retailer fulfillment etc.

Exhibit 51: Case in point - How JioMart is building its B2C and B2B deliveries



Source: Ambit Capital research

According to media reports, JioMart is looking to scale up its B2B over B2C. In this quest, Reliance is looking to service retailers through their own platform. To us, the rise of eB2B and B2C platforms can bring a renaissance in the way distribution of FMCG has been historically conducted in India.

Exhibit 52: Channel margins favoring JioMart, Udaan etc. vs distributors

In ₹, unless specified	Distributor channel	JioMart	Udaan
Gross sales/MRP	**100**	**100**	**100**
Commission:			
Distributor	5%		
Retailer	10%	22-25%	22-25%
Schemes & incentives	2%		
Logistic cost (approx)	2%		
Total cost	*19%*	*22-25%*	*22-25%*
Net Sales after channel commission and logistic cost	**81**	**75-78**	**75-78**

Source: Ambit Capital research

Medium to long-term impact

As mentioned above, increasing saliency of new distribution channel intermediaries (eB2B and eB2B/eB2C) may lead to some structural changes in the way one estimates long-term revenue growth, potential to scale up innovations and NPDs, margin structure and return ratios. The below exhibit summarises the same.

Exhibit 53: In a nutshell, increasing saliency of new channels of distribution will impact distributors the most followed by FMCG companies; impact to retailers and consumers is neutral to positive

Particulars	Impact to:				
	FMCG Co	**Distributor**	**New channel partners - Udaan, JioMart, etc**	**Retailer**	**Consumer**
Volume/Revenue growth	Neutral to positive - May gain shelf space vs competition	Negative - losses volume growth to Udaan, JioMart etc	Positive - Gaining trade share	Indifferent	Indifferent
	☺	☹	☺	😐	😐
Scale up of new launches	Neutral to negative - New channel partners may focus only on main SKUs	Indifferent - Distributor should ask for higher margins to push new launches which can compensate for an otherwise loss of volumes	Indifferent - Focus will be on key SKUs which helps them rapidly grow GMVs	Negative - May lose out to e-com if new launches does not come to GT channel	Indifferent - Will move across platforms for relevant product at right price
	☹	😐	😐	☹	😐
Margins	Negative - offers higher margin to new channel partners	Negative - not achieving targets will lead to lower incentives, etc	Positive - improving bargaining power to yield higher margins	Positive - New channel partners are offering higher schemes and margins	Indifferent
	☹	☹	☺	☺	😐
Cost towards sales team	Positive – Company can look to lower their FoS	Neutral to negative – either will need to prune sales team or hold which will lower than net margins	Positive – same sales force can push more brands and SKUs	Neutral	Indifferent
	☺	☹	☺	😐	😐
Working capital	Negative - extends credit of 15-30 days vs negative WC terms with distributors	Negative - blockage of capital with slower incremental turnover	Positive - gets credit from FMCG cos which it passes on to retailers	Positive - Gets better ToT and credit period	Indifferent
	☹	☹	☺	☺	😐
Bargaining power	Negative - May weaken gradually	Negative	Positive - Improving share of trade will help them improve bargaining power	Neutral	Indifferent
	☹	☹	☺	😐	😐
Return ratios	Negative - Will optically slowly deteriorates unless it gets compensated with higher revenue growth	Negative	Positive	Positive	Indifferent
	☹	☹	☺	☺	😐
Data	Negative – Seeking data comes with a cost	Neutral	Positive – bargaining power can increase with huge data across primaries and secondaries	Neutral	Indifferent
	☹	😐	☺	😐	😐
Vulnerability	Neutral to negative - Company with non leadership position and portfolio susceptible to pvt label may lose in LT	Negative - Consolidation of distributors to happen gradually	Positive	Neutral	Indifferent
	☹	☹	☺	😐	😐

Source: Company, Ambit Capital research

Some unanswered questions

Since this is an emerging dynamic environment, we have some questions for which we do not have conclusive and exhaustive answers yet. But it would be important for investors to get answers to some of the following questions to ascertain the long-term impact on FMCG companies.

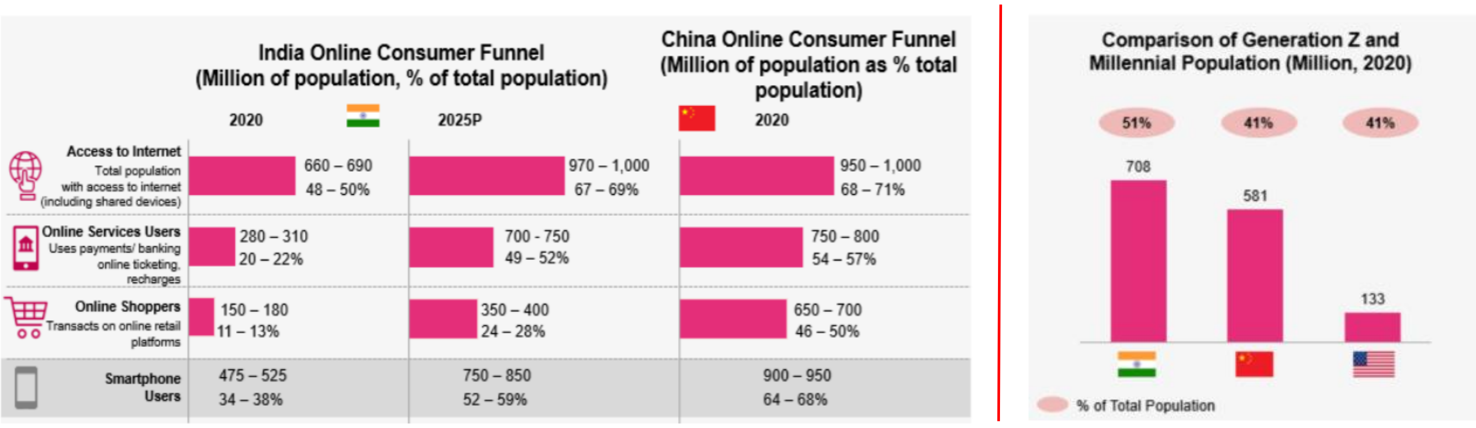
- In light of the above mentioned positives and negatives, what is the compelling reason for FMCG companies to adopt to these new channel intermediaries over the traditional distributor model?
- We understand new channel intermediaries focusses only on fast moving SKUs for FMCG companies. In this scenario how will FMCG companies scale up new launches if traditional distributors were to move out owing to channel conflict?

- Structural impact on margins and working capital of FMCG companies.
- How will FMCG companies remain ahead of the curve if they are not able to seek real time data across consumption, consumer behaviour etc?
- Will it entail lower investment by FMCG companies in building warehouses/depots, thereby lowering logistics costs?
- Who remains powerful in the long run, retailer or brand owner? This is critical, especially in light of the increasing share of private labels in some categories such as home care, staples, etc.

Threat from D2C brands is for real

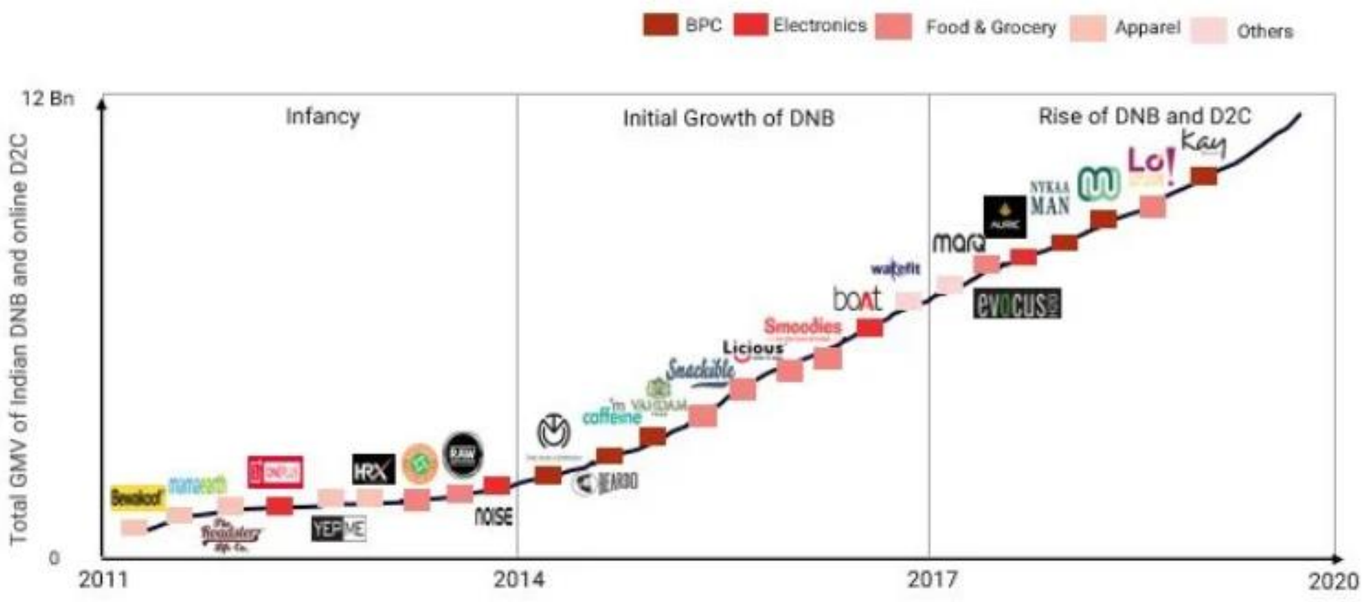
Multiple macro factors, category and channel nuances lead to the success of a brand. In the case of D2C/DNB and its scale-up, we believe it is a combination of all the three factors. Over the last decade, India has seen: (i) increased penetration of smartphones, (ii) improving affordability of data, (iii) increasing awareness and adoption of online shopping not only within top 25 cities but till Tier 4 cities, (iv) improvement of payment gateways and cash on delivery option, (v) entry of multiple logistic players, etc. Exploiting these macro tailwinds gave birth to a new genre of companies – Direct 2 Consumer (D2C) or Digitally Native Brands (DNB). Alongside these, consumer requirements and preferences have also evolved. However, the incumbents have not been able to keep pace with these emerging consumer needs or have ignored them owing to limited TAM. To start with, D2C companies are addressing these whitespaces.

Exhibit 54: There is only one way online usage and penetration are likely to go – upward



Source: Nykaa DRHP, Ambit Capital research

Exhibit 55: BPC and electronics have the highest number of D2C and DNB companies in India



Source: Ambit Capital research, Redseer

While there is valid skepticism around scalability and profitability of D2C companies, one cannot ignore the long-term threat that some of these D2C companies can potentially have on incumbent FMCG companies' revenue momentum. D2C companies in HPC are potentially differentiating themselves through:

- Addressing to the unique consumer needs which incumbents are ignoring;
- Focusing on mid to premium-end products where TAM could be smaller but as consumers upgrade, there is potential of TAM expansion;
- Building a unique and scalable route to market strategy and undertaking targeted performance marketing help improve RoI;
- Reading consumer signals and basis that working on new product launches;
- Expanding TAM by foraying into adjacencies;
- In order to achieve scale, D2C brands are looking to ramp up their offline retail presence too;
- All these eventually will lead to lowering of CAC, increase in LTV, improving retention rates – all of which will drive profitability.

Considering, there are apprehensions of scalability of D2C companies, below we present a case study of how MamaEarth has scaled up in an otherwise competitive personal care category (refer exhibit 57 & 58). For details on how some D2C companies are expanding into adjacencies, looking to achieve scale and thinking of profitability, refer to our conference note on D2C.

DNA of incumbents vs D2C companies

Business styles, strategies and DNA of incumbent companies remain completely different from that of D2C companies. As incumbents are also looking to make their mark in the D2C space, we believe the journey could be relatively difficult unless incumbents:

- think of D2C as a completely separate business with different team, sales, supply chain and distribution model;
- curate a basket of products with differentiated offers and promos;
- not focus on profitability per order but rather think of how to improve retention rates, lower customer acquisition cost and increase long-term value of customers;
- pick up consumer signals almost instantaneously by deciphering data and insights.

While the above list may not be exhaustive, thinking on these lines will help understand whether the incumbent is truly looking to scale up its D2C portfolio or is merely marking its presence.

Exhibit 56: DNA to scale up D2C is different from how incumbents run their businesses traditionally

	Incumbents	D2C Startups
Qualitative		
Innovation	Limited innovation and slow to address consumer needs	Rapid product feedback and innovation timelines
Management style	More traditional, process driven, profit focused and conservative	Entrepreneurial, young, agile and focused on solving problems/filling whitespaces
Target market	Focused on mass to mid segments	Focused on mid to premium segments
Dominant channel	All channels - GT, MT, E-com	Economics work best for online channel; with improving brand saliency moves to offline channel
Data insights	End consumer data aggregation and insights may come with a lag	Picks up consumer signals almost instantly as purchases are made online on own platforms/third party websites.
Quantitative		
Sales growth	High single to low double digit growth p.a.	At least doubling p.a., albeit on a small base
Marketing budget	6-10% of sales	Approx. 50% of sales - on the journey towards brand creation
Profitability	EBITDAM in the band of 17-25%	Some D2C cos have achieved breakeven on EBITDAM; most could be breaking even on order basis or in older cohorts

Source: Nielsen, Ambit Capital research

Exhibit 57: Journey of Mamaearth brand from FY17-21

	FY17	FY18	FY19	FY20	FY21
Sales	2	53	168	1,098	4,610
YoY Growth		*2293%*	*217%*	*552%*	*320%*
Gross Profit	1	38	109	715	3,279
Advertising exp	2	21	87	458	1,922
EBITDA	(3)	(4)	(45)	(78)	254
% of sales					
GP Margin	66%	71%	65%	65%	71%
Advertising exp	89%	39%	52%	42%	42%
EBITDA margin	-135%	-8%	-26%	-7%	6%

Source: Ace Equity, Ambit Capital research

Exhibit 58: Categories where Mamaearth competes with incumbents

	Mama Earth	Competing with which incumbents
Baby care	Diaper, Shampoo, Lotion, Oral care, Skin care, Powder	HUL, Dabur, J&J, Himalaya, Colgate
Hair	Hair oil, Hair mask, Shampoo, Conditioner, Serum	HUL, Dabur, Marico, Loreal, P&G, Emami
Face	Face wash, Face mask, Face gel, Face serum, Face sheet mask, Face toner	HUL, Zydus Wellness, Dabur, Loreal, Himalaya, P&G
Body	Body lotion, Body lotion, Body butter, Body wash	HUL, Loreal, Himalaya, Nivea

Source: Ambit Capital research

Growth of Mamaearth to ₹4.6bn sales is an outcome of expansion of market size, share gains as well as marking their entry into offline retail channel. As many more D2C companies expand, it will come at the cost of revenues of incumbents and hence we believe the threat from D2C companies is for real. Inorganic acquisition adopted by some of the incumbents (Marico, Tata Consumer) can be an answer to ebb the rising threat of D2C brands.

Private labels of both MT and Ecomm

Currently, private labels' share of overall retail is sub 1% in India. This share is much higher in the mid-teen range globally and even as high as 30%+ in the European Union (refer exhibit 59). As sales saliency of MT, ecom and B2C platforms increase, those retail channels will also look to roll out their own private labels across categories. This structurally implies there is an immense potential for private labels to grow in India (refer exhibit 60). As per a Nielsen report, the share of private labels in MT has moved up from 3.5% in Mar'20 to 4% in Aug'20. In e-com, private label share has increased from 10.7% in Jan'20 to 12.1% in Mar'20 for categories in which private labels are present.

Exhibit 59: Share of private labels in India is <1%; Private label market share has seen a mixed bag response across geographies

Share of private label in retail	2015	2019	Inc/Dec
Global	16.3%	16.3%	0.0%
European Union	30.5%	31.7%	1.2%
North America	17.6%	17.9%	0.3%
Asia Pacific	3.9%	3.1%	-0.8%
India		<1.0%	NA

Source: Nielsen, Ambit Capital research

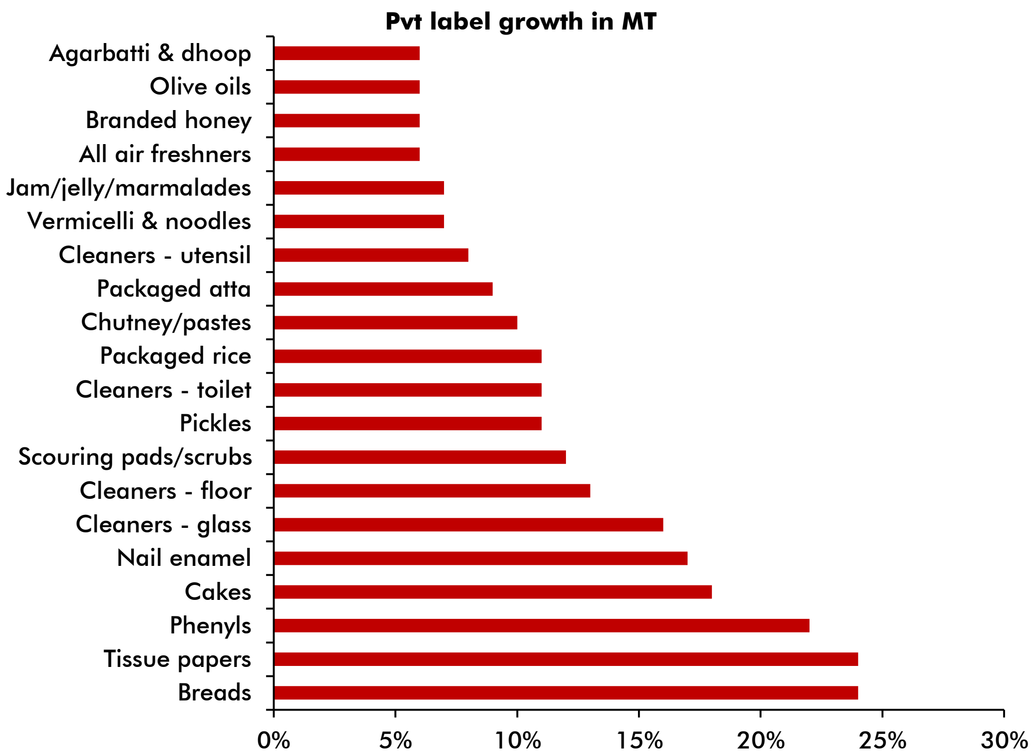
Private labels are suitable for categories with (i) limited product choice, (ii) low consumer involvement, and (iii) where brand loyalty is low. Private labels enhance consumer loyalty and improve margins for the retailer. Within HPC categories we believe home care categories such as toilet care, surface care and air care are more susceptible to risk from private labels as consumers in these segments are more price conscious than brand conscious and hence are willing to experiment products. Also, when we look at the fastest growing categories within private labels in MT (refer exhibit 61), 6 out of the top 10 categories are home care (such as phenyls, tissue paper, floor cleaners etc.). Therefore, incumbents in these categories must innovate to provide product differentiation, offer products across price points and inch up their A&P spends to reduce threat from private label.

Exhibit 60: Home care categories are more susceptible to threat from private labels than Beauty & Personal care

Categories	Market size	Brand Importance	Price Conscious	Probability of success for pvt label
Bar Soap	Strong	Relatively Strong	Average	Medium
Hair Care (Shampoo, Conditioners, Colorant, etc)	Strong	Strong	Average	Medium
Skin Care	Relatively Strong	Strong	Average	Low
Oral Care	Relatively Strong	Relatively Strong	Relatively Strong	Low
Men's Grooming (Shavings, Toiletries & Fragrance)	Relatively Strong	Relatively Strong	Average	Medium
Hair oil	Relatively Strong	Average	Average	Medium
Colour Cosmetics	Average	Strong	Relatively Strong	Low
Baby and Child-specific Products	Average	Strong	Average	Low
Deodorants	Average	Relatively Strong	Average	Medium
Body Powder	Relatively weak	Average	Average	Low
Body Wash/Shower Gel	Relatively weak	Relatively Strong	Average	Low
Laundry Care	Strong	Average	Relatively Strong	Medium
Home Insecticides	Average	Average	Relatively Strong	Medium
Dishwashing	Average	Average	Relatively Strong	Medium
Surface Care	Average	Average	Relatively Strong	High
Toilet Care	Relatively weak	Average	Relatively Strong	High
Air Care	Relatively weak	Average	Relatively Strong	High

Source: Ambit Capital research Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Exhibit 61: Home care categories account for 6 out of the top 10 fastest growing private label categories in MT



Source: Nielsen, Ambit Capital research; Note – MAT May'20

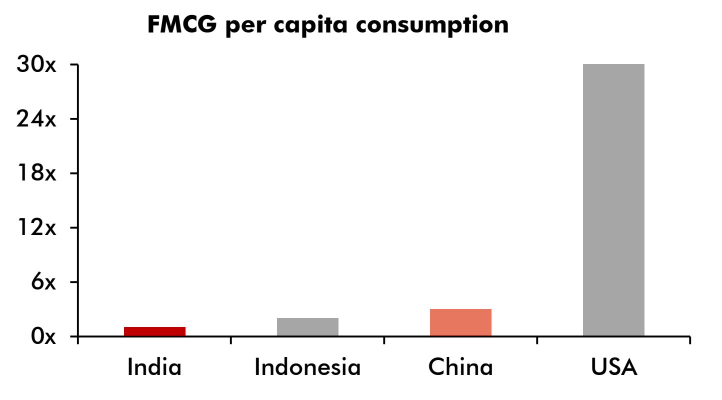
Look for earnings triggers & valuation comfort, be wary of disruption risks

Growth predictability, longevity (refer exhibit 62), superior return ratios (>30%), professional management and top tier corporate governance are key arguments why FMCG companies deserve to trade at a premium (read as P/E multiple!). Despite past growth headwinds between FY16-20, FMCG index's P/E multiple (ex-ITC) got re-rated from ~35x to 55x largely owing to the TINA factor. Going ahead, despite near-term growth pressures, solidification of macro tailwinds should aid FMCG/capita spends to grow at 8% CAGR over FY21-41E, translating to ~10% revenue growth for most companies. One cannot however take eyes off category and distribution disruption emerging and hence incremental re-rating is unjustified. On a relative basis (refer exhibit 85), expect FMCG companies to trade equal to alcobev companies but at a discount to leaders in paint, jewellery and QSR cos. Considering the above parameters and category nuances, company-wise strategies and valuations, we initiate on DABUR (BUY), HUL (SELL) and on MARICO (BUY).

Premium for Longevity, Predictability & Premiumisation

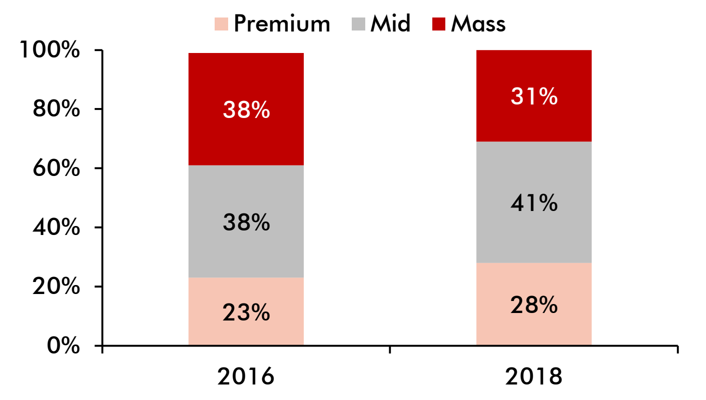
Valuation multiples of FMCG companies in India are at a premium to most sectors as FMCG offers: (i) growth longevity on the back low per capita consumption vs other emerging economies (1/3rd of China), (ii) higher scope of premiumisation with increasing disposable income, (iii) better growth predictability vis-à-vis other sectors, (iv) strong balance sheet and return ratios, and (v) high standards of corporate governance and adoption of ESG.

Exhibit 62: Low per capita FMCG consumption offers growth longevity



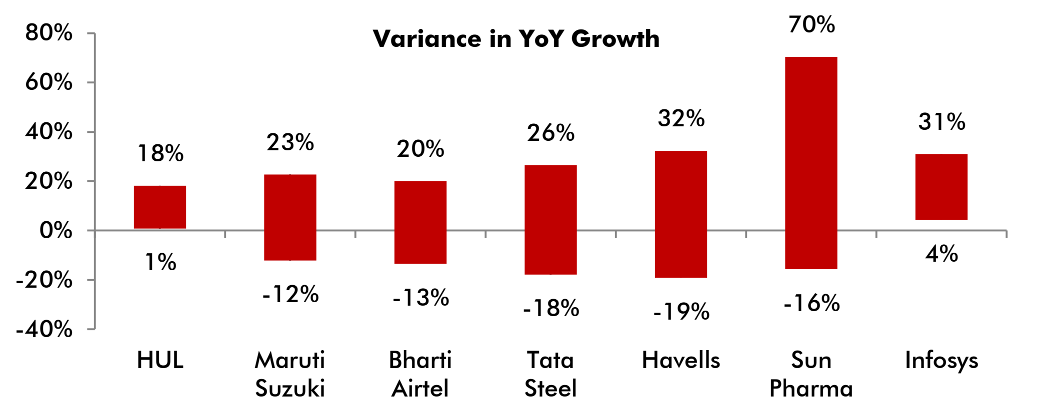
Source: HUL, Ambit Capital research

Exhibit 63: Premiumisation journey picking up pace with improving disposable incomes



Source: HUL, Ambit Capital research

Exhibit 64: Across sectors FMCG has witnessed least variance in YoY revenue growth over the last decade = higher predictability

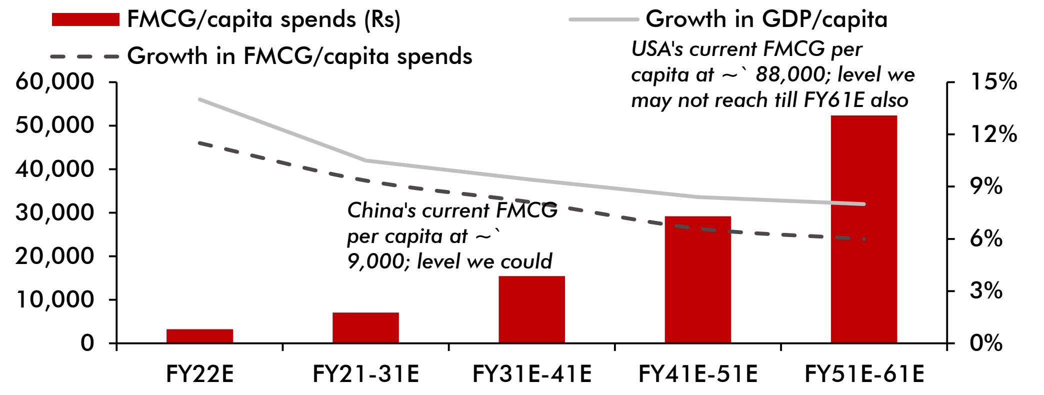


Source: Companies, Ambit Capital research

Per capita FMCG spends can compound at 8% over next 2 decades

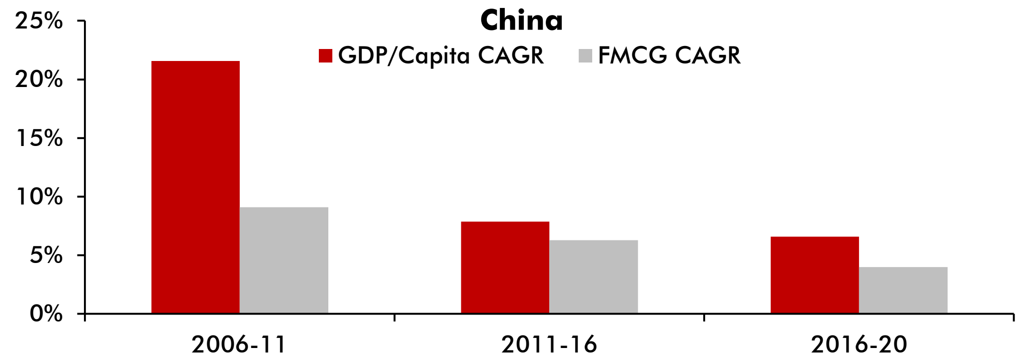
As highlighted in exhibit 62, India's per capita FMCG spends are lowest across EMs. However, in the context of an anticipated J-curve in consumption pattern on GDP per capita crossing USD2,000, expectation is of healthy demand led by widening consumer base, increasing disposable income, improving penetration, premiumisation, etc. Macro tailwinds coupled with our learnings from what happened in China (from 2006 when GDP per capita crossed USD2,000, refer exhibit 66) gives us confidence in building 8% CAGR for FMCG per capita spends.

Exhibit 65: Building all positives can lead to GDP per capita/FMCG per capita growth of 9%/8% over the next two decades



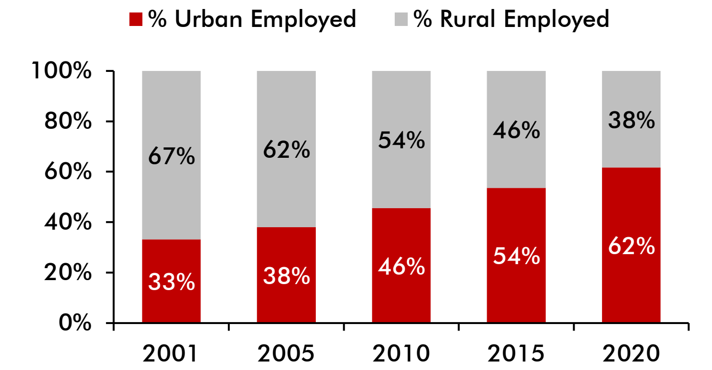
Source: IMF, Ambit Capital research

Exhibit 66: China's FMCG sector CAGR was ~7% over 2006-2020 vs GDP per capita growth of ~12%; investment-led GDP growth led to massive outperformance in GDP vs FMCG sector growth



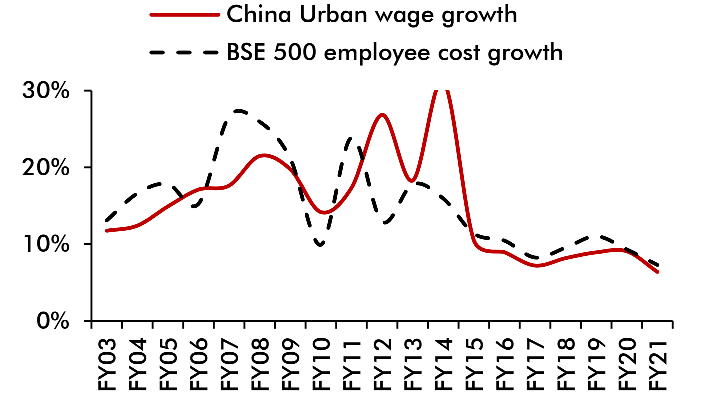
Source: IMF, Ambit Capital research

Exhibit 67: Over the last two decades, urban employment (ppt) in China almost doubled; India's urbanization too at current levels of ~34%



Source: National Bureau of Statistics of China, Ambit Capital research

Exhibit 68: What is required is that strong urban wage growth, like in China from FY03-20, should happen in India

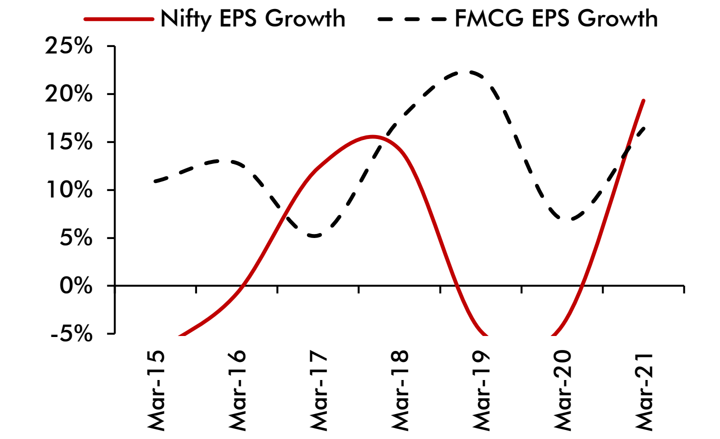


Source: National Bureau of Statistics of China, Ambit Capital research

Do not see re-rating levers

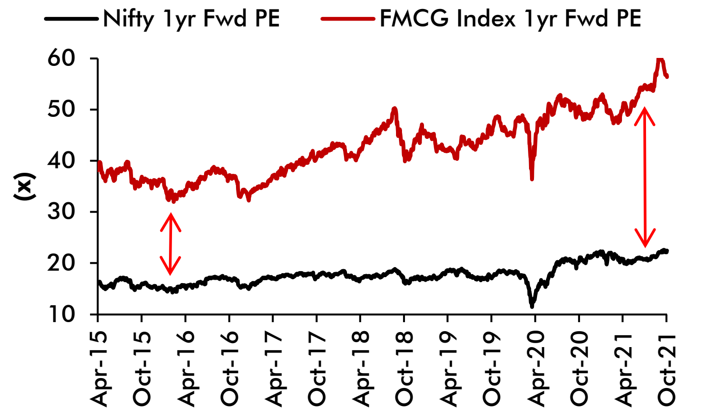
FMCG stocks posted healthy re-rating from FY15-YTDFY22 on the back of: (i) overall re-rating in the broader market, (ii) share of consumption improving within GDP vs investments and net exports (refer exhibit 72), (iii) revenue growth belied expectations in cyclical stocks, (iv) margin expansion across FMCG companies in spite of soft revenue growth (refer exhibit 71), and (v) events like DeMon and GST led to share of organized increasing across most of consumer categories. All these led to Nifty's FMCG 1-year fwd P/E getting re-rated from ~16x in FY16 to ~23x YTDFY22 vs FMCG index PE multiples getting re-rating from ~35x to 55x over the said period.

Exhibit 69: Low earnings predictability of Nifty (owing to cyclicals) and TINA factor led to…



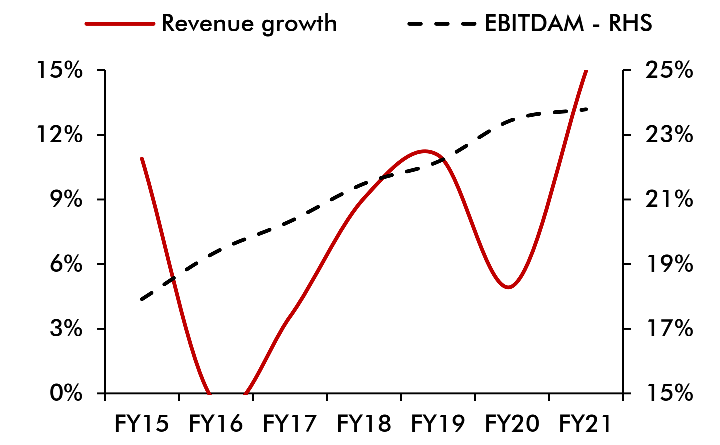
Source: Bloomberg, Ambit Capital research; Note – Constituents of FMCG Index are Dabur, HUL, GCPL, Marico, Britannia, Nestle and Tata Consumer

Exhibit 70: …premium of FMCG Index's 1 year fwd PE multiple expand; signs of reversal likely now



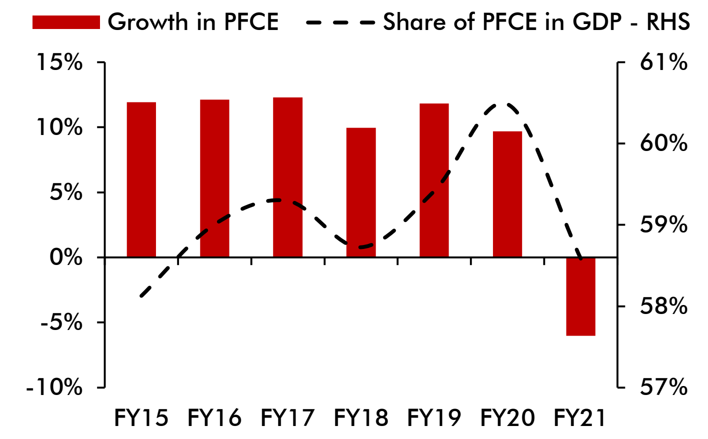
Source: Bloomberg, Ambit Capital research; Note – Constituents of FMCG Index are Dabur, HUL, GCPL, Marico, Britannia, Nestle and Tata Consumer

Exhibit 71: Soft revenue growth but EBITDAM expansion helped in re-rating



Source: Ambit Capital research; Note – Constituents of FMCG Index are Dabur, HUL, GCPL, Marico, Britannia, Nestle and Tata Consumer

Exhibit 72: Share of PFCE within the GDP pie has continued to inch up; fall in FY21 was due to Covid

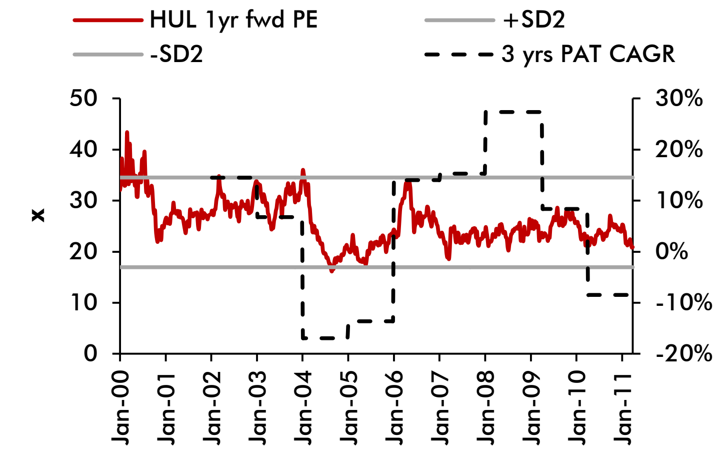


Source: CMIE, Ambit Capital research

Can there be de-rating nevertheless?

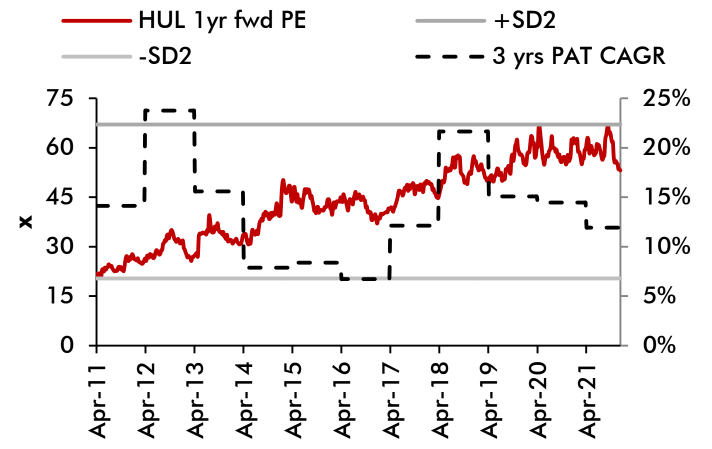
With expected FY21-24E PAT growth for FMCG peers in the 11-14% band vs Nifty's EPS CAGR of 24%, any likely moderation to FMCG's earnings can lead to potential P/E de-rating. This is especially a possibility since the current P/E multiples are already elevated, ask rate to justify CMP is FCF CAGR of 10-12% over the next 3/4 decades, and the interest rate cycle is tending to reverse and move up from hereon. To understand if FMCG companies have undergone a de-rating cycle before, we take a look at HUL's P/E multiple cycle over the last two decades (refer exhibit 73 & 74).

Exhibit 73: Between FY01-11, HUL had seen de-rating triggered by earnings decline and strong Nifty's earnings CAGR



Source: Bloomberg, Ambit Capital research

Exhibit 74: In the last decade, however, HUL has not seen major de-rating cycle in spite of sub 10% 3 years rolling average PAT CAGR between FY15-17



Source: Bloomberg, Ambit Capital research

We, however, believe the above de-rating and re-rating should be seen in the context of HUL's and Nifty's earnings growth during different periods (refer below exhibit).

Exhibit 75: HUL's re-rating/de-rating cycles in the context of Nifty EPS

	Sales CAGR	EPS CAGR	Share price CAGR	Nifty EPS CAGR	Min PE	Max PE	Median PE
FY01-09	8%	8%	0%	18%*	16	43	25
FY09-13	6%	6%	18%	10%	21	35	25
FY13-20	6%	12%	24%	2%	27	60	45
FY21-24E	10%	14%	NA	24%			

Source: IMF, Ambit Capital research, Bloomberg; Note – Nifty EPS CAGR is from FY03-09

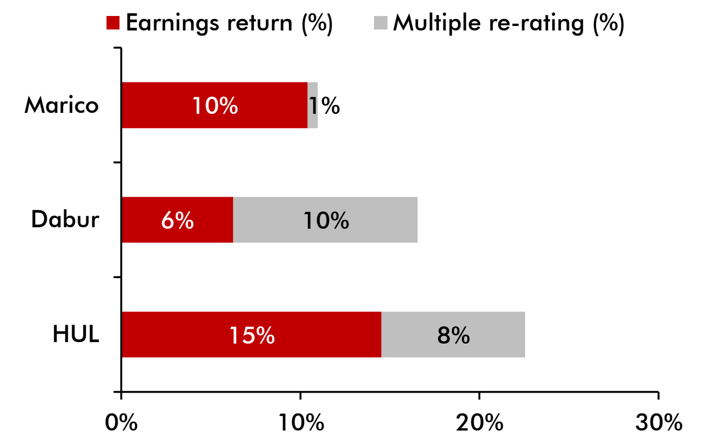
With Nifty's FY21-24E EPS CAGR at 24% vs HUL's 14%, building any narrative for HUL's re-rating hereon is clearly unjustified. On the flip side, any risk to HUL's EPS CAGR can potentially lead to its de-rating. However, if the risk to HUL's EPS CAGR is perceived to be lower than the risk to Nifty's EPS CAGR, then any potential de-rating of HUL would be short-lived as seen in the last decade. Add to this, FMCG companies can also be potentially at risk to disruption: (i) rise in share of private labels, (ii) rise of D2C companies, and (iii) distribution channel disruption (refer previous section). Current stock prices of FMCG companies are not pricing in any of the mentioned disruption risks. As these disruption risks materialise, FMCG companies could be subject to the risk of P/E de-rating.

Exhibit 76: HUL fares best on IBAS followed by Marico and Dabur; the constraining factor for HUL is its slower pace of new launches owing to multi layers of approval from global HO

Parameters	HUL	Marico	Dabur	Comments
Innovation				
Pace of new launches	2	3	4	▪ HUL is a pioneer in terms of R&D within FMCG sector in India. HUL has developed an 'Agile Innovation Hub' which is a virtual hub that is continuously spotting, market sizing and prototyping new consumer trends. HUL also benefits from R&D programmes undertaken by Unilever globally. ▪ Marico has an in-house R&D and product testing facility that spearheads their innovation agenda. Increasing pace of innovations towards food category. ▪ Dabur has a research & development centre and an innovation cell that is responsible for nurturing new ideas/products across verticals. Dabur's innovation drive has been secular.
R&D capability (including benefits of strong parent)	4	3	3	
Innovation to expand TAM	3	4	4	
Brand				
Market share in core categories	3	3	3	▪ HUL, Dabur and Marico hold leadership positions (i.e. amongst top three brands in terms of market share) in majority of their core categories and have been able to pass on price hikes to consumers without losing market share.
Ability to take price hikes & charge premium	Yes	Yes	Yes	
Brand Trust	4	4	4	
Architecture				
Ability to attract & retain quality talent	4	3	3	▪ HUL, Dabur and Marico have an ESOP plan to incentivise and retain top talent. ▪ For Marico, 80% of its current leadership team comprises of home-grown employees. Low attrition rate of 3.97%.
Employee development/ career growth	4	4	4	
Relationship with suppliers	4	4	4	
Strategic Assets				
Distribution reach	8mn+	6.9mn+	5.3mn+	▪ HUL has led from the front in using data analytics and technology to drive growth. HUL uses AI & ML across all business functions for all its key decisions. ▪ Marico and Dabur also use data analytics and technology but HUL is much ahead of competition on this front.
Use of technology & data analytics	4	3	3	
International presence/opportunity	Not possible	Yes	Yes	

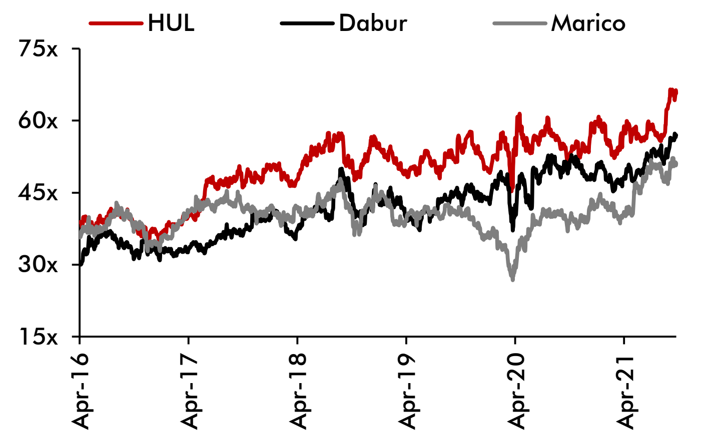
Source: Company, Ambit Capital research

Exhibit 77: Dabur's P/E multiple has re-rated the most and Marico's the least over FY16-21



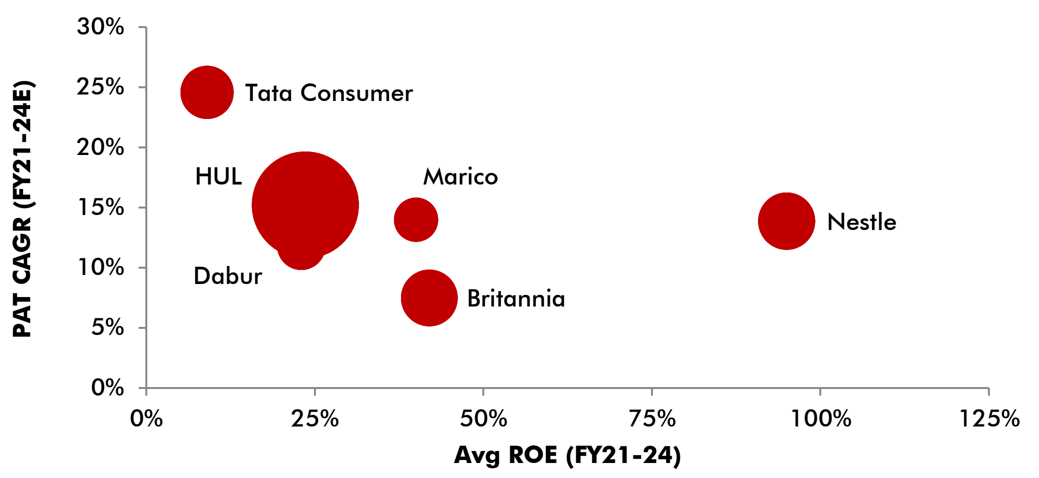
Source: HUL, Ambit Capital research

Exhibit 78: Marico has undergone highest P/E re-rating from April'21



Source: HUL, Ambit Capital research

Exhibit 79: TCPL, HUL and Marico's PAT growth likely to be the best; TCPL however fares poorly on RoE; Nestle has a fine blend of PAT CAGR and RoE



Source: Ambit Capital research; Note: Bubble size indicates FY21 revenue

Exhibit 80: Marico likely to post highest revenue, EBITDA and PAT CAGR followed HUL and Dabur; HUL likely to have highest CFO; Dabur and Marico's CFO impacted by best WC conversion in FY21

Company / metric	Revenue CAGR		EBITDA CAGR		PAT CAGR		CFO CAGR	
	FY16-21	FY21-25E	FY16-21	FY21-25E	FY16-21	FY21-25E	FY16-21	FY21-25E
Dabur	4%	11%	6%	12%	6%	12%	12%	8%
Hindustan Unilever	6%	10%	15%	12%	15%	14%	18%	15%
Marico	6%	12%	9%	13%	10%	14%	12%	0%

Source: Company, Ambit Capital research

Exhibit 81: HUL likely to have best EBITDAM expansion whereas Marico would have highest RoE

Company / metric	EBITDAM				Asset turnover (x)				RoE			
	FY19	FY21	FY23E	FY25E	FY19	FY21	FY23E	FY25E	FY19	FY21	FY23E	FY25E
Dabur	20%	21%	22%	22%	2.7	2.5	2.8	3.1	27%	24%	23%	23%
Hindustan Unilever	23%	25%	26%	27%	6.2	2.3	2.6	2.8	83%	29%	22%	28%
Marico	18%	20%	19%	20%	6.0	5.1	5.2	5.5	41%	38%	40%	47%

Source: Company, Ambit Capital research

Relative valuations: FMCG companies to trade at a discount to paints companies

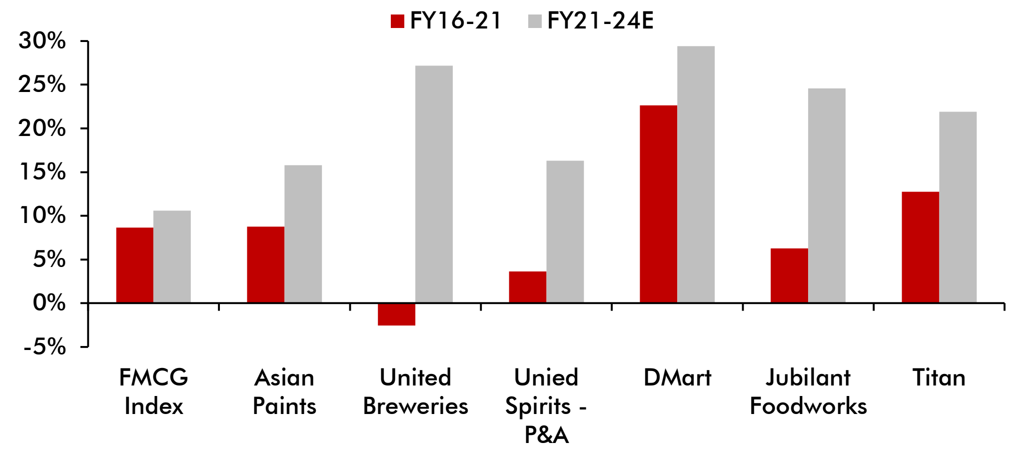
Apart from looking at absolute valuations, it is also important to compare relative valuations of FMCG companies with comparable sectors such as paints, alcobev and consumer discretionary.

Exhibit 82: FMCG companies fare high on growth predictability, scope for EBITDAM expansion, return ratios and corporate governance but are susceptible to disruption risk, competitive intensity and lower category growth rate

	FMCG companies	Paint companies	Alcobev companies	Jewellery cos (leader)	Grocery retailing (leader)
Buying frequency	High	Medium - repainting cycle have shrunk from 7 years to 4-5 years	High	Medium - occasion & festive driven	High
Category growth rate	8-12%	12-15%	7-11%	Mid to high teens	20-25%
Predictability of growth rate	●	◕	◕	◕	●
Scope of premiumisation	◕	◕	●	●	◕
Possibility of distribution disruption	◕	◔	◔	◔	◕
Competitive intensity	●	◑	◑	◑	●
Share of organised sector	65-70%	65-70%	>90%	~15%	~20%
Scope for EBITDAM expansion	◑	◑	◕	◕	◑
Return ratios	●	◕	◕	◕	◕
Corporate Governance	●	●	◕	●	●

Source: Ambit Capital research

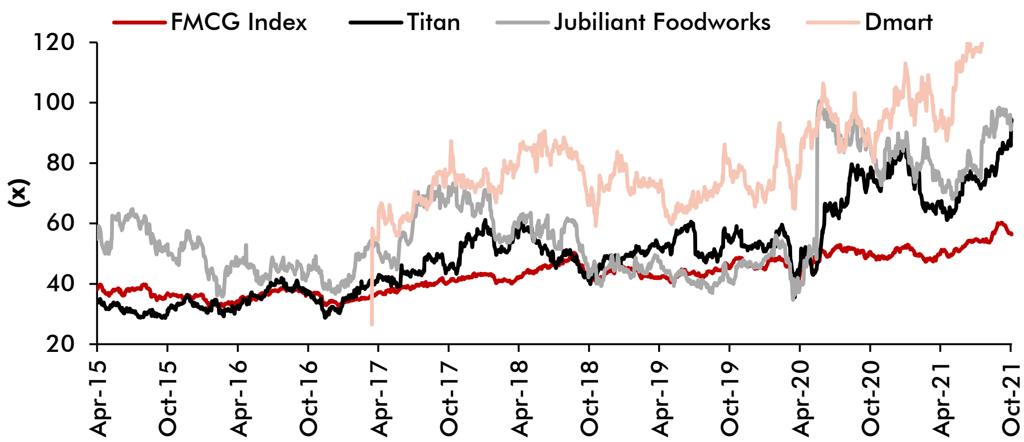
Exhibit 83: FMCG companies' 10-11% revenue CAGR over FY21-24E is likely to be lowest across peer consumer segments



Source: Company, Ambit Capital research; Note – Constituents of FMCG Index are Dabur, HUL, GCPL, Marico, Britannia, Nestle and Tata Consumer

On a relative basis, in a best case, FMCG companies should trade at par to alcobev companies but at a discount vs leaders in paints, jewellery, grocery retailing and QSR.

Exhibit 84: Slower revenue growth has also led to lower re-rating for FMCG index vs leaders in consumer discretionary categories



Source: Company, Bloomberg, Ambit Capital research; Note – Constituents of FMCG Index are Dabur, HUL, GCPL, Marico, Britannia, Nestle and Tata Consumer

Summary view of our thesis and valuations

Dabur: Play for earnings led return

Dabur's 1-year fwd P/E multiple got re-rated from 32x to 50x over FY17-20 (vs HUL's re-rating from 40x to 55x) led 7% EPS CAGR vs HUL's 18% EPS CAGR over the said period. This re-rating considers: (i) management's refocused strategy on scaling healthcare and power brands; (ii) TAM expansion; and (iii) benefits of distribution expansion (rural markets expansion from 40k to 60k). Going ahead near term growth will sustain on the back of new category entry and existing categories growing at high single digit coupled with Dabur's share gains trajectory. Thus we believe our near term (FY21-25E)/LT (FY21-41E) revenue growth expectation of 10.7%/10.5% looks achievable. Over the LT, we expect EBIT margin expansion of 420bps emanating from GM expansion (led by product mix improvement), operating leverage and cash accumulation leading to higher other income. All this leads to 11% EBIT CAGR over FY21-41E. Incremental re-rating scope (negligible probability) hinges on expanding market size of healthcare categories (doable) and succeeding in new forays (relatively difficult). Our DCF based TP of ₹ 630, gives upside of 11%. Risk: slower rural growth and losing focus on core categories.

Hindustan Unilever: Premium for predictability and longevity, but how much?

HUL has historically traded at ~15% premium to FMCG peers on the back of: (i) wide portfolio, leadership and share gains across most of categories offering growth predictability and longevity; (ii) seeking to expand category size, improve penetration and premiumisation; (iii) M&A activities to bridge whitespaces and TAM expansion; (iv) higher EBITDAM expansion vs peers (>1,100bps over last decade vs <500bps for peers); and (v) cutting edge usage of technology, data and AI. This said, with >55% portfolio in highly penetrated categories, we expect FY21-25E revenue/EBITDA/PAT growth at 10%/12%/14%. For a long term (FY21-41E), we are building 10%/12%/15% revenue/EBIT/FCF CAGR which takes into account share gains, category expansion and benefits of premiumisation. This said, our DCF-based TP of ₹ 2,424, does not leave any upside. Our TP implies FY24E P/E of 47x, ~10% premium to peers.

Marico: Diversity in earnings at play

Marico's 1-year fwd P/E re-rated from ~39x (in Apr'21) to ~45x now on the back of (i) strong performance of Saffola edible oils led by increased penetration and (ii) expanding TAM in foods portfolio and management's confidence in scaling it. As long as Marico is able to retain its high single-digit to low double-digit revenue growth in Saffola edible oil and expand revenues of foods (to ₹8.5-10bn by FY24E), we see no reason for de-rating. We build in 12%/13%/13% revenue/EBITDA/PAT CAGR over FY21-25E led by the above mentioned thesis. With diversity in portfolio, scale-up of new category forays and premiumisation in hair care, our DCF factors in 11%/9% revenues/FCF over FY21-41E. Unlike Dabur's TG at 7%, we assign TG of 6% for Marico since its portfolio is skewed towards high penetrated hair oil portfolio. At our DCF-based TP of ₹580, implied FY24 P/E is 43x, largely in line with comparable FMCG peers.

Pecking order within overall FMCG

We now have coverage of six large FMCG companies. Of that, we remain BUYers on Marico, Dabur and Britannia and SELLers on HUL, Nestle, Tata Consumer. Amongst the sells, our relative preference would be Nestle>Tata Consumer>HUL.

Exhibit 85: Over the last 12 months, FMCG companies has seen some de-rating still don't see any immediate reason for de-rating to ebb

Companies	Rating	Mcap ($ mn)	P/E (x)				CAGR (FY18-21)			CAGR (FY21-24E)			RoE			
			FY21	FY22E	FY23E	FY24E	Sales	EBITDA	EPS	Sales	EBITDA	EPS	FY21	FY22E	FY23E	FY24E
FMCG																
Hindustan Unilever	SELL	75,160	68	64	53	46	10%	16%	12%	10%	12%	13%	29%	18%	22%	25%
ITC	N.A.	37,174	21	18	16	15	4%	0%	5%	12%	14%	12%	21%	25%	27%	28%
Nestle India	SELL	25,188	89	80	69	61	10%	14%	19%	11%	13%	14%	106%	100%	92%	84%
Dabur	BUY	13,761	60	54	48	42	7%	7%	8%	11%	12%	12%	24%	23%	23%	23%
GCPL	N.A.	12,649	54	50	42	37	4%	5%	16%	11%	13%	14%	20%	19%	20%	21%
Britannia	BUY	12,118	48	57	46	39	9%	19%	23%	9%	7%	7%	47%	40%	41%	39%
Tata Consumer Products	SELL	9,493	73	56	45	38	20%	23%	6%	10%	20%	25%	7%	8%	10%	11%
Marico	BUY	8,716	54	53	44	37	8%	12%	13%	12%	13%	14%	38%	36%	40%	45%
Colgate-Palmolive India	N.A.	5,392	39	38	35	32	5%	11%	15%	8%	7%	7%	75%	88%	94%	104%
Emami	N.A.	2,998	49	32	27	24	5%	9%	45%	11%	8%	26%	25%	36%	38%	38%
Zydus Wellness	BUY	1,598	47	45	31	31	54%	40%	-17%	10%	14%	15%	6%	6%	8%	7%
Median			54	53	44	37							25%	25%	27%	28%
FMCG - International																
Unilever PLC		137,198	23	19	18	17	-2%	-3%	0%	3%	6%	10%	39%	45%	46%	47%
Nestle SA		375,416	28	27	25	24	-2%	9%	23%	4%	4%	6%	25%	28%	31%	33%
Procter & Gamble		383,054	28	27	25	23	4%	9%	15%	4%	5%	6%	31%	33%	35%	36%
Median			28	27	25	23							31%	33%	35%	36%
Consumer Discretionary/Retail																
Avenue Supermarts		37,661	254	170	107	82	17%	9%	10%	33%	43%	46%	9%	13%	17%	19%
Page Industries		6,683	145	102	77	65	4%	-1%	-1%	22%	28%	31%	40%	49%	55%	56%
Titan Co		31,105	237	111	83	67	8%	2%	-5%	24%	43%	52%	14%	25%	27%	28%
Jubilant Foodworks		7,045	223	107	79	63	3%	20%	4%	25%	31%	52%	17%	30%	31%	31%
Median			230	109	81	66							16%	27%	29%	29%
Paints																
Asian Paints		43,462	102	95	70	59	9%	15%	15%	19%	18%	20%	27%	25%	31%	32%
Berger Paints		10,100	104	80	63	54	8%	14%	16%	20%	22%	25%	24%	26%	29%	30%
Kansai Nerolac		4,474	63	64	45	38	3%	3%	1%	18%	16%	18%	14%	12%	17%	18%
Akzo Nobel India		1,216	43	32	28	23	-4%	5%	-19%	18%	18%	24%	16%	20%	21%	25%
Pidilite Industries		18,485	121	103	82	70	6%	8%	6%	19%	19%	20%	23%	22%	24%	25%
Median			102	80	63	54							23%	22%	24%	25%
Alcobev																
United Breweries		5,904	362	102	58	46	-9%	-25%	-34%	27%	59%	99%	3%	11%	18%	19%
United Spirits		9,266	161	70	56	45	-1%	-1%	-18%	14%	28%	52%	11%	21%	21%	21%
Radico Khaitan		2,162	59	54	42	35	10%	15%	30%	15%	17%	20%	16%	16%	17%	18%
Median			161	70	56	45							11%	16%	18%	19%

Source: Bloomberg, Ambit Capital research; CMP as on 14 Jan 2022

ESG

Most of the large FMCG companies have always scored in the top quartile of the ESG parameters. On Environment, HUL has amongst the strongest quantitatively defined parameters followed by Marico and Dabur. On Social, all the companies have duly spent their CSR spends in FY21. In terms of gender diversity, HUL is the best. In terms of governance, too, HUL fares the best with no independent director present for more than 10 years in the company.

Exhibit 86: HUL fares the best in ESG followed by Marico and Dabur; Dabur & Marico likely to quantify emission and renewable energy targets in their FY22E/23E annual reports

	HUL	Dabur	Marico
Environment		**GREEN FLAG**	
Carbon/GHG and zero emission target	Replace fossil-fuel derived carbon by moving to 100% renewable or recycled carbon by 2030 & zero emissions in operations by 2030	Commitment to reduce carbon footprint	Reduce GHG emission intensity (Scope 1 & 2) by 75% from FY13
Renewable energy target	Source 100% of energy from renewable sources by 2030	Reduce reliance on fossil fuels and shift to renewable energy sources	Improve share of renewable energy (currently 72%)
Plastic waste target	100% of plastic packaging reusable, recyclable or compostable by 2025	Plastic neutral by collecting, processing & recycling 100% of the plastic waste generated from packaging in FY22	100% recyclable, reusable or compostable packaging portfolio by 2025
Social		**GREEN FLAG**	
Met CSR obligations			
Gender diversity	42% females in management; Targeting 5% of workforce to include people with disabilities by 2025	Females across India functions: Marketing - 26%, R&D Centre - 30%, Finance - 19%	24% Gender diversity (managers & above); 58% of employees in Marketing, R&D, HR are women
Safety related	NA	FY21: 0.29 All Injury Rate & four major incidents	FY21 Incidents: 3 - Lost Time Injury , 21 - First Aid Case, 3 - Medical Treatment; Zero fatalities since 4 years
Governance		**GREEN FLAG**	
% of Independent directors	56%	56%	54%
No. Independent directors >10yrs	0 out of 5	4 out of 7	3 out of 5
No. of women directors	1	1	1
Other comments	N.A.	In process of developing targets beyond 2022, including Plastic Waste Neutral, Water Neutral and Carbon Neutral	Current 5-year sustainability targets are due for completion in 2022. Will declare 2030 environment commitments by end of FY22

Source: Companies, Ambit Capital research

Dabur

BUY

Capitalising on opportunities

Adaptive and aggressive mindset helped Dabur capitalize on shifting preference for ayurvedic/naturals products. Foray into more categories in quest to expand TAM (baby care, healthcare, beverages etc.) showcases growth longevity and strengthens Dabur's position, especially in Ayurveda-led segments. This is a right step but should not lead to over-diversification, which adds limited synergistic value. Growth from scale-up of ayurveda portfolio, distribution expansion (60K to 80K villages and transition from chemist channels to GT) and TAM expansion can yield 10.5%/9% revenue/FCF CAGR (FY21-41E). Incremental surprise can come from improving capital allocation (D2C initiatives, M&A) but track record gives us limited confidence to build into numbers. Risks: Over diversification and subdued rural growth extending for long.

Competitive position: STRONG   Changes to this position: NEUTRAL

Management's renewed aggression is encouraging

After Mohit Malhotra took over as CEO (FY19), Dabur has become aggressive with its power brand strategy (8 brands), NPDs, TAM and distribution expansion. These strategies led to 10.3%/6.2% revenue growth in FY19/11MFY20. Covid-led tactical bets in healthcare portfolio paid handsome returns, with 31% YoY growth in that portfolio in FY21.

Home grown company with scalability potential

Dabur's leadership in Ayurveda/naturals will benefit the company in the shift in consumer preference. Share of ayurveda at <30% (refer exhibit 6) in core personal care categories reflects growth longevity. Blending this with initiatives in distribution expansion (rural coverage increase by 20,000 villages, healthcare outlets increase from ~0.1mn to ~2mn in GT) and category expansion will aid Dabur in remaining a large fish in a large pond.

Diversification, an opportunity but a threat too

In the last 24 months, Dabur has extended into 9 new categories and expanded TAM by ₹1tn (refer exhibit 18). However, some diversifications add limited synergistic value and hence we find management's resources not aptly spent. Past diversification viz. international business (IB, ~25% revenue saliency) too has fared poorly (IB/domestic rev growth of -0.1%/5.5% over FY16-21). Further, FY21 cash surplus of ₹55bn with low dividend policy (@45%) will lead to suppression of RoE (33%/24%/23% in FY16//21/25E), which needs to change.

Visible growth trajectory

FY21-41E revenue/FCF CAGR of 10.5%/9% factors rising saliency of domestic business, benefit of distribution expansion and premiumisation in ayurveda. With this, our TP comes to ₹630, implying 47x FY24 P/E multiple, 10% premium to FMCG peers, aided by better revenue and margin profile. Further upside can come from accelerated growth in new forays.

Key financials

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Operating income (₹ mn)	95,466	106,031	117,364	129,795	143,473
EBITDA (₹ mn)	20,027	22,910	25,418	28,305	31,431
EBITDA Margin (%)	21.0%	21.6%	21.7%	21.8%	21.9%
PAT (₹ mn)	16,950	18,619	21,208	23,903	26,877
EPS (₹)	9.6	10.5	12.0	13.5	15.2
RoE (%)	23.8%	22.7%	22.8%	22.8%	22.8%
P/E (x)	59.4	54.1	47.5	42.1	37.5

Source: Company, Ambit Capital research

Consumer Staples

Recommendation

Mcap (bn):	₹1,007/US$13.6
6M ADV (mn):	₹1,324/US$17.8
CMP:	₹570
TP (12 mths):	₹630
Upside (%):	11

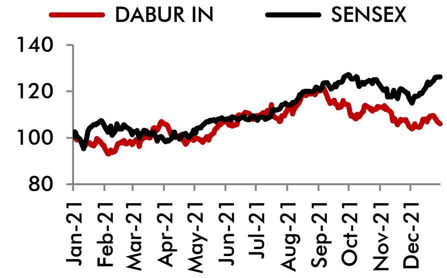
Flags

Accounting:	GREEN
Predictability:	GREEN
Earnings Momentum:	GREEN

Catalysts

- 11% revenue CAGR in Healthcare on 31% growth in FY21.
- 40%/11% FY22E/23E revenue in foods category.

Performance (%)



Source: Bloomberg, Ambit Capital Research

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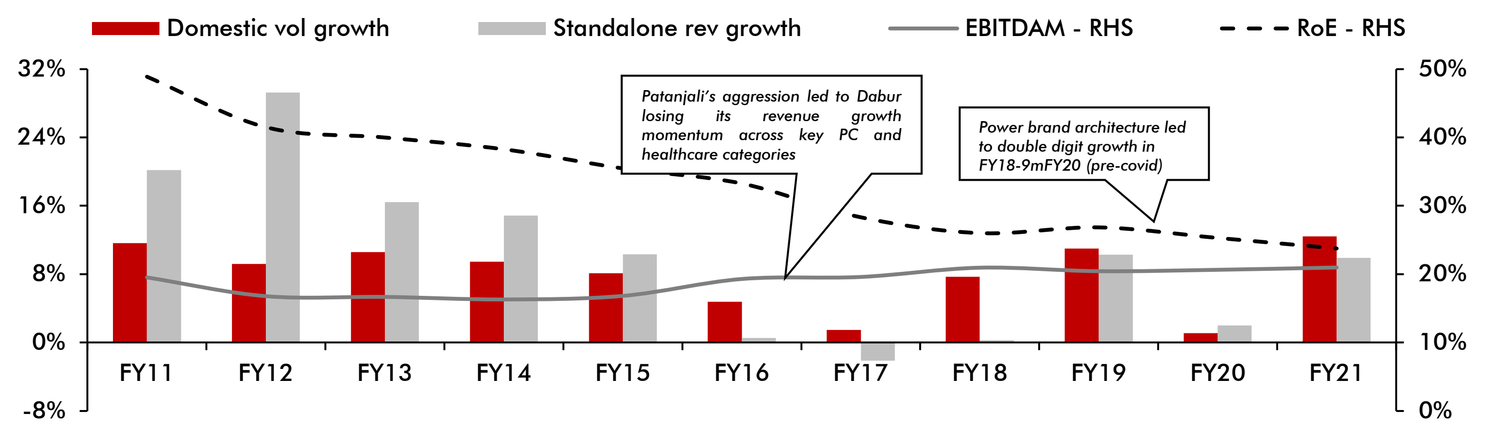
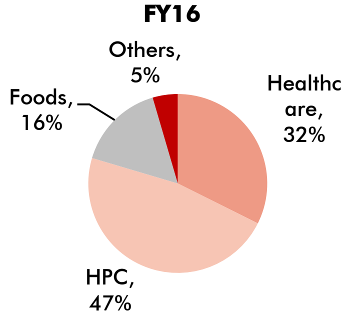
The Narrative In Charts

Exhibit 1: Competition from Patanjali took away revenue growth from FY16-18, but made the company nimble, aggressive and innovative; incremental EBITDAM expansion levers however limited



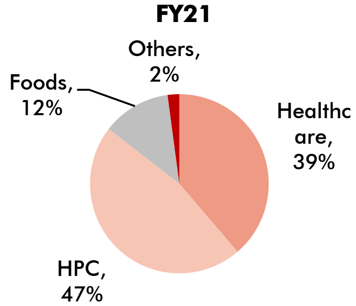
Source: Company, Ambit Capital research

Exhibit 2: Dabur's attempt to scale up its healthcare portfolio...



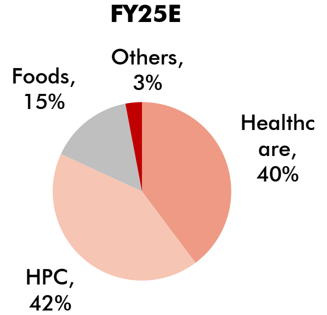
Source: Company, Ambit Capital research

Exhibit 3: ...finally saw traction due to Covid; we expect its share to stay at current levels...



Source: Company, Ambit Capital research

Exhibit 4: ...as growth moderation expected + improving growth in Foods and HPC portfolio



Source: Company, Ambit Capital research

Exhibit 5: Category construct signifies medium competitive risk and low disruption risk across categories should help Dabur clock ~12% domestic business revenue CAGR over FY21-25E

Category name	FY16-21 growth rate (%)	FY21-25E growth rate (%)	Growth driver	Competitive scenario	Disruption risk
Healthcare (~39% revenue share)					
Health Supplements	11%	13%	Improving awareness, Penetration increase, distribution expansion to chemist and to GT	Average	Relatively weak
Digestives	4%	12%		Average	Average
OTC & Ethicals	8%	12%		Average	Relatively Strong
HPC (~48% revenue share)					
Hair care	2%	9%	Consumers shift to Ayurveda based products	Strong	Average
Home care	4%	10%	Foray into adjacencies	Relatively Strong	Relatively Strong
Oral care	10%	10%	Consumers shift to Ayurveda based products	Relatively Strong	Average
Skin care	7%	5%	Improving distribution	Relatively Strong	Strong
Food (~13% revenue share)	0%	18%	Expanding TAM and distribution expansion	Relatively Strong	Relatively Strong

Source: Company, Ambit Capital research Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Exhibit 6: Share of Ayurvedic products within personal care categories has been steadily increasing; sustenance of this trend to benefit Dabur for growth longevity

Categories	Category size (₹ bn)	% of Ayurveda/Naturals	Growth rate differential between Naturals and overall category
Soap	232	5-10%	0.8x
Hair care	232	55-65%	1.2x
Skin care	152	12-17%	2.2x
Oral care	128	32-37%	>2x
Baby care products	44	55-60%	1.4-2x

Source: Company, Ambit Capital research, Kantar World Panel; Note – Time horizon for growth rate differential ranges from 2 – 5 years

~9-11% growth over FY22-25E and broader growth longevity in HPC hinges on consumer shift towards naturals

Exhibit 7: TAM expansion is a welcome move but watch for over diversification into categories with limited right to win

Category	Old product range	Old TAM (₹ bn)	New foray	New TAM (₹ bn)	Competition	Competitive intensity	Complementarity with existing product/brand
Baby care	Baby oil	5.5	Entire baby care incl Diapers	100	P&G, Unicharm, Himalaya, J&J, HUL		Medium
Beverages	Juices	18	Fruit drinks, milk shakes, fizzy drinks	400	Pepsi, Parle		High
Herbal teas	None	NA	Herbal green and black tea	NA	TCPL, HUL, Organic India		Low
Cooking oils	None	NA	Mustard oil, Sesame oil	NA	Adani Wilmar, Marico, Emami		Low
Spices & pickles	None	NA	Picklets, Chutneys	NA	Mother's recipe, Eastern, Tops Gold, Nilon, Regional brands		Low
Cow Ghee	None	NA	Ghee	400	Amul, Mother Dairy, Britannia, Parag milk, local and regional players		Low
HFD	None	NA	Dabur Vita	75	Horlicks, Boost, Complan, Bournvita		Low
LV	None	NA	Odomos LV	25	Good Knight, AllOut, Maxo		Medium
Face wash	None	NA	Face wash & nourishing gel	30	Loreal, Everyuth, Fair & Glow		Low

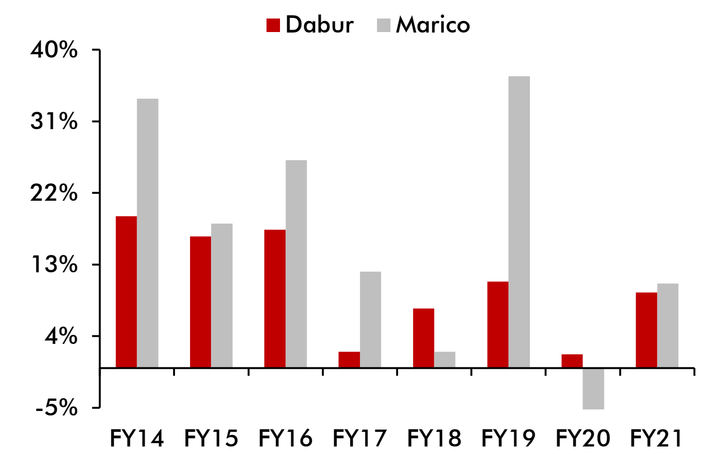
Source: Company, Ambit Capital research

Exhibit 8: How Dabur will utilize its surplus cash remains crucial – track record of domestic M&A is absent but is now important in our view

₹ mn	FY19	FY20	FY21	FY22E	FY23E	FY24E	FY25E
Operating cash flow	14,991	16,136	21,147	18,854	23,232	26,010	29,039
Investing cash flow	3,369	(5,168)	(14,058)	(2,250)	(2,250)	(2,250)	(2,250)
Financing cash flow	(18,882)	(10,430)	(6,134)	(8,453)	(10,221)	(11,988)	(13,756)
Closing cash balance	377	917	1,888	21,441	32,202	43,974	57,007
Cash & bank balance as per Balance sheet	3,282	8,114	13,290	21,441	32,202	43,974	57,007
Liquid investment	33,588	28,003	41,596	41,596	41,596	41,596	41,596
Total cash plus liquid investment	**36,869**	**36,116**	**54,887**	**63,038**	**73,799**	**85,570**	**98,604**

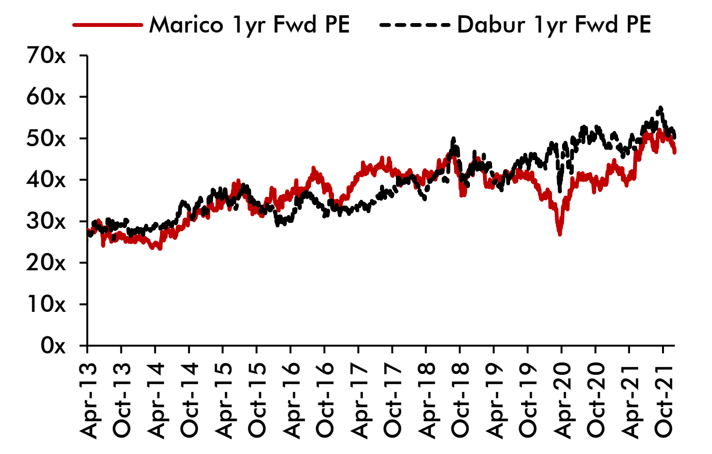
Source: Company, Ambit Capital research; Note – ₹14bn which is part of FY21's investing cash flow cash parked in debt and liquid schemes; Dividend payout has been assumed at ~50%

Exhibit 9: Dabur has largely unperformed vs Marico in terms of earnings...



Source: Company, Ambit Capital research;

Exhibit 10: ...but over last 7-8 years, extent of re-rating has largely been the same



Source: Ambit Capital research

The known growth pillars

Dabur is a natural beneficiary of consumers' shifting preference towards Ayurveda products. To this end, Dabur's power brand strategy (5 of 9 brands are skewed towards Ayurveda healthcare range) fits well. Increasing the pace of innovation and NPDs (20/50+ launches in FY19/21), entering adjacencies (e.g. moving from fruit based juices to larger beverage category) and new categories expand TAM, strengthen brand equity but may also put strain to its exiting sales & distribution structure, which concerns us. New launches while offer near term revenue growth but with limited scalability in longer term puts strain on existing human/financial resources of the company. Parallel to this, Dabur is also working on scaling its distribution reach largely in rural markets. For this, Dabur has split sales and distribution teams, is targeting increasing rural coverage by adding 20,000 villages till FY23E (from ~60,000 now), and expanding coverage of its healthcare range from just Ayurvedic shops (~0.1mn) to chemist channels (~0.5mn, current reach 0.2-0.25mn outlets) and eventually to ~6mn GT outlets. For that, Dabur is also working on differentiated packaging, multiple SKUs, etc. So, while there are growth levers remaining focused will lead to sustained double digit growth.

Scaling up of power brands

After management change in 2019, Dabur identified 9 power brands (~70% of Dabur's revenue), 5 in Healthcare, 2 in HPC and 1 in Foods. Core strategy for power brands is to expand the market size by increasing penetration and awareness, drive share gains through NPDs, innovations, and usage of modern formats to recruit millennial and Gen Z, etc. Having more power brands from the healthcare range is a conscious strategy considering segmental penetration is sub-25% and Dabur with its leadership position and distribution headroom has more opportunity to scale them with limited competition.

Exhibit 11: Most of the power brands have potential to grow at high single digit to low double digit levels

Brand name	Category	Market size (₹ bn)	Market share (%)	Penetration (%)	Growth strategy	FY21-25E growth rate
Dabur Chyawanprash	Health supplements, Healthcare	8	~60%	~7-9%	▪ Introduction of modern formats to recruit more consumers ▪ Make product appealing during non-winter season as well ▪ Expand distribution ▪ New launches and flavours targeting kids, sugarfree variants, etc	Low to mid teens
Dabur Honey	Health supplements, Healthcare	17.5	~60%	~18-22%	▪ Health & wellness proposition ▪ Ingredient for calorie conscious consumers; Positioned towards fitness ▪ Launching more SKUs, variants and flavours ▪ Premiumisation	Low to mid teens
Dabur Pudin Hara	Digestive, Healthcare	29	N.A.	Low	▪ Improving category relevance through consumer awareness ▪ Introducing different formats for consumption - oral, tablets, effervescent, syrup ▪ Effective media spends	Low double digit
Dabur Lal Tail	OTC & Ethicals, Healthcare	1,047	Low	Low	▪ Extending from e-com to mass market products ▪ Expanding equity of Dabur into wider baby care products ▪ Fit for consumers looking for an alternate to J&J ▪ Differentiated naturals positioning resonates well with mothers	High single digit
Dabur Honitus	OTC & Ethicals, Healthcare	NA	High	Low	▪ Ayurvedic treatment to cold/cough ▪ Easy to use formats ▪ Consumer shift from allopathic remedies to Ayurvedic remedies	Low double digit
Dabur Amla hair oil	Hair care, HPC	100	N.A.	High	▪ Consumers to move towards natural products over normal products ▪ Launching flanker brands ▪ Premiumisation by launching products for kids ▪ LUPs to help them improve distribution in rural markets	High single digit
Dabur Red	Oral care, HPC	125	~16.5%	High	▪ Consumers shift from chemical based to natural toothpaste ▪ Introduction of more products to bridge pricing gap ▪ Improving distribution in rural markets ▪ Upgrading consumers from powder to toothpaste format	Low double digit
Real juice	Juices, Foods	80	~60% in ₹18bn J&B category	Low	▪ Launching products in ₹10/20 packs; expand distribution to Tier 2-4 markets with those packs ▪ Moving out of mere J&N category to larger beverage category ▪ Launching products for kids, milk based beverages	High single digit

Source: Company, Ambit Capital research, Euromonitor International Limited 2021 © All rights reserved; Note – Baby care products market size covers larger baby care items in which Dabur may not operate currently

In FY21, Dabur's power brands grew at 19.2% YoY vs 8.6% YoY for other brands. As per management commentary, even in FY19 and 20, power brands grew at almost 2x vs non-power other brands.

NPDs, flanker brand and increasing ad spends

Dabur, in order to consolidate and improve market share, has implemented the strategy of launching flanker brands which help build brand saliency of its power brands. This strategy has led to increasing contribution of NPDs from 1.5-2% in FY19 to ~5.6% in FY21. Going ahead, management expects contribution of NPDs to be in the range of ~4-5%. Innovation will likely not be restricted only in power brands. Case in point: While Dabur's homemade brand does not stand among the power brands, management is keen to scale up that brand with the launch of pickles, chutneys, etc. and is targeting revenue of ₹5bn, vs current ₹1bn, over the next 5 years. Likewise in order to fortify the power brands, Dabur is launching adjacencies and extensions. This will lead to consumers sticking to the brand even if they were to premiumise or opt for different flavours, ingredients etc. E.g., standing on its leadership position in Dabur Amla, the company has launched almond plus amla-based hair oil. This would imply that as consumers premiumise from amla to almond-based hair oil, there is a higher propensity to stay with Dabur rather than switching to a competing brand. This is being adopted in some of the other power brands too.

Exhibit 12: Through the flanker brand strategy, Dabur continues to build consumer interest in the category, thereby improving brand saliency

Source: Company, Ambit Capital research

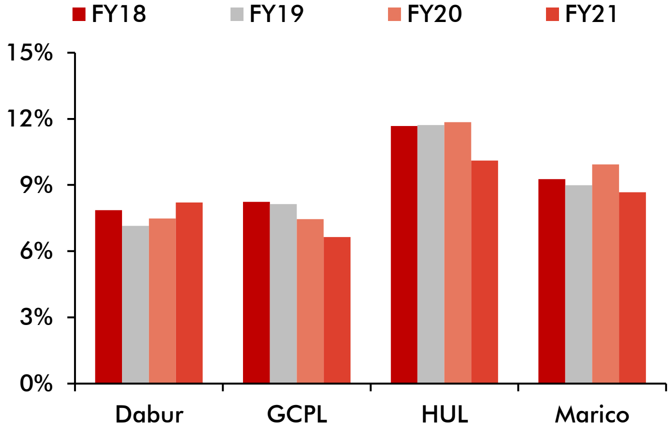
To back existing brands as well as the new launches, Dabur is looking to increase its ad spends to ~9% on an annualized basis from 7% in FY19. This will potentially help Dabur build better consumer awareness and keep competition at bay.

Exhibit 13: Dabur continues to scale up its annual new launch pipeline

	FY19	FY20	FY21
No of new launches	20+	40+	50+

Source: Company, Ambit Capital research

Exhibit 14: Run rate of ad spends needs to increase further to keep in pace with NPDs run-rate



Source: Company, Ambit Capital research

Scope to improve on packaging and formats

Over a period of time Dabur has realized the need to improve its packaging to attract the new age consumers and millennials. This realization has not only led to improved packaging across different categories but also into introducing more formats across products. These helps in expanding the market size, TG, and aids in as products move from chemist channels to GT.

Exhibit 15: Examples of few products/brands which have undergone either packaging changes or format enhancements

Source: Ambit Capital research

This said, we believe there is a range of products across healthcare and foods where Dabur can potentially look to enhance its packaging to create its attractiveness in the market. Thus to that extent we believe there is still journey that Dabur should traverse.

Increasing saliency of Ayurveda/naturals

The rise of Patanjali led to changing consumer preference towards naturals/Ayurvedic products. This change is happening across multiple FMCG categories (refer exhibit 16). Dabur with its Ayurvedic heritage has already started to benefit from this structural tailwind. The demand for Ayurveda/naturals-based products is driven both by urban and rural consumers, with the latter's purchases being driven by the availability of mass brands priced affordably with natural ingredients. This has made them shift from unbranded, homemade variants to packaged, branded products. As per studies, the share of Ayurveda within the personal care basket is set to increase by at least 1% p.a. (current share is ~45%) over the next few years. Another study predicts that against overall growth of personal care at ~9%, growth of Ayurvedic products is set to be ~14%. At this growth rate, our calculation suggests that over the next 5 years, the share of Ayurveda can reach ~50% by CY26. This said, in some categories like hair oil, soap, skin care, etc. the share of Ayurveda is very low. This signifies headroom for growth for Dabur over the coming decade.

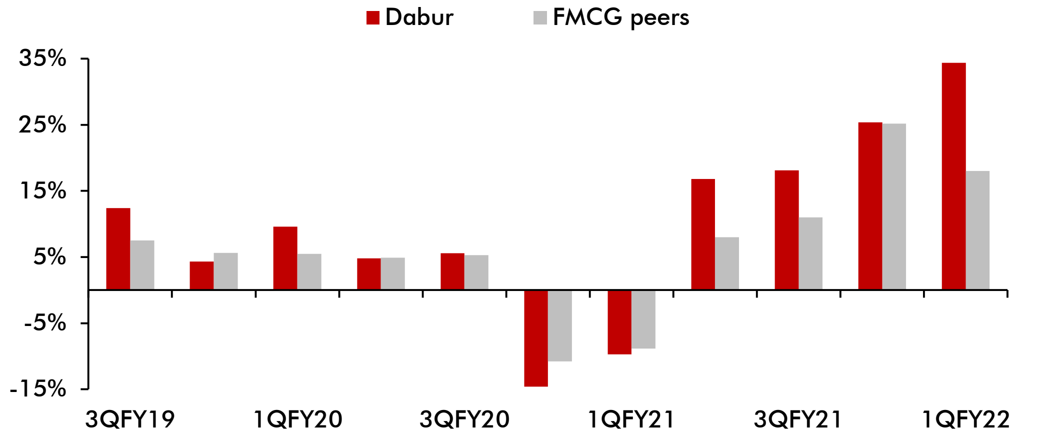
Exhibit 16: Significance of Ayurvedic/naturals products within personal care is set to increase

Categories	Category size (₹ bn)	% of Ayurveda/ Naturals	Growth rate differential between Naturals and overall category
Soap	232	5-10%	0.8x
Hair care	232	55-65%	1.2x
Skin care	152	12-17%	2.2x
Oral care	128	32-37%	>2x
Baby care products	44	55-60%	1.4-2x

Source: Company, Ambit Capital research, Kantar World Panel; Note – Time horizon for growth rate differential ranges from 2 – 5 years

Dabur with its heritage and brand pedigree in Ayurveda coupled with innovation in products, packaging and format is set to reap the benefits as consumers opt for naturals products. Thus, for Dabur in its oral care and hair oil category, in spite of penetration levels >90%+ and category growth of 5-7%, we expect FY21-25E growth CAGR to be ~10%/7.5%. Apart from this, Dabur's healthcare portfolio which is largely Ayurveda-based is also ripe for a double-digit growth basis its power brand strategy described earlier.

Exhibit 17: Dabur's volume outperformance vs peers in recent quarters has come owing to strong growth seen in Ayurveda-backed healthcare segment



Source: Company, Ambit Capital research

Awareness and relevance of Ayurveda/naturals products within most of the FMCG categories had risen post the rise of Patanjali and Covid has only accentuated this transition. Case in point: Penetration of Chyawanprash more than doubled from 2-3% pre-Covid to 5-6% now. If new habits die hard, this increase in penetration across healthcare categories will put Dabur, being a market leader, in a sweet spot. However, it is important to note that unlike developed economies where Ayurveda/naturals products have potential to charge a premium over regular products, that price premium is absent in the Indian context. At this juncture, we do not see companies like Dabur, Emami etc. having the ability to charge premium for its Ayurvedic range of products. Gradually, we expect Dabur to segment the Ayurveda market between the mass and premium segments and charge a premium for its premium segment products.

Aggressive diversification needs to pause

While Dabur has expanded its portfolio by entering adjacencies, it is also entering into many new small categories. These forays is expanding TAM but are categories where Dabur seems to have limited right to win (refer below exhibit). TAM expansion should be seen in the context of brand equity, potential consumer resonance to the brand, supply chain infrastructure etc. Thus as new categories get introduced on the existing sales & distribution platform, it can either put strain on the core portfolio or impact scalability of new categories. Should this be the case, Dabur while could be beneficiary of near term revenue growth emanating from new launches (5% of revenue contributed by new launches), but over the longer term it may need to allocate human/financial/brand resources better to seek growth opportunities and improve return ratios. Thus, we would prefer Dabur to focus on limited but scalable opportunities with larger right to win vs launching products across categories with limited synergies. Of the new launches made, we would bank on scalability of baby care, beverages and LV category.

Exhibit 18: TAM expansion is a welcome move but Dabur seems to be over diversifying with limited right to win or complementarity to existing product range/back-end or distribution synergies

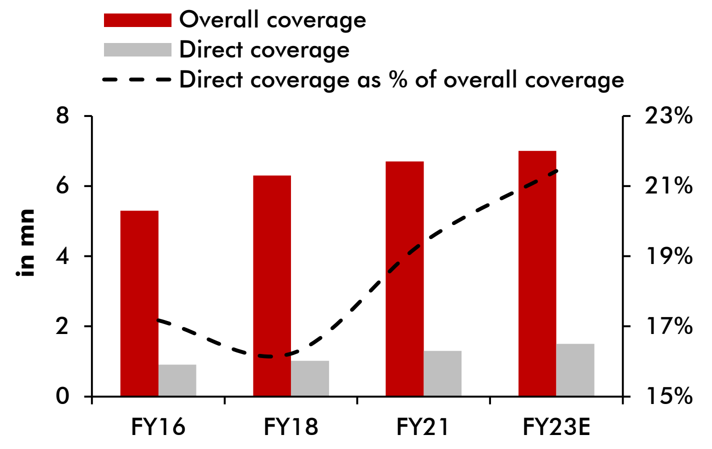
Category	Old product range	Old TAM (₹ bn)	New foray	New TAM (₹ bn)	Competition	Competitive intensity	Complementarity with existing product/brand
Baby care	Baby oil	5.5	Entire baby care incl Diapers	100	P&G, Unicharm, Himalaya, J&J, HUL	Relatively Strong	Medium
Beverages	Juices	18	Fruit drinks, milk shakes, fizzy drinks	400	Pepsi, Parle	Average	High
Herbal teas	None	NA	Herbal green and black tea	NA	TCPL, HUL, Organic India	Relatively Strong	Low
Cooking oils	None	NA	Mustard oil, Sesame oil	NA	Adani Wilmar, Marico, Emami	Strong	Low
Spices & pickles	None	NA	Picklets, Chutneys	NA	Mother's recipe, Eastern, Tops Gold, Nilon, Regional brands	Strong	Low
Cow Ghee	None	NA	Ghee	400	Amul, Mother Dairy, Britannia, Parag milk, local and regional players	Strong	Low
HFD	None	NA	Dabur Vita	75	Horlicks, Boost, Complan, Bournvita	Strong	Low
LV	None	NA	Odomos LV	25	Good Knight, AllOut, Maxo	Relatively Strong	Medium
Face wash	None	NA	Face wash & nourishing gel	30	Loreal, Everyuth, Fair & Glow	Strong	Low

Source: Company, Ambit Capital research Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Distribution expansion scope persists

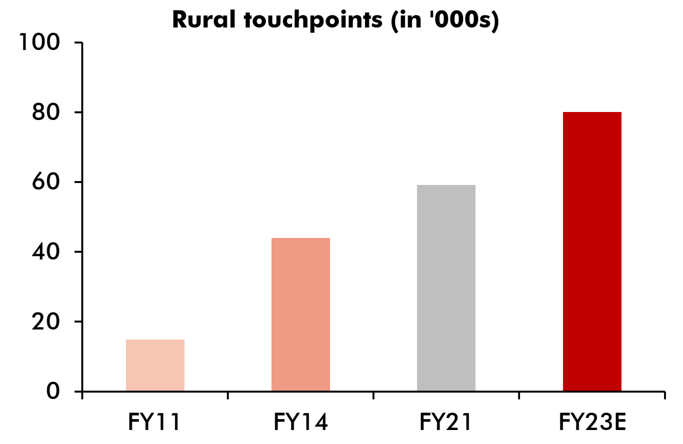
Another growth strategy for Dabur has been to increase its overall reach, direct reach and village presence. To this end, over the last 6 years, Dabur's overall reach/direct reach has compounded at 5%/7.5%, respectively. Dabur gets ~50% of its revenues from rural geographies. In order to harness the potential of rural markets, from FY16, Dabur split the rural distribution between separate sales personnel for HPC and Healthcare categories. This potentially enables the sales personnel to undertake frequent store visits, range selling, increase shelf space, understand competition and its pricing better, etc. Further, Dabur's increasing pace of innovation too requires it to have separate sales force and deeper rural connect in order to proliferate its assortment better. Apart from this, company is also working on improving servicing levels for various distribution channels while optimising costs across the supply chain (implementation of CRS, Project Drishti - real time ordering by retailer, Project Lakshya - availability across channels). All this initiatives will make inventory pipeline leaner, while placing the right product at the right shelf at the right time.

Exhibit 19: Dabur remains aggressive in its retail reach despite being at the top quartile among peers



Source: Company, Ambit Capital research; Note – FY23E is as per management guidance

Exhibit 20: Increasing rural footprint to strengthen penetration



Source: Company, Ambit Capital research; Note – FY23E is as per management guidance

Moving from Ayurveda-based shops to chemists to the wider GT channel

Dabur is looking to expand its healthcare portfolio distribution from ~0.1mn Ayurvedic shops to ~0.5mn chemist channels (currently reaches 0.2-0.25mn outlets) and eventually to 2-2.5mn GT outlets. While this transition will be a slow process, the ingredients such as usage of modern packaging formats, expanding sales force and appointment of distributors etc. are all being implemented. As this distribution scales up, Dabur's Digestives and OTC & Ethicals portfolio (11-12% revenue contribution) will benefit and likely clock double-digit growth over the longer term.

Further improving rural quotient

India has ~600,000 villages whereas most FMCG companies reach just 100,000-120,000 villages. Among its FMCG peers, Dabur has one of the highest revenue contributions from rural areas, i.e. ~45-50%. That said, Dabur is consistently looking to increase its rural depth and breadth. In order to increase its depth, it is looking to increase rural reach from 60,000 to 80,000 villages by FY23; the medium-term target of the company is to reach 100,000 villages. In order to improve penetration into rural markets, Dabur is looking to democratize its pack size and introduce ₹5/10 products across its HPC and foods portfolios.

Growth levers in light of category nuances

Dabur's USP lies in its Ayurveda-based healthcare, oral care and juice portfolios (~50% of revenues). Within healthcare, while product relevance is high, incremental work on moving to modern packaging formats and awareness will widen its distribution (into GT network of ~2.5mn from Ayurveda/chemist network of 0.1mn/0.5mn outlets) but will not be easy. In foods, Dabur's strategy of expanding TAM by entering into larger beverages (₹80bn) and culinary (₹210bn) looks encouraging; but crucial to know that presently Dabur does not have an established back-end to scale it up. In HPC, we remain confident of ~10%/8% revenue CAGR in oral/hair care over FY21-25E, but limited investment by management in skincare and home care (we build 5-7% revenue growth) needs to change looking at the category potential. Incremental revenue tailwinds can come from how it uses surplus cash (₹54bn at FY21, rising to ₹98bn by FY25E even post dividend payout); but no history of domestic acquisition makes this more a hope than any real optionality at the current juncture.

Healthcare portfolio – niche portfolio presence

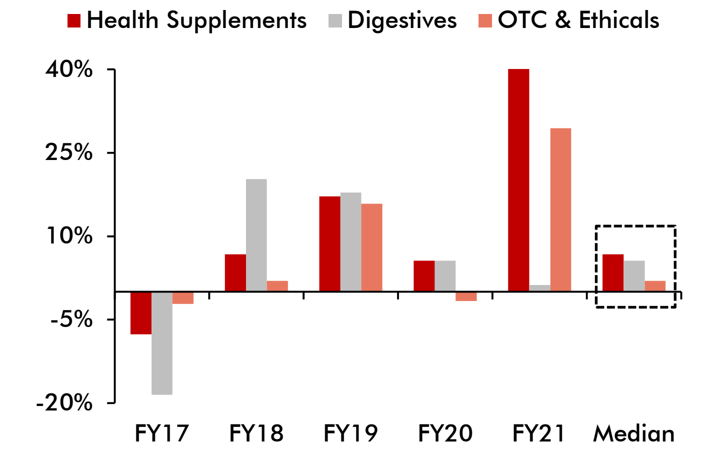
Dabur's edge over FMCG peers is its healthcare portfolio. Most of the products have low penetration and high gross margin. Dabur with its leadership is undertaking category expansion, building consumer awareness which can lead to share gains for Dabur. This coupled with distribution expansion, viz. selling from Ayurvedic stores to chemist to larger GT channel, can provide growth longevity. But this transition requires Dabur to re-package its products into modern formats, launch multiple variants and SKUs and undertake high decibel advertisements – all of which will take years of perseverance. This said, basis past execution record and category tailwinds, we estimate 13% revenue CAGR over FY21-25E on a high base for the segment (vs 9.4% over FY16-21). Over the next two decades, we expect ~10.5% revenue CAGR, led by consumer preference towards Ayurveda based healthcare product.

Exhibit 21: Increase in penetration & distribution and changing consumer preference towards naturals will give low double-digit growth over the next 2 decades

Categories	Market size (₹ bn)	Market share (approx %)	Penetration	Competition	Growth opportunity	Revenue growth potential (FY22-25E)	Probability
Healthcare (~39% revenue share)							
Health Supplements	273.5						
Chyawanprash	8	60%	~7-8%	Baidyanath, Zandu, etc	Penetration increase, introduction of more formats	Low teens	3
Honey	17.5	65%	~18-22%	Patanjali, Apis, Zandu, Saffola, etc	Penetration led growth	Low teens	4
Others health supplements	90	NA	Low single digit	Baidyanath, Zandu, regional players	Awareness, Penetration, Distribution from Ayurvedic to chemist channels.	Low double digit	4
Digestives							
Overall Digestives	29	22%	~20%	GSK Consumer, Abott, Himalaya	Distribution and format extensions	Low double digit	3
OTC & Ethicals							
Honitus Baby care Other OTC products Overall Ethicals	129	NA	Low teens	Himalaya, Baidyanath, Patanjali, Other Ayurvedic & Pharma cos	Consumers shift towards Ayurvedic products	Low double digit	4

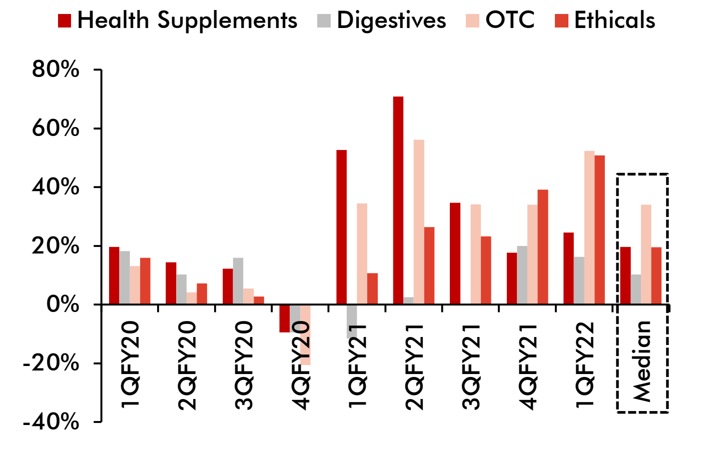
Source: Company, Euromonitor International Limited 2021 © All rights reserved, Ambit Capital research

Exhibit 22: Dabur's last 5 years' median growth across healthcare categories has been in mid-single digit...



Source: Company, Ambit Capital research

Exhibit 23: ...Covid changed the growth landscape but mean reversion likely from FY22E



Source: Company, Ambit Capital research

HPC – Confused between large and high-penetrated vs small and low-penetrated categories

Within HPC, Dabur is into hair care, oral care, home care and skin care. Of this, hair care and oral care are large TAM with size of ₹200bn and 125bn respectively. Home care and skin care are smaller with ₹75bn and ₹25bn market sizes. The below points highlight Dabur's growth levers in each of the sub-segments:

- **Oral care** – Despite a highly penetrated category (>90% penetration), Dabur has the potential to clock low double-digit growth vs mid to high single-digit category growth over FY21-25E. This would be led by consumers moving from white-based to Ayurveda-based toothpaste. Case in point is that the share of Ayurveda which was <20% pre-Patanjali (2015) has reached ~35% now. Industry participants expect this to hit ~50% in the coming years. Dabur with its strong brands – *Red*, *Babool* and *Meswak* – is set to benefit disproportionately. This has helped Dabur improve its market share from ~12% in 2015 to ~16.5%. Going ahead, we expect Dabur's strong Ayurvedic proposition in oral care to help it gain market share and lead to ~10% revenue CAGR over FY21-25E.
- **Hair care** – Dabur is expanding its hair oil portfolio from erstwhile amla-based to almond and coconut-based. In almond and coconut-based hair oil, Dabur is a challenger brand but it plans to ride on brand affinity and distribution. Our checks suggest Dabur has started to gain share in adjacencies as well. Thus, in spite of high penetration, we expect the hair oil segment to conservatively grow at 5-7% over FY21-25E. Shampoo, on the other hand, with its low penetration and consumer shift from chemical-based to naturals is likely to post faster growth. However, since shampoo constitutes just 15-20% of overall hair care for Dabur, double-digit growth of Shampoo will lead to ~9% revenue CAGR over FY21-25E.
- **Home care** – Small revenue contributor (~4%), small market sizes and challenger brand position drive limited investment by Dabur in expanding the category, innovations and new product launches. Thus, we do not build any major TAM expansion or penetration-led growth for the home care category, while building ~9% revenue CAGR over FY21-25E (4.3% over FY16-21). Aggression in home care if any would come if Odomos LV scales up.
- **Skin care** – This portfolio contributes ~4% to Dabur's revenues and hence limited product launches in core or adjacencies. Considering this brand does not feature within Dabur's power brands, its execution track and management's commentary, we do not expect Dabur to heighten its investments in these brands/category. We build modest revenue growth of ~6% over FY21-25E (6.6% over FY16-21). Aggression in skin care, if any, could lead to minor upgrades.

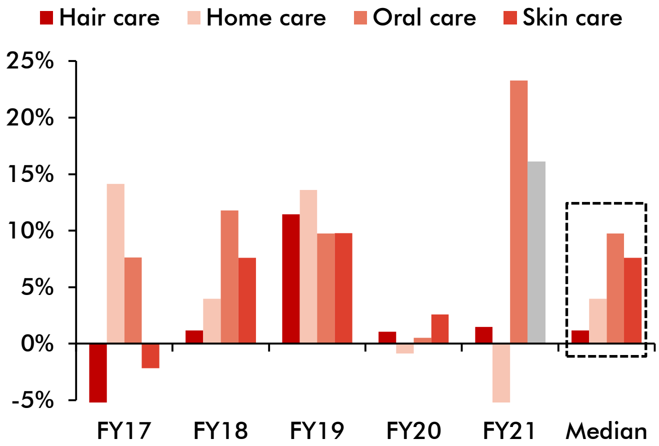
Thus, we expect HPC to clock 9% revenue CAGR over FY21-25E (vs 5.3% over FY16-21). Over the next two decades, we expect ~8% revenue CAGR largely from oral care and hair care range.

Exhibit 24: Increasing consumer acceptance of Ayurvedic products + expansion of market size to yield high single-digit growth

Categories	Market size (₹ bn)	Market share (approx %)	Penetration	Competition	Growth opportunity	Revenue growth potential (FY22-25E)	Probability of success
HPC (~48% revenue share)	420						
Hair care	125 - Hair oil; 70 - Shampoo	16% - Hair oil; 6% - Coconut hair oil; 7% in Shampoo	High	HUL, P&G, Marico, Emami, etc	Consumers preference for Naturals/Herbal product	High single digit	3
Home care	75	NA	Sub 20%	GCPL, RB, HUL	Scale up of Toilet cleaner; Wider HI play; Revamping Odonil brand	Mid to high single digit	4
Oral care	125	16.6% - Toothpaste; 50% - Herbal's toothpaste (~32% of overall category)	>90%	Colgate, HUL, Patanjali	Consumers preference for Naturals/Herbal product	Low double digit	4
Skin care	25	5%	High single digit	RB, Pfizer	Penetration, increase reach in salon	Mid to high single digit	3

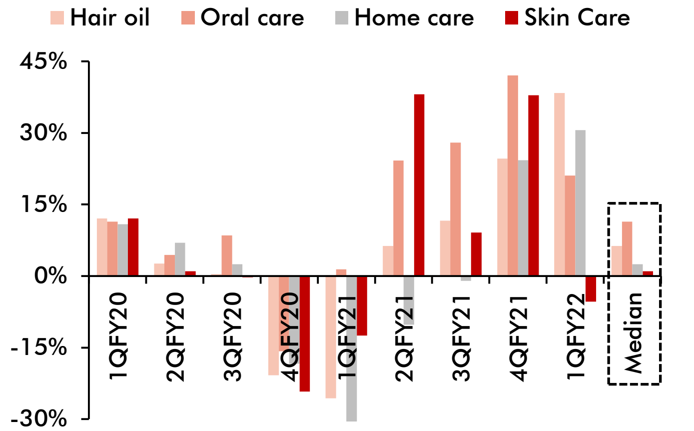
Source: Company, Euromonitor International Limited 2021 © All rights reserved, Ambit Capital research
Note: - Strong; - Relatively Strong; - Average; - Relatively weak

Exhibit 25: Considering the category construct, high single-digit growth is most optimistic



Source: Company, Ambit Capital research

Exhibit 26: A similar thesis played out as seen in data for the last 9 quarters too



Source: Company, Ambit Capital research

Foods – Seeking to expand TAM

Within foods, Dabur is largely present in fruit juice and to some extent in the culinary food preparation range currently. However, incrementally Dabur is looking to expand its TAM in foods segment. Dabur has moved out of ₹18bn juices category to ₹80bn beverage category with the launch of milk-based RTDs, coolers, fizzy drinks, etc. Apart from this, Dabur has launched ₹10/20 tetrapacks across formats in order to penetrate distribution outside of metro and top 25 cities – through this Dabur will be able to take Real juice from the existing 0.5mn outlets to ~3mn outlets. Apart from beverages, Dabur is looking to expand its presence into the wider culinary range. It had limited products under its brand '*Hommade*' such as coconut milk, coconut water, lemoneez, etc. However, over the last 12 months Dabur has expanded its Hommade brand to launch chutneys, pickles, puree, condiments, etc. Through this, Dabur is looking to enter ~₹210bn market opportunity of spices, pickles & chutneys. This category is highly fragmented with multiple regional players. Thus, Dabur with its brand, aggressive pricing and distribution is looking to gain share and scale up. At this time, Dabur is focusing more on e-com and MT trade. As consumer acceptance improves, Dabur will introduce these products in the GT channel. One caution here is that Dabur at this point in time does not have a differentiated back-end supply chain or strong in-house manufacturing strength in its newly launched Hommade range of products. It is looking to build scale and ride on existing sales and supply chain network. Once it is able to achieve scale, we expect Dabur to work on strengthening its back-end (e.g. post gaining heft in healthcare, Dabur is setting up a ₹5.5bn plant in MP). Thus, while we expect the foods category to clock 18% revenue CAGR over

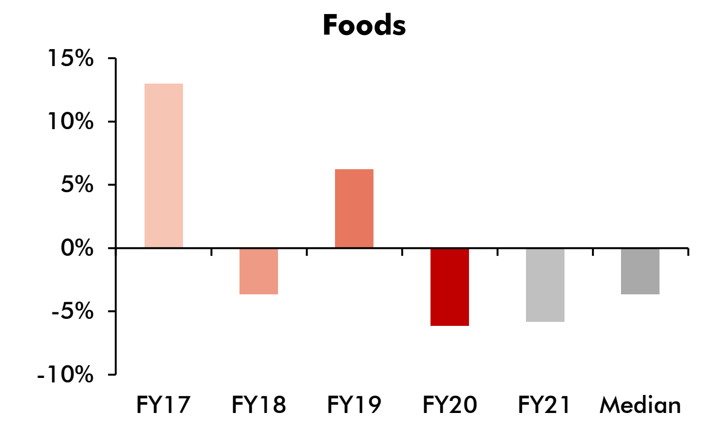
FY21-25E, sustenance of this growth cannot be extrapolated since a lot of this growth will come solely by primary placements of new products. While factoring in this growth, we are building optionality of expansion of Hommade apart from Dabur's extensive play into larger beverage category.

Exhibit 27: Expanding TAM and distribution expansion to be the growth mantra for the foods division

Categories	Market size (₹ bn)	Market share (approx %)	Penetration	Competition	Growth opportunity	Revenue growth potential (FY22-25E)	Probability of success
Food (~13% revenue share)	**290**						
Juices	18 (Juice & Nectar category); 80 (Beverage category)	60% - Fruit Juice category	Low	Medium	Introduction of ₹ 10/20 packs; Expand from Urban to Rural; Distribution headroom (current 500,000 outlets); Launch of Carbonated PET bottles;	High single to low double digit	3
Other food	210	NA	~20-30%	High	Scale up of Hommade range from ₹1bn in FY22 to ₹5bn by FY25/26; Introduce sauces and condiments; NPD share to Food to be ~8-10%	Low double to early teens	3

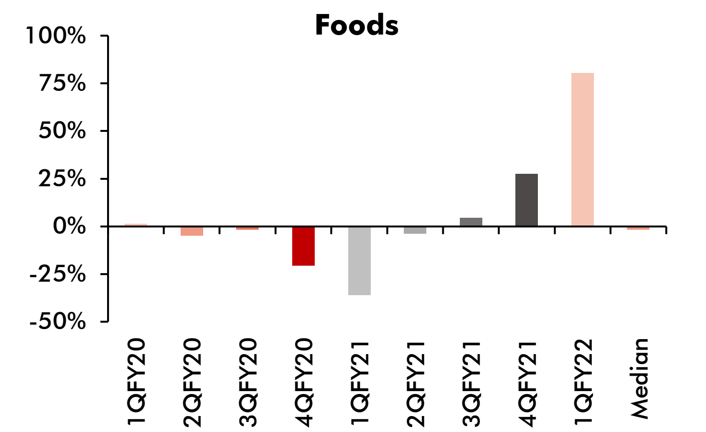
Source: Company, Euromonitor International Limited 2021 © All rights reserved, Ambit Capital research

Exhibit 28: Despite looking at historical growth and building benefit of expanding TAM…



Source: Company, Ambit Capital research

Exhibit 29: …expecting 18% revenue CAGR over FY21-25E will be building all narratives

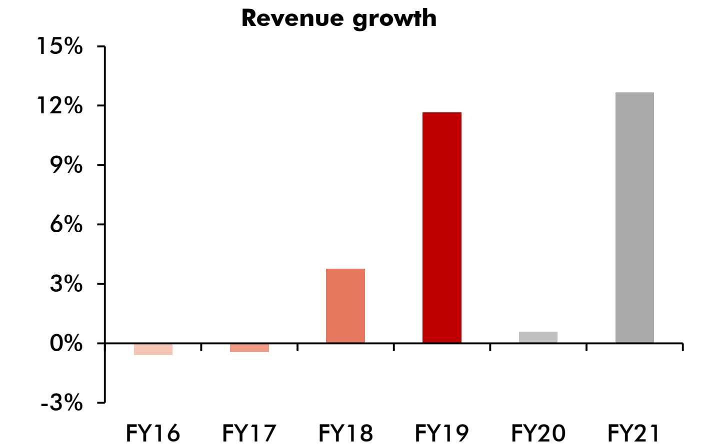


Source: Company, Ambit Capital research

Domestic business on firm footing

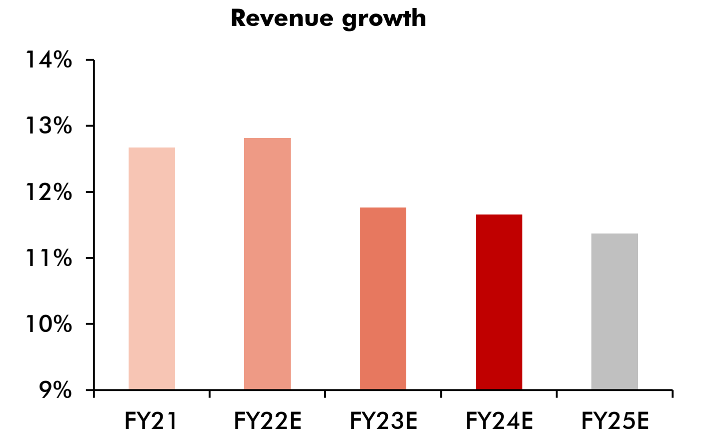
Thus, at the company level, we expect domestic business (~75% of revenues) to clock ~12% CAGR over FY21-25E even on a high base of ~13% YoY growth in FY21. However, 7.5% IB revenue CAGR over FY21-25E will drop overall company-level sales CAGR to 10.7%.

Exhibit 30: Historical growth marred by demonetisation & GST; improving growth trajectory from FY19



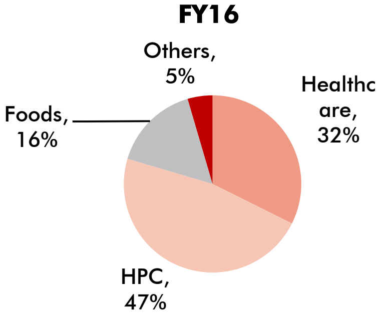
Source: Company, Ambit Capital research

Exhibit 31: Run-rate to sustain backed by management aggression, NPDs and distribution expansion



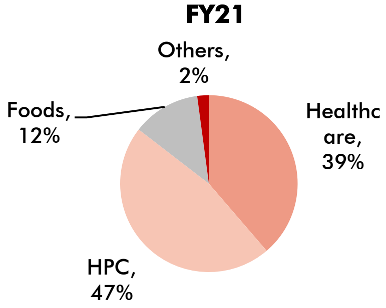
Source: Company, Ambit Capital research

Exhibit 32: Dabur's attempt to scale up its healthcare portfolio…



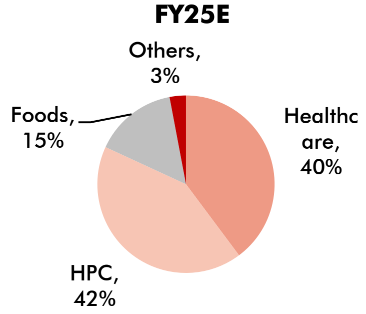
Source: Company, Ambit Capital research

Exhibit 33: …finally saw traction due to Covid; we expect its share to stay at current levels…



Source: Company, Ambit Capital research

Exhibit 34: …as growth moderation expected + improving growth in Foods and HPC portfolio



Source: Company, Ambit Capital research

What can potentially drive growth surprise?

Management's stance on incremental capital deployment

Consumer staple companies are cash generating machines and usually have dividend payouts in the range of 50-100% of PAT. For Dabur, the last three year's dividend payout was ~45%. As at FY21, Dabur is sitting on cash plus liquid investments of ~₹54bn. Looking at the potential free cash flow over FY21-25E and even after factoring dividend payout of ~50% over the said period, we estimate overall cash plus liquid investment to reach ~₹98bn (refer exhibit 35). This makes us wonder what management is thinking in terms of utilizing its surplus cash – will it increase dividend payout, will it buy back shares, will it continue to park cash in liquid debt schemes or will it go the inorganic route.

Exhibit 35: Annual cash accumulation makes capital allocation strategy important

₹ mn	FY19	FY20	FY21	FY22E	FY23E	FY24E	FY25E
Operating cash flow	14,991	16,136	21,147	18,854	23,232	26,010	29,039
Investing cash flow	3,369	(5,168)	(14,058)	(2,250)	(2,250)	(2,250)	(2,250)
Financing cash flow	(18,882)	(10,430)	(6,134)	(8,453)	(10,221)	(11,988)	(13,756)
Closing cash balance	377	917	1,888	21,441	32,202	43,974	57,007
Cash & bank balance as per Balance sheet	3,282	8,114	13,290	21,441	32,202	43,974	57,007
Liquid investment	33,588	28,003	41,596	41,596	41,596	41,596	41,596
Total cash plus liquid investment	**36,869**	**36,116**	**54,887**	**63,038**	**73,799**	**85,570**	**98,604**

Source: Company, Ambit Capital research

₹14bn invested in FY21 is idle cash parked in debt and liquid schemes.

Patchy M&A track makes us unsure of inorganic route

In its quest to expand overseas, Dabur took the inorganic route in 2010-17 and acquired 5 companies across Turkey, USA and South Africa.

Exhibit 36: History of past acquisitions – success rate patchy nevertheless

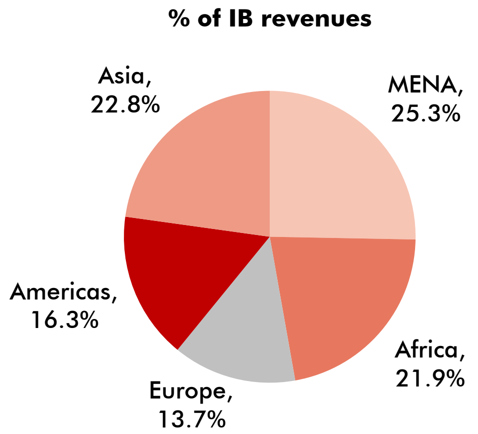
Year	Acquired Co.	Country	Product Category	Acq cost (₹ bn)
2010	Hobi Kozmetik	Turkey	Hair care and skin care	3.2bn
2010	Namaste	United States	Ethnic hair care products	4.6bn
2016	CTL Contracting	South Africa	Manufacturer of ethnic hair care products	0.1bn
2017	D&A Cosmetics Proprietary	South Africa	Hair care	0.2bn
2017	Atlanta Body & Health Products	South Africa	Hair care	

Source: Company, Ambit Capital research

IB is nothing to boast of

Dabur expanded organically in MENA and South East Asian markets and inorganically in RoW, but success in IB has been sup-par (refer below exhibits).

Exhibit 37: Asia, MENA and Africa remain key markets for Dabur's IB…



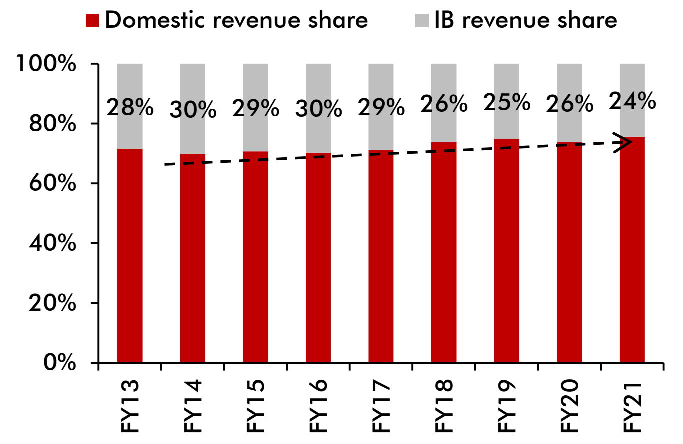
Source: Company, Ambit Capital research

Exhibit 38: … and those geographies also have wider portfolios to offer

MENA	Africa	Europe	Americas	Asia
Hair care	Hair care	Hair care	Hair care	Health care
Oral care	Home care	Personal care	Healthcare	Oral care
Skin care	Oral care			Hair care
Health care	Personal care			Home care
Foods				Personal care

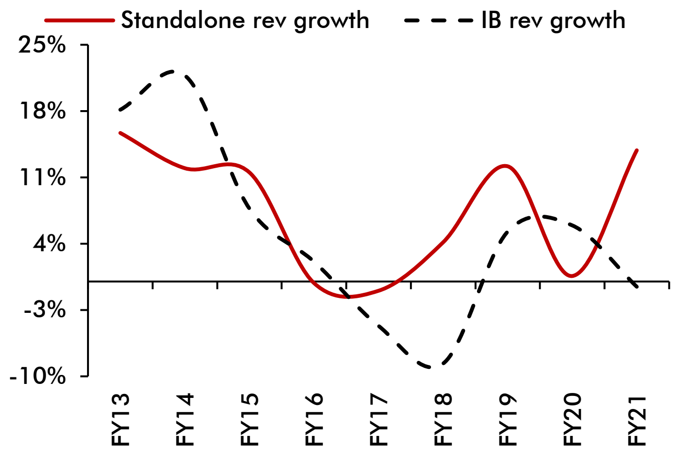
Source: Company, Ambit Capital research

Exhibit 39: Despite using organic and inorganic levers, share of IB revenues has continued to go down



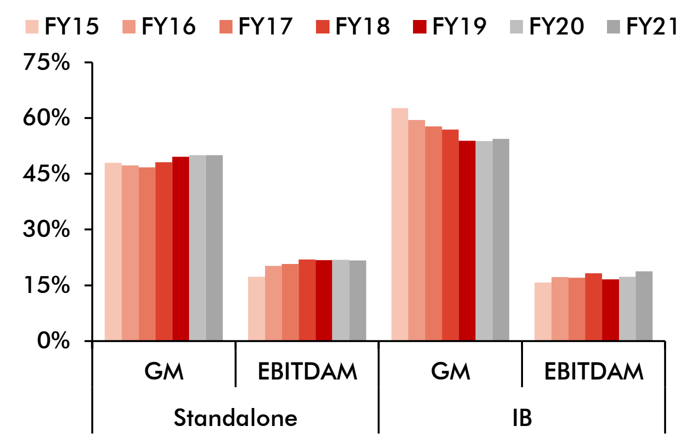
Source: Company, Ambit Capital research

Exhibit 40: From FY15, IB revenue growth has lagged domestic revenue growth



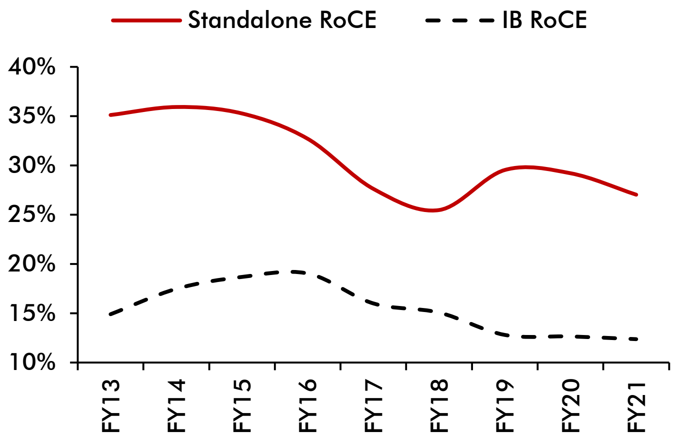
Source: Company, Ambit Capital research

Exhibit 41: Standalone GM and EBITDAM on improving trajectory whereas that of IB has been shrinking…



Source: Company, Ambit Capital research

Exhibit 42: …leading to 12-13% RoCE for IB vs >25% for the standalone business



Source: Company, Ambit Capital research; Note – RoCE has been calculated as summation of PAT and post-tax interest by average CE

Considering that the overseas expansion of Dabur has been RoCE-dilutive, we do not expect Dabur management to expand its overseas business inorganically. This makes us wonder if management is geared to look at domestic acquisitions. Dabur can potentially look to acquire regional niche brands in healthcare or food. Over the past 5 years, while management commented that they would look at inorganic opportunities as a growth driver but lack of domestic acquisitions makes us unsure of building any potential growth inorganically.

Domestic M&A, the missing link in spite of Dabur having human and financial capital!

According to us, a prudent use of surplus cash would be to launch and build premium healthcare range on own D2C platform or to undertake niche domestic M&A. Consumer connect with Dabur's mass and mid-priced products remains strong but it does not have products in the premium price points. One ingredient for scale up of D2C is to have products with high category gross margins, potential wide range of products which can help increase the LTV of consumer as well as average order value; all of this are within realms of Dabur's healthcare portfolio. Thus, if Dabur were to introduce a brand for its premium healthcare range on the D2C platform, it can potentially be a new growth vector. If management were to act on the same, it can generate any optionality in valuation.

Play for earnings-led return

Dabur's 1-year fwd P/E re-rated from 32x to 50x over FY17-20 (vs HUL's re-rating from 40x to 55x) led by 7% EPS CAGR vs HUL's 18% EPS CAGR. This re-rating considers: (i) management's refocused strategy on scaling healthcare and power brands; (ii) TAM expansion; and (iii) benefits of distribution expansion (rural markets expansion from 40k to 60k). Near-term growth will sustain on the back of new category entry and existing categories growing at high single digit coupled with Dabur's share gains trajectory. Thus, we believe our near-term (FY21-25E)/LT (FY21-41E) revenue growth expectation of 10.7%/10.5% looks achievable. Over the long term, we expect EBIT margin expansion of 420bps emanating from GM expansion (led by product mix improvement), operating leverage and cash accumulation leading to higher other income. All this leads to 11% EBIT CAGR over FY21-41E. Incremental re-rating scope (negligible probability) hinges on expanding market size of healthcare categories (doable) and succeeding in new forays (relatively difficult). Our DCF-based TP of ₹630 gives upside of 11%. Risk: Slower rural growth and losing focus on core categories.

Revenue/EBITDA/PAT CAGR of 11%/12%/12% over FY21-25E

Aggression to win consumers as they gravitate towards Ayurveda based products across healthcare and oral care, aggression in new launches, especially foods, and distribution expansion (both breadth and depth) would drive 12% revenue CAGR over FY21-25E in the domestic business. However, IB revenue CAGR of 7.5% will lead to overall sales CAGR of 10.7%.

Exhibit 43: Expecting 10.7% revenue CAGR over FY21-25E vs ~4% over FY16-21

₹ mn, unless specified	FY21	FY22E	FY23E	FY24E	FY25E	Comments
P&L						
Revenue	95,466	106,031	117,364	129,795	143,473	Building 10.7% revenue CAGR over FY21-25E
Revenue growth (%)	9.9%	11.1%	10.7%	10.6%	10.5%	Volume led revenue growth expected over the forecasted period
- Healthcare	30.6%	7.8%	14.6%	14.6%	14.2%	Healthcare's FY22E growth to be soft on a high base; beyond that expecting low double digit growth
- HPC	8.9%	8.3%	9.5%	9.1%	9.1%	Double digit growth in oral care to led to high single digit growth rate
- Foods	-5.8%	40.0%	11.0%	11.0%	11.0%	Potential growth from expanding TAM
- IB	2.2%	8.7%	7.2%	7.0%	7.0%	Recovery in MENA market to aid growth bounce back
Gross margin (%)	50.0%	50.2%	50.3%	50.4%	50.4%	Inflation and expansion in rural market to offset any GM improvement emanating from rising share of high-margin healthcare portfolio
Ad spends (%)	8.2%	8.1%	8.3%	8.4%	8.4%	Increased ad spends a must in light of introducing more products
EBITDA growth (%)	11.7%	14.4%	10.9%	11.4%	10.9%	Expecting 11.9% EBITDA CAGR
EBITDA margin (%)	21.0%	21.6%	21.7%	21.8%	21.9%	EBITDAM expansion more a function of cost savings and operating leverage
PAT growth (%)	9.5%	9.8%	13.9%	12.7%	12.4%	Resulting into PAT CAGR of 12.2% over FY21-25E
Cash flow statement						
Operating cash flow	21,147	18,854	23,232	26,010	29,059	8% OCF CAGR owing on a favourable WC base in FY21
Free cash flow	18,083	16,604	20,982	23,760	26,809	OCF to FCF conversion at >85%
Ratios						
Gross asset turnover (x)	2.5	2.6	2.8	2.9	3.1	Steady improvement in asset turnover
RoE (%)	23.8%	22.7%	22.8%	22.8%	22.8%	With cash accretion, RoE compression likely
RoCE (%)	47.5%	58.0%	62.2%	69.2%	77.0%	However, ex-cash return ratios likely to improve further

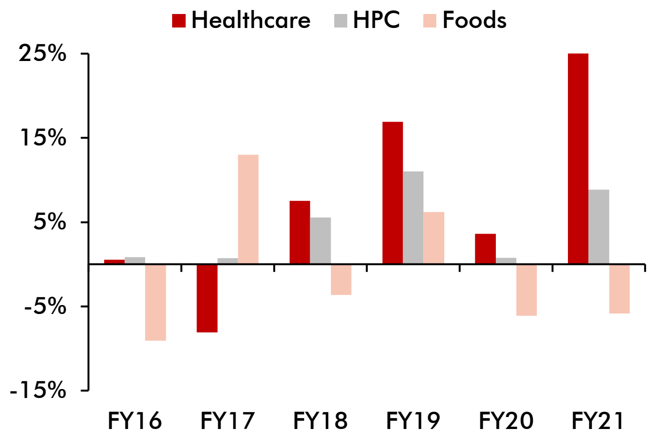
Source: Company, Ambit Capital research

Exhibit 44: We are lower than consensus for FY23E/24E on revenues and margins

₹ mn	Ambit estimates			Consensus estimates			vs. consensus		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues	106,031	117,364	129,795	109,093	121,624	135,467	-3%	-4%	-4%
EBITDA	22,910	25,418	28,305	23,016	26,419	30,012	0%	-4%	-6%
PAT	18,619	21,208	23,903	18,671	21,558	24,490	0%	-2%	-2%

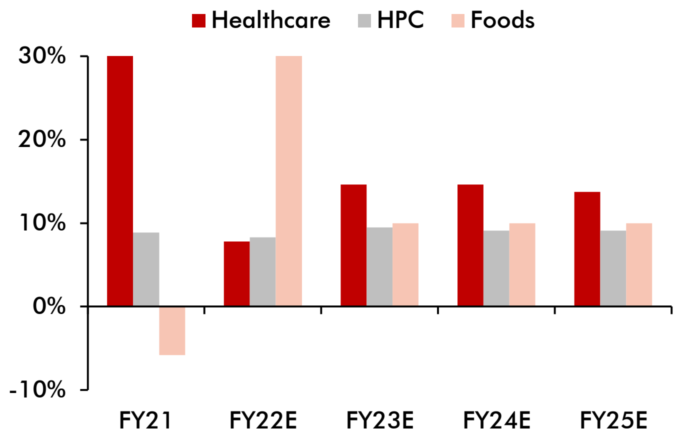
Source: Bloomberg, Ambit Capital research

Exhibit 45: Segmental domestic growth has been volatile owing to demonetisation, GST, soft rural growth



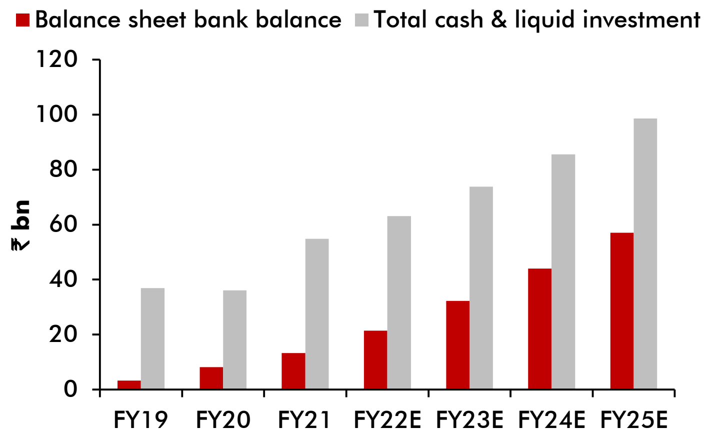
Source: Company, Ambit Capital research

Exhibit 46: Expect linear growth across categories backed by companies strategic initiatives



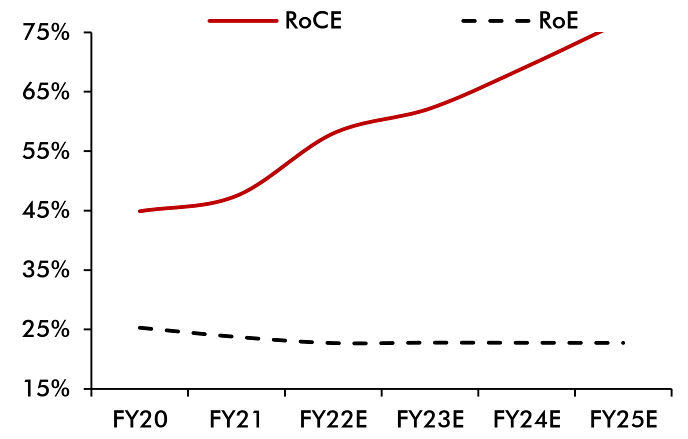
Source: Company, Ambit Capital research

Exhibit 47: Track record suggests limited M&A aggression and preference to retain cash on books…



Source: Company, Ambit Capital research

Exhibit 48: …will lead to improvement of RoCE but will be a drag on RoE



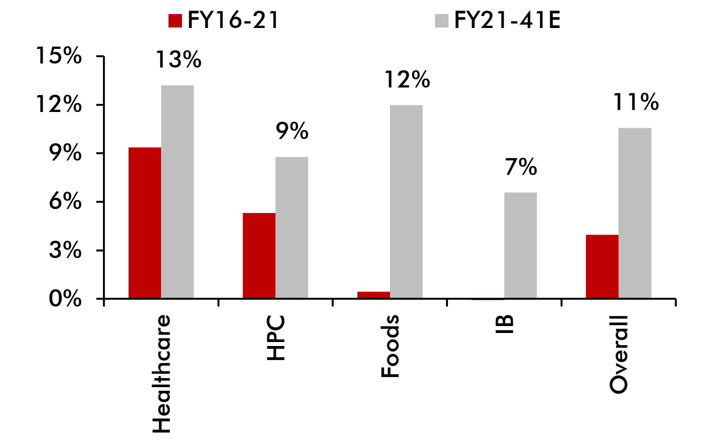
Source: Company, Ambit Capital research

Absolute valuations: DCF captures LT value accretion

Our FY21-25E revenue, EBITDA and PAT estimates of 10.7%, 11.9% and 12.2% are below consensus estimates (refer exhibit 44) largely owing to lower revenue estimates for FY22E/23E/24E. In our DCF-based valuation model, we build 10.4%/11.4%/9.1% revenue/EBIT/FCF CAGR over FY21-41E. After that, we build in two-stage TG, i.e. 9.5% over FY41-61E and 7% beyond that. While building LT growth estimates, we are estimating:

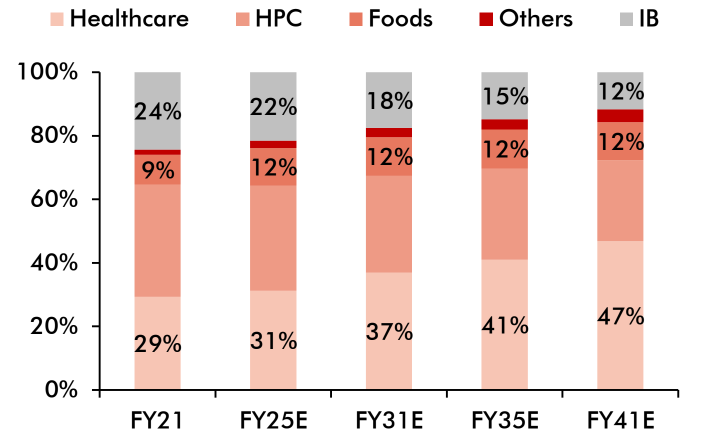
- Within the category construct of Dabur, we expect healthcare followed by foods and HPC to post strong growth of 13%/11%/8% over FY21-41E.
- Growth in healthcare to be led by consumers opting for naturals/Ayurveda (structural trend which has picked up from FY16) together with Dabur's initiatives of introducing modern formats, expansion of TAM, distribution expansion, etc.
- Growth in foods category would be led by Dabur's participation in the larger beverages and foods category.
- Share gains from regional and unorganized players.
- Near-term (FY21-25E) EBIT margin (including other income) expansion of 210bps will be a function of 90bps EBITDAM expansion and increasing share of other income bolstered through rising cash surplus. On the flip side, if Dabur were to invest the surplus in an acquisition or scale up some of its existing brands through higher ad spends etc., then scope of EBIT margin expansion will go down but there could be potential upside to revenue growth estimates.
- We consider CoE of 11.5%.

Exhibit 49: Healthcare likely to report best (13%) growth and IB the lowest (7%) over FY21-41E…



Source: Company, Ambit Capital research

Exhibit 50: …which will lead to increasing saliency of healthcare and foods

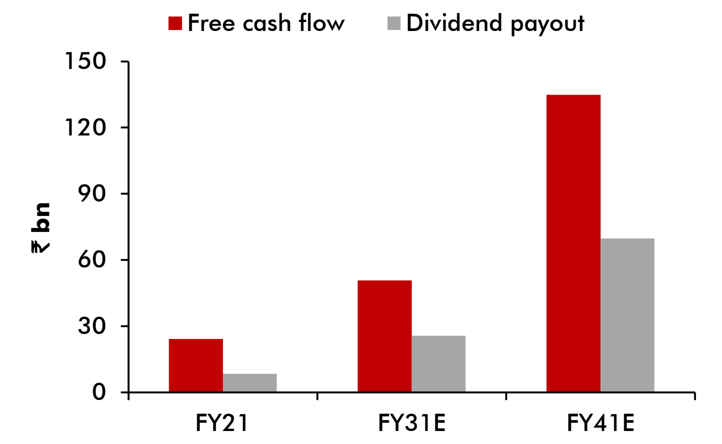


Source: Company, Ambit Capital research

EBIT margin expansion and capital allocation

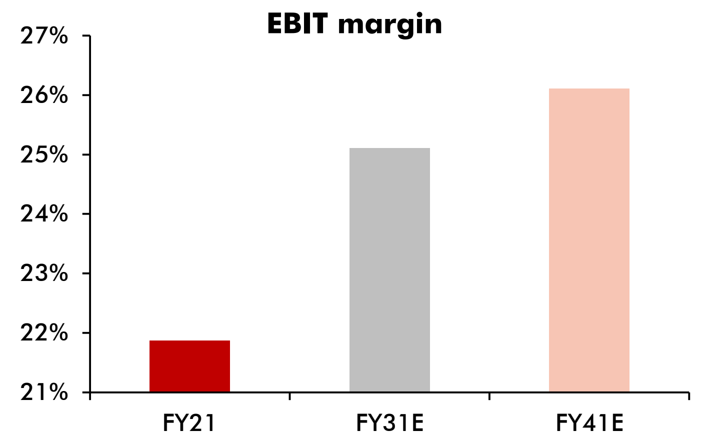
Over the last decade (FY11-21), Dabur clocked just 150bps EBITDAM expansion; however, EBIT margin (including other income) expanded by 390bps. The difference is largely attributable to higher other income owing to surplus cash accumulation. Going ahead, as mentioned in exhibit 47, we expect Dabur's cash accumulation to reach ~₹98bn by FY25E. Absent strategic capital deployment initiatives, we expect EBIT margin expansion (over FY21-25E) to be ~210bps vs just 90bps EBITDAM expansion. Likewise, over the DCF period, too, since we are not building any M&A activities, share buyback etc. and hence EBIT margin is likely to improve by overall 420bps over FY21-41E.

Exhibit 51: Absent capital allocation policy and dividend payout tad @50%, healthy cash accumulation likely



Source: Company, Ambit Capital research

Exhibit 52: GM expansion (better product mix) and other income to lead EBIT margin expansion



Source: Company, Ambit Capital research

Exhibit 53: Scenario analysis of TP basis different cost of equity and TG estimates

		Cost of Equity				
		10.5%	11.0%	11.5%	12.0%	12.5%
TG	5.5%	749	656	582	521	471
	6.0%	776	675	595	530	477
	6.5%	810	698	611	542	486
	7.0%	854	727	630	555	495
	7.5%	912	764	655	572	506

Source: Ambit Capital research

What can change the valuation?

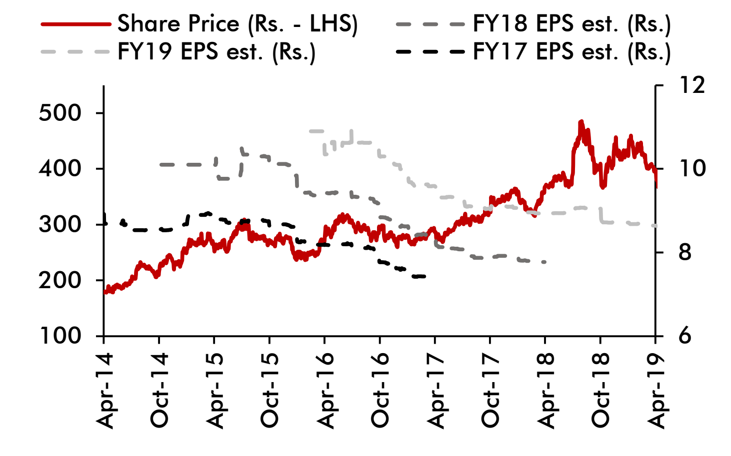
While building our DCF valuation, we have not factored in certain structural events which may play out over the coming years as it is not possible to build these into our DCF currently (refer below exhibit). That said, the below exhibit summarises the likely events, impact on P&L and cash flow and hence on valuations along with probability of the event happening.

Exhibit 54: The below events can potentially change LT valuation estimates; but quantifying them is difficult at the current juncture

Events	Impact on P&L	Impact on Cash flow	Right to win	Probability of event happening
Seeding new categories	☺	☺	◑	◕
Inorganic acquisitions	☺	☺	◔	◑
Creating own platform for healthcare range of products	☺	☺	◕	◕
Emergence of eB2B channels and consequential distribution changes	☹	☹	N.A.	◕

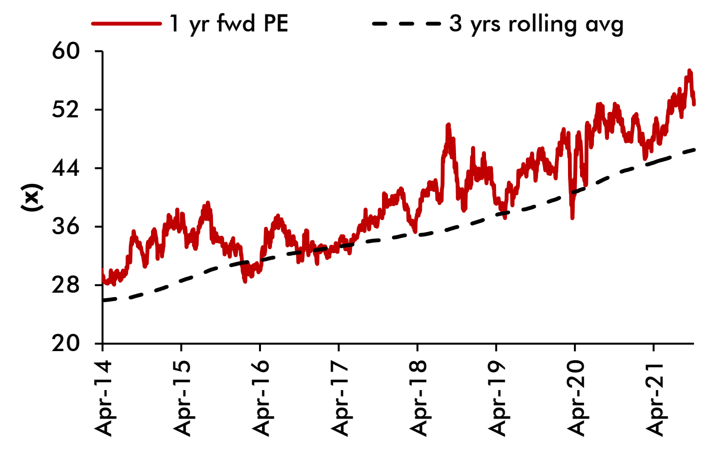
Source: Ambit Capital research; Note – Right to win factors in current categories that Dabur is looking to seed

Exhibit 55: Despite downgrades in Dabur's FY17, FY18 and FY19 EPS estimates…



Source: Bloomberg, Ambit Capital research;

Exhibit 56: ..1-year fwd P/E re-rated and is at 10% premium to 3-year average; negligible scope for incremental re-rating



Source: Ambit Capital research

Catalysts & risks

Near and medium-term catalysts

- **Double-digit growth in healthcare:** FY21 was a blockbuster year for healthcare with revenue growth of 31% YoY. Even on that base we are expecting 8%/15% YoY growth in FY22E/23E.
- **Growth momentum in foods:** As against flat rev CAGR over FY16-21, we are building 40%/11% rev growth in foods for FY22E/23E.
- **Distribution expansion:** Dabur has room to penetrate its distribution into rural markets and widen its portfolio in its existing distribution. This could support revenue growth. While we are factoring distribution expansion led growth but better than expected revenue growth led by distribution expansion can change revenue growth trajectory of Dabur.
- **Acceleration in consumers habit change:** Habit forming changes leading to increasing penetration-led usage of healthcare and immunity-boosting products can lead to sustained growth for Dabur in its healthcare category. Any acceleration in habit formation may accelerate the growth.

Near and medium-term risks

- **EBITDA margin contraction:** To scale up new launches, Dabur will need to increase ad spends. We are conservatively building 8.3-8.4% of sales to be spent towards ad spends. Any increase of ad spends may lead to cuts in EBITDAM.
- **Aggression in competition:** Dabur's HPC and foods segment was historically prone to higher competition. Post Covid many companies are looking to foray into or widen their healthcare portfolios. Dabur has strong leadership in most categories, but a higher number of players can increase competitive intensity and/or shrink the profit pool if price competition increases.
- **Growth support from macro tailwinds:** Our 10.7% revenue CAGR for FY21-25E hinges on Dabur benefitting from macro tailwinds, rural buoyancy, increasing disposable income, double-digit GDP growth, etc. Any change in that narrative will lower near-term revenue growth forecasts.

Ambit's HAWK Analysis

Over FY15-20, Dabur has consistently featured in D1 ('Zone of Safety') on our forensic accounting framework. Dabur scores high on parameters such as CFO/EBITDA, CWIP/gross bloc, auditor remuneration CAGR, volatility in depreciation rate and cumulative FCF/median revenue. On our greatness framework, Dabur features in the 'Good, but not great' zone and ranks below universe (47th percentile) and sector median percentile (36th percentile).

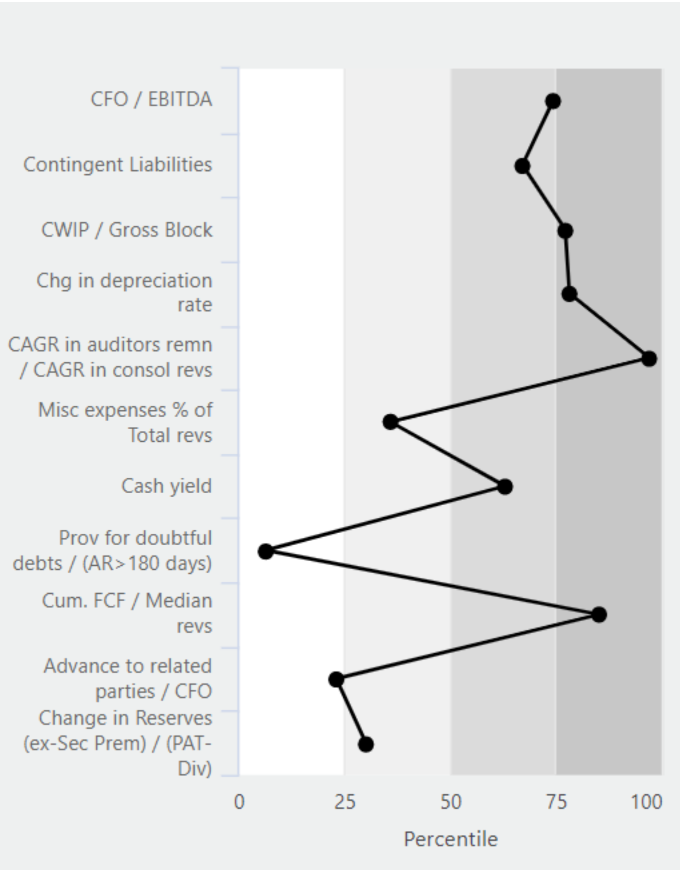
Key contributors to accounting scores

Dabur has always featured in the D1 decile on our forensic accounting framework over FY15-20. Dabur scores high on parameters such as CFO/EBITDA, CWIP/gross bloc, auditor remuneration CAGR, volatility in depreciation rate and cumulative FCF/median revenue. Relative to other parameters, Dabur scores low on parameters such as misc. expenses and change in reserves.

Our analysis of FY21 data suggests improvement in CFO/EBITDA, volatility in depr. rate and misc. expenses. However, certain parameters such as CWIP/gross block and cum. FCF/median revenue have deteriorated YoY.

Dabur ranks in the top ten percentile on our accounting framework compared to its sector (90th percentile) and universe (96th percentile).

Exhibit 57: Forensic accounting score contributors



Source: Company, Ambit Capital research

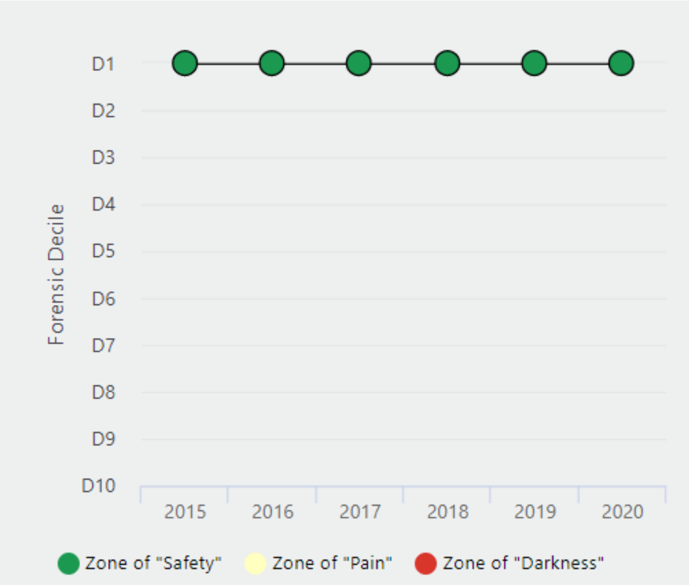
Exhibit 58: Forensic score percentile to universe and sector

Source: Company, Ambit Capital research

Comments on evaluation of accounting scores

Dabur's accounting score has consistently remained in D1 ('Zone of Safety') over FY15-20.

Exhibit 59: Forensic accounting score evolution



Source: Company, Ambit Capital research

Exhibit 60: Movement in accounting checks

Category	Accounting ratios	FY19	FY20	FY21
P&L mis-statement check	CFO/EBITDA	104%	105%	120%
	Volatility in depreciation rate	8	72	11
	PFD - % of debtors beyond credit period	NA	NA	NA
Balance sheet mis-statement check	Cash yield	7%	7%	8%
	Change in reserves (ex-sec prem) / (PAT ex dividend)	(0.13)	0.73	0.78
	Cont liab - % of NW	4.0%	4.0%	4.0%
Pilferage checks	Misc exps - % of total revs	1.0%	2.0%	1.0%
	Adv to related parties / CFO	NA	NA	NA
	CWIP / Gross block	2.0%	4.0%	5.0%
	Cum. FCF / median revs	22%	13%	7%
Audit quality checks	Auditor's rem CAGR/revenue CAGR	(1.6)	(2.1)	(2.5)

Source: Company, Ambit Capital research;

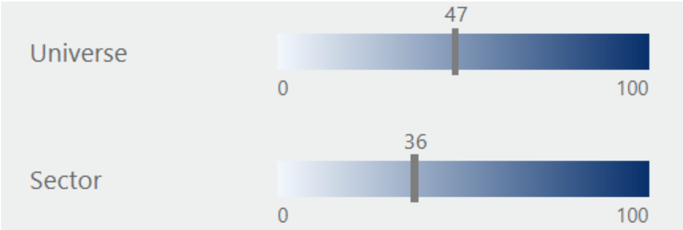
Evolution of greatness score

Our greatness framework evaluates companies on drivers of 'Greatness' (e.g. cash generation, incremental capex, efficiency in capital employed turnover, etc.). Dabur has featured in the 'Good, but not great' zone over FY17-20.

Exhibit 61: Greatness score contributors

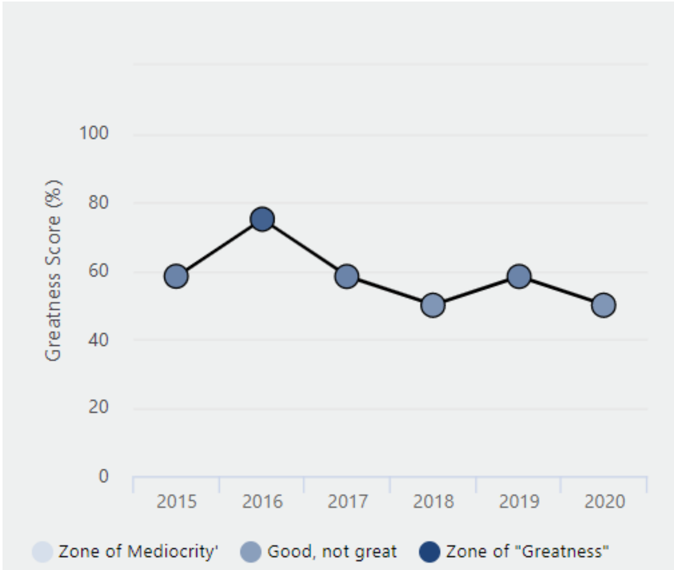
Source: Company, Ambit Capital research

Exhibit 62: Greatness score percentile to universe and sector



Source: Company, Ambit Capital research

Exhibit 63: Greatness score evolution



Source: Company, Ambit Capital research

Exhibit 64: Explanation to our flags

Segment	Score	Comments
Accounting	**GREEN**	Dabur is in D1, zone of safety on our forensic accounting framework. Dabur scores high on parameters such as CFO/EBITDA, CWIP/gross block, auditor remuneration CAGR, volatility in depr. rate and cum. FCF/median revenue but fares low on parameters such as misc. expenses and change in reserves.
Predictability	**GREEN**	Dabur's near-term growth rate has remained strong on the back of rapid pace of new launches. Sustaining this pace will keep predictability high. Also GM volatility for Dabur is low compared to many other FMCG peers.
Earnings momentum	**GREEN**	Consensus numbers have largely been met or upgraded

Source: Company, Ambit Capital research

Financials

Balance Sheet

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Shareholders' equity	1,767	1,767	1,767	1,767	1,767
Reserves & surpluses	74,868	85,534	97,021	109,436	123,058
Total networth	**76,635**	**87,301**	**98,788**	**111,203**	**124,825**
Minority Interest	367	367	367	367	367
Debt	**4,833**	**4,333**	**3,833**	**3,333**	**2,833**
Deferred tax liability	985	985	985	985	985
Total liabilities	**82,820**	**92,986**	**103,973**	**115,888**	**129,010**
Gross block	37,790	40,040	42,290	44,540	46,790
Net block	22,429	22,150	21,724	21,152	20,434
CWIP	1,473	1,473	1,473	1,473	1,473
Investments	**41,596**	**41,596**	**41,596**	**41,596**	**41,596**
Cash & equivalents	13,290	21,441	32,202	43,974	57,027
Debtors	5,616	10,167	11,254	12,446	13,758
Inventory	17,343	17,430	19,293	21,336	23,585
Loans & advances	369	290	322	356	393
Other current assets	6,130	6,681	7,396	8,179	9,041
Total current assets	42,748	56,010	70,466	86,290	103,803
Creditors	19,153	19,754	21,865	24,181	26,729
Current liabilities	3,987	5,810	6,431	7,112	7,862
Provisions	2,512	2,905	3,215	3,556	3,931
Total current liabilities	25,652	28,469	31,511	34,849	38,522
Net current assets	**17,097**	**27,542**	**38,955**	**51,441**	**65,282**
Deferred Tax Asset	225	225	225	225	225
Total assets	**82,820**	**92,986**	**103,973**	**115,888**	**129,010**

Source: Company, Ambit Capital research

Income statement

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Operating income	**95,466**	**106,031**	**117,364**	**129,795**	**143,473**
% growth	9.9%	11.1%	10.7%	10.6%	10.5%
Operating expenditure	75,439	83,121	91,946	101,490	112,042
EBITDA	**20,027**	**22,910**	**25,418**	**28,305**	**31,431**
% growth	11.7%	14.4%	10.9%	11.4%	11.0%
Depreciation	2,401	2,529	2,676	2,822	2,968
EBIT	**17,626**	**20,381**	**22,742**	**25,483**	**28,463**
Interest expenditure	308	302	265	233	200
Non-operating income	3,253	3,640	4,540	5,200	5,976
Adjusted PBT	**20,570**	**23,718**	**27,017**	**30,449**	**34,239**
Tax	3,611	5,099	5,809	6,547	7,361
Adjusted PAT/ Net profit	**16,960**	**18,619**	**21,208**	**23,903**	**26,877**
% growth	9.6%	9.8%	13.9%	12.7%	12.4%
Extraordinaries	-	-	-	-	-
Reported PAT / Net profit	16,960	18,619	21,208	23,903	26,877
Minority Interest	(10)	-	-	-	-
Adjusted Consolidated net profit	**16,950**	**18,619**	**21,208**	**23,903**	**26,877**
Reported Consolidated net profit	**16,950**	**18,619**	**21,208**	**23,903**	**26,877**

Source: Company, Ambit Capital research

Cash flow statement

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
EBIT	17,626	20,381	22,742	25,483	28,463
Depreciation	2,401	2,529	2,676	2,822	2,968
Others	847	3,338	4,275	4,967	5,776
Tax	(3,611)	(5,099)	(5,809)	(6,547)	(7,361)
(Incr) / decr in net working capital	3,884	(2,294)	(652)	(715)	(787)
Cash flow from operations	**21,147**	**18,854**	**23,232**	**26,010**	**29,059**
Capex	(3,063)	(2,250)	(2,250)	(2,250)	(2,250)
(Incr) / decr in investments	(13,611)	-	-	-	-
Others	2,616	-	-	-	-
Cash flow from investments	**(14,058)**	**(2,250)**	**(2,250)**	**(2,250)**	**(2,250)**
Net borrowings	93	(500)	(500)	(500)	(500)
Issuance of equity	-	-	-	-	-
Interest paid	(306)	-	-	-	-
Dividend paid	(5,921)	(7,953)	(9,721)	(11,488)	(13,256)
Others	0	-	-	-	(0)
Cash flow from financing	**(6,134)**	**(8,453)**	**(10,221)**	**(11,988)**	**(13,756)**
Net change in cash	955	8,151	10,761	11,772	13,053
Closing cash balance	1,888	21,441	32,202	43,974	57,027
Free cash flow	**18,083**	**16,604**	**20,982**	**23,760**	**26,809**

Source: Company, Ambit Capital research

Ratio analysis

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Gross margin (%)	50.0%	50.2%	50.3%	50.4%	50.4%
EBITDA margin (%)	21.0%	21.6%	21.7%	21.8%	21.9%
EBIT margin (%)	18.5%	19.2%	19.4%	19.6%	19.8%
Net profit margin (%)	17.8%	17.6%	18.1%	18.4%	18.7%
Dividend payout ratio (%)	49.5%	42.7%	45.8%	48.1%	49.3%
Net debt: equity (x)	0.1	0.0	0.0	0.0	0.0
Working capital turnover (x)	25.1	17.4	17.4	17.4	17.4
Gross block turnover (x)	2.5	2.6	2.8	2.9	3.1
RoCE (%)	47.5%	58.0%	62.2%	69.2%	77.0%
RoE (%)	23.8%	22.7%	22.8%	22.8%	22.8%

Source: Company, Ambit Capital research

Valuation parameters

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
EPS (₹)	9.6	10.5	12.0	13.5	15.2
Diluted EPS (₹)	9.6	10.5	12.0	13.5	15.2
Book value per share (₹)	44.0	50.1	56.7	63.8	71.6
Dividend per share (₹)	3.0	4.5	5.5	6.5	7.5
P/E (x)	59.4	54.1	47.5	42.1	37.5
P/BV (x)	13.0	11.4	10.1	8.9	8.0
EV/EBITDA (x)	49.9	43.2	38.5	34.2	30.3
Price/Sales (x)	10.6	9.5	8.6	7.8	7.0

Source: Company, Ambit Capital research

Hindustan Unilever

SELL

INITIATING COVERAGE | HUVR IN EQUITY | January 18, 2022

Believer of story but not valuations

Broad-based portfolio, leadership in most categories, widest distribution reach (>8mn outlets), and ability to leverage data & AI are cornerstones of growth. But re-attaining >10% sustained revenue growth (seen pre-FY16) require macro tailwinds, double-digit growth in F&R and share gains in BPC, of which we remain under-confident owing to limited innovation vs consumer needs. Re-rating from FY16-20 (P/E up from 40x to 55x) was led by 14%/20% PAT/FCF CAGR and technical factor (underperformance of broader sectors). With FY22-25E projected PAT/FCF CAGR of 16%/14% and increasing disruption risk (distribution & D2C-led), we find current implied expectations (12% revenue CAGR) high. Risks: Favourable macro and acquisitions to bridge whitespaces.

Competitive position: STRONG   Changes to this position: NEGATIVE

Optimism with a pinch of salt

Share gains in Home care (HC) and Foods & Refreshment (F&R) is exciting but share loss in few Beauty & Personal care (BPC) categories (owing to limited presence in Ayurveda, low innovation and focus on limited brands) can't be overlooked. Premiumisation journey is commendable (exhibits 11 & 12) but competition, especially in premium segment, needs to be monitored. Efficiency and cost savings gave 1,120bps EBITDAM expansion over FY11-21, with focus now shifting to volume growth, we estimate moderate EBITDAM expansion of 220bps led by product mix improvement and cost saving efforts.

We await the next surprise

Over the last 6 years, HUL's WiMi strategy (dividing India into 15 clusters), investment in technology, data and AI, distribution revamp (own ordering app, Shakti entrepreneurs program) etc. were some master strokes. These initiatives were much ahead of FMCG peers which helped HUL clock 10-12% revenue growth in FY15/18/19 (normalized years ex-disruptions). Incremental gains from these initiatives are already factored in and hence we wait for the next strategic surprise which may come from share gain in BPC, distribution revamp.

Near term growth optically strong on soft base

As post Covid normalcy arrives, we expect HUL to clock 10% revenue CAGR over FY21-25E. This captures growth recovery in HUL's discretionary portfolio (15% saliency), likely revival of rural markets, market share improvement across >75% of categories, distribution-led double-digit growth in GSK portfolio, and limited threat from D2C companies (could be medium-term risk though).

Better growth predictability but expectations riding high

We remain appreciative of HUL's DNA of being nimble, agile and adaptive. But recognizing the portfolio, penetration and its potential, building 10% revenue growth and 680bps EBIT margin expansion over FY21-41E is already implying the best case scenario. Factoring these, our CMP of ₹ 2,424, implies FY24 PE of 47x, ~10% premium to FMCG peers, which we believe is just right.

Key financials

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Operating income (₹ mn)	470,280	511,338	566,340	625,176	690,172
EBITDA (₹ mn)	116,260	123,180	144,642	164,358	185,931
EBITDA Margin (%)	24.7%	24.1%	25.5%	26.3%	26.9%
PAT (₹ mn)	79,990	87,249	104,667	120,369	137,075
EPS (₹)	35.1	37.1	44.5	51.2	58.3
RoE (%)	29.5%	18.4%	22.2%	25.1%	28.1%
P/E (x)	68.2	64.4	53.7	46.7	41.0

Source: Company, Ambit Capital research

Consumer Staples

Recommendation

Mcap (bn):	₹5,614/US$75.6
6M ADV (mn):	₹4,192/US$56.3
CMP:	₹2,390
TP (12 mths):	₹2,424
Upside (%):	1

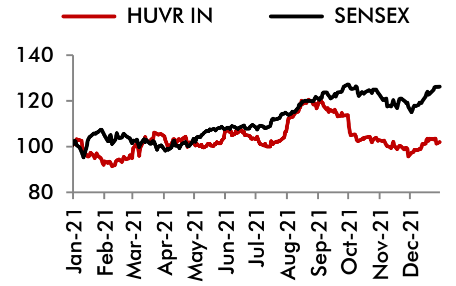
Flags

Accounting:	GREEN
Predictability:	GREEN
Earnings Momentum:	AMBER

Catalysts

- FY22E/23E GM likely at 51.8%/52.9%, lower than FY21 GM of 53.8%.
- 8.5% FY21-23E revenue CAGR in BPC despite FY16-20 CAGR of 2%, builds in all positives already.

Performance



Source: Bloomberg, Ambit Capital Research

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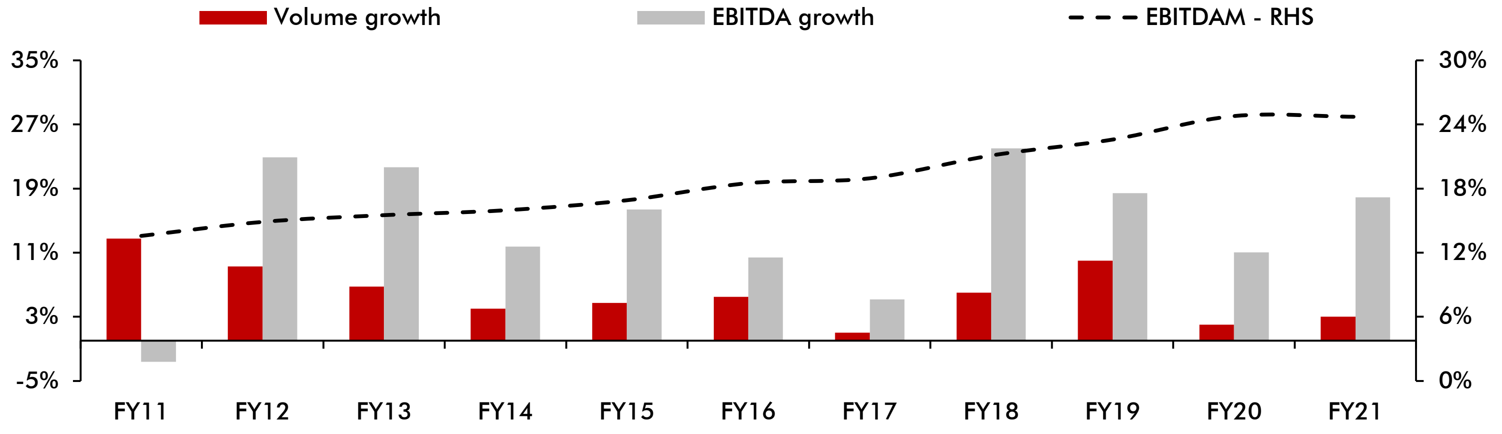
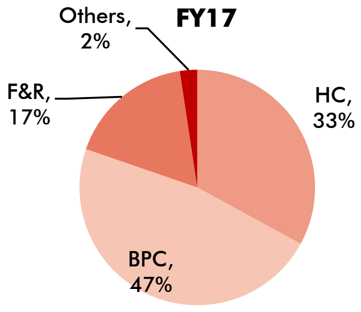
The Narrative in charts

Exhibit 1: Despite 6% median volume growth over the last decade, EBITDAM expansion of 1,100bps (second best amongst FMCG peers) led to EBITDA/PAT CAGR of 16%/15% and stock price CAGR of 26%



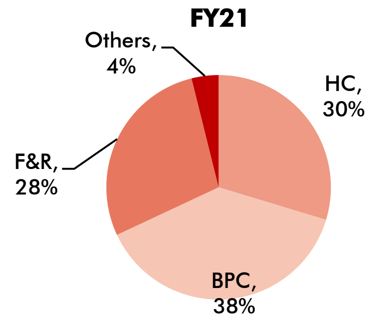
Source: Company, Ambit Capital research

Exhibit 2: Share gains-led growth in HC but slower growth in BPC+



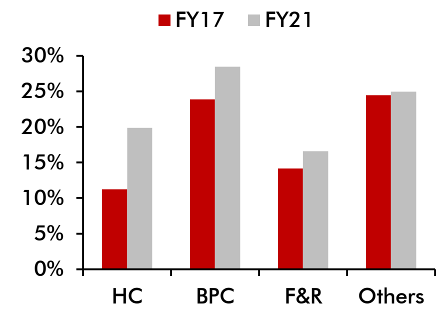
Source: Company, Ambit Capital research

Exhibit 3: Acquisition of GSK brands resulted in increasing share of F&R



Source: Company, Ambit Capital research

Exhibit 4: Incremental EBIT margin expansion largely through F&R



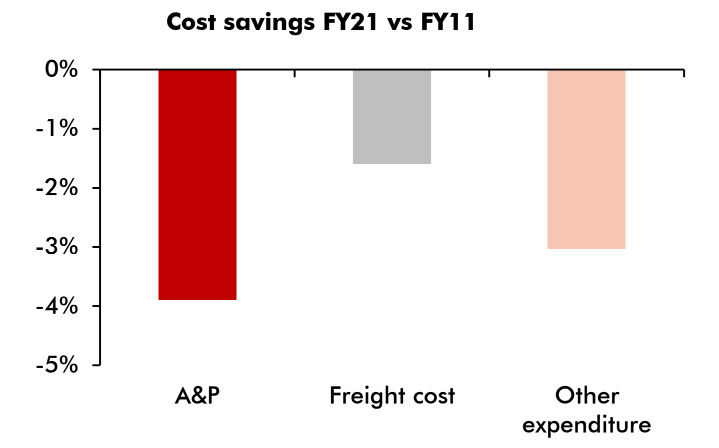
Source: Company, Ambit Capital research

Exhibit 5: Framework for expected growth rate across categories and segments; increasing competitive landscape but lower disruption risk should help HUL

Category name	FY21-25E growth rate (%)	Growth led by	Competitive landscape	Disruption risk	Overall risk
Home care	**9%**				
Laundry care	8%	Upgradation to mid and premium segment	Average	Relatively weak	Low
Dishwash	9%	Penetration and upgradation liquids format	Relatively strong	Relatively weak	Low
Surface care	12%	Distribution and product launches	Relatively strong	Relatively strong	Medium
Toilet care	12%	Distribution and product launches	Average	Relatively strong	Medium
Beauty & Personal care	**9%**				
Bar soap	7%	Premiumisation	Strong	Average	High
Hair care	9%	Penetration and premiumisation	Relatively strong	Relatively strong	Medium
Skin care	7%	Brand awareness and penetration	Relatively strong	Relatively strong	High
Oral care	6%	Arresting MS loss	Strong	Strong	High
Color cosmetics	11%	Brand awareness and penetration	Relatively strong	Relatively strong	High
Liquid soaps	12%	Penetration	Relatively strong	Average	Medium
Body Powder	5%	Brand awareness and penetration	Average	Average	Medium
Body wash	12%	Penetration	Average	Average	Low
F&R	**12%**				
Tea	9%	MS gains and premiumisation	Strong	Average	Medium
Coffee	9%	MS gains and penetration	Strong	Relatively strong	Medium
HFD	10%	Penetration	Relatively strong	Average	Low
Jams, Sauces	12%	Penetration	Relatively strong	Relatively strong	Low
Ice creams	16%	Distribution	Average	Relatively strong	Low

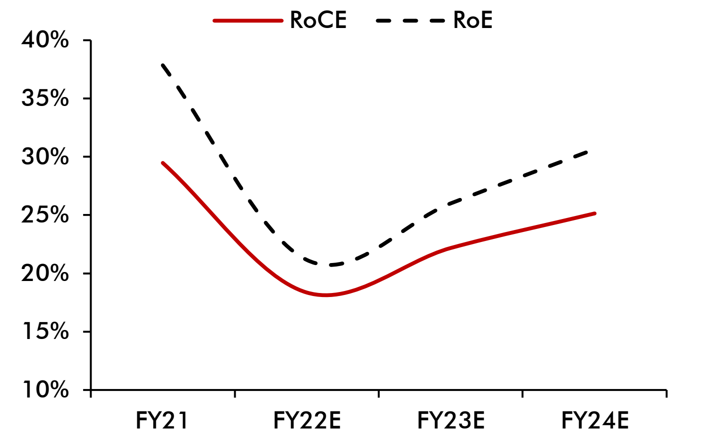
Source: Ambit Capital research Note: - *Strong;* - *Relatively Strong;* - *Average;* - *Relatively weak*

Exhibit 6: EBITDAM expansion is a result of conscious cost savings strategy and implementation of ZBB



Source: Company, Ambit Capital research

Exhibit 7: Acquisition of GSK led to dip in RoCE & RoE; will improve as synergy benefit seeps in



Source: Company, Ambit Capital research

Exhibit 8: Despite building capex and dividend payout basis historical trends, HUL to see strong cash accumulation…bolt on acquisitions, right strategy going ahead

₹ bn	FY19	FY20	FY21	FY22E	FY23E	FY24E
Operating cash flow	58	76	92	107	124	141
Less:						
Capex	(8)	(8)	(41)	(9)	(10)	(10)
Free cash flow	50	68	51	98	114	131
Dividends	(55)	(63)	(88)	(94)	(100)	(112)
Closing cash balance	65	64	72	76	90	110

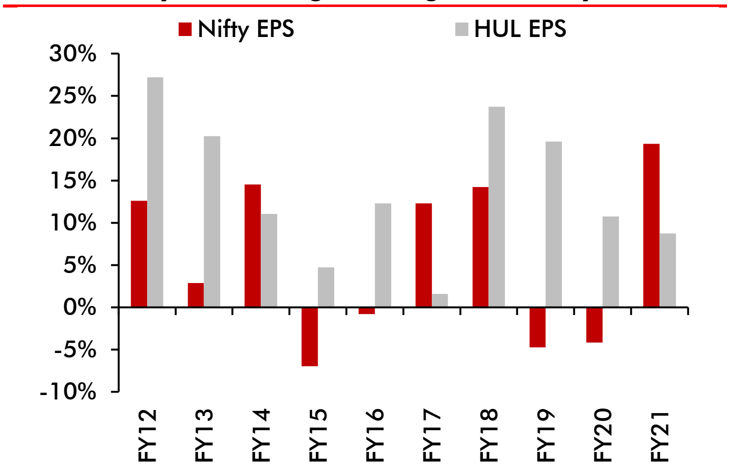
Source: Company, Ambit Capital research

Exhibit 9: Heating competition in D2C space to HUL's disadvantage

Brand name	Category	Sub-category	Competing HUL's brand
Nykaa	BPC	Cosmetics, hair care, skin care	Laxme, Love Beauty and Planet, Tresemme, Ponds, Clinic Plus, Sunsilk
Purplle			
Sugar Cosmetics			
Plum			
Wow Skin Science		Skin care, hair care	Love Beauty and Planet, Tresemme, Ponds, Clinic Plus, Sunsilk
Mama Earth		Skin care, hair care	
Sleepy Owl	F&B	Coffee	Bru
Rage Coffee			
Blue Tokai			
MyFitness		Peanut Butter	Kissan
Veeba		Sauces, Dips, Spreads	Kissan, Hellman's

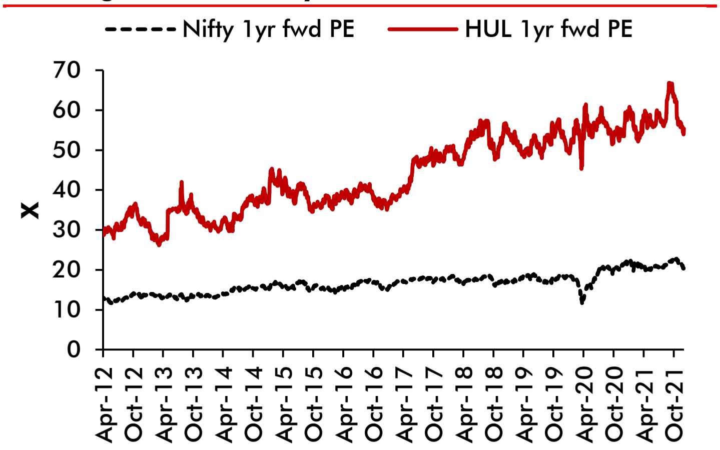
Source: Company, Ambit Capital research

Exhibit 10: 6% Nifty EPS CAGR vs 13% for HUL over the last decade led by HUL's EPS growth higher in 7/10 years…



Source: Company, Ambit Capital research

Exhibit 11: …led to HUL's 1-year fwd P/E premium almost doubling over the last 5 years



Source: Company, Ambit Capital research

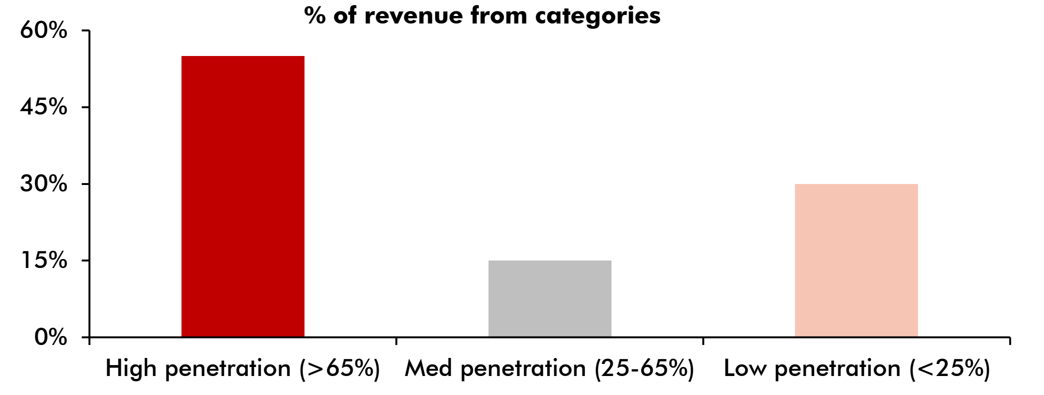
Portfolio, Placement and Predictability: cornerstones of growth

HUL has an institutionalized process to seize growth opportunities by using multiple levers depending on category – penetration, premiumisation, distribution expansion, category awareness etc. as the case may be. Approximately 55% revenue coming from categories with >65% penetration offers revenue predictability but also limits growth to high single digit levels. These despite increasing investments towards future channels of distribution (e-com, D2C platforms, tie-ups with JioMart, Udaan etc.), and adoption of data analytics and AI will restrict HUL's FY21-25E CAGR at ~11%. However, any acceleration beyond 11% would need strong macro tailwinds, acceleration in premiumisation, consumer loyalty as well as TAM expansion through M&A.

High on revenue predictability

HUL is an FMCG behemoth with presence across Home Care (~32%), Personal Care (~40%) and Foods & Refreshments (~28%). Our estimates suggest ~55% of HUL's revenue comes from high penetrated categories (penetration >65%), 12-15% from moderately penetrated categories (25-65%) and ~30% from low-penetrated categories (<25%). This means for categories where penetration is high, HUL will have to play the premiumisation game and categories where penetration is low, it will need to undertake market development and increase penetration.

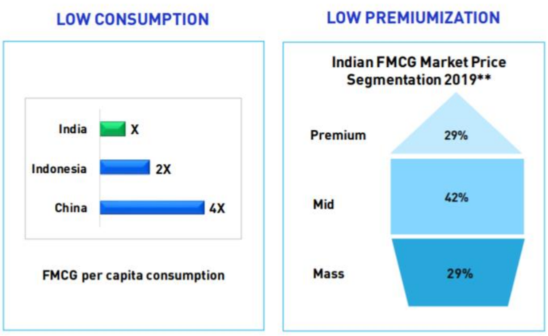
Exhibit 12: Adopting and investing in future channels of distribution



Source: Company, Ambit Capital research; Note: Based on internal estimates

Basis HUL's track record of showcasing both premiumisation (laundry care, dishwash, etc.) as well as market development (color cosmetics, green tea etc.), we remain confident of HUL replicating it to other categories. This benefit we are ascribing in spite of incremental competition coming not only from traditional offline companies but also from new-age startups and D2C companies which are agile and faster in responding to consumer requirements, identifying whitespaces and fulfilling them.

Exhibit 13: HUL is ready to exploit the growth headroom available in Indian FMCG market…

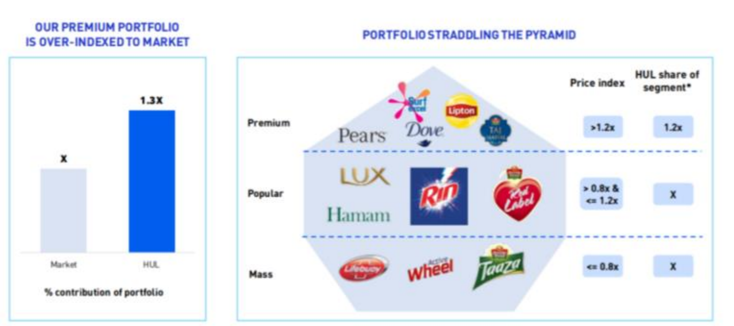


Source: Company, Ambit Capital research

Exhibit 14: …by adopting right strategies like penetration, market expansion and premiumisation

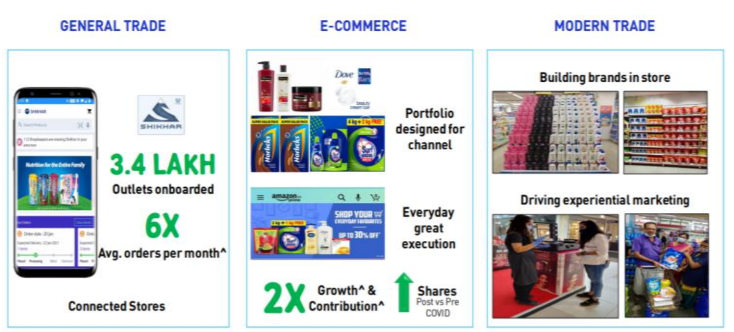
Source: Company, Ambit Capital research

Exhibit 15: HUL's portfolio too is future fit to reap benefit of premiumisation…



Source: Company, Ambit Capital research

Exhibit 16: …and also straddles distribution platforms to seize growth opportunities



Source: Company, Ambit Capital research

Exhibit 17: Acceleration of premiumisation to ensure sustainable double-digit growth

Categories	Revenue contribution (approx %)	Penetration	MS (~ %)	Competition	Growth led by	Probability of success	Revenue growth potential
Home care							
Laundry care	25%	High	40-45%	P&G, RSPL	Focus on mid and premium segment		Mid to high single digit
Dishwash	5%	Mid	55-60%	Jyothy, RSPL, Pitambari	Penetration increase and premiumisation		Mid to high single digit
Surface care	<1%	Low	2-5%	RB, SC Johnson, GCPL, Pvt labels	Increase distribution and consumer awareness		Low to mid teens
Toilet care	<1%	Low	3-6%	RB, Dabur, Pvt labels	Increase distribution and consumer awareness		Low to mid teens
Personal care							
Bar soap	15%	High	35-40%	Wipro, GCPL, RB	Focus on mid and premium segment		Mid to high single digit
Hair care	7%	Medium	40-45%	P&G, Dabur, Marico, D2C companies	Focus on mid and premium segment		High single digit
Skin care	11%	Low	38-43%	Himalaya, Nivea, Loreal, Startups	Improve penetration, focus across price points		High single to low double digit
Oral care	3%	High	15-19%	Colgate, Dabur, Patanjali	Revitalise herbal segment		Mid single digit
Color cosmetics		Low	14-18%	Loreal, Colorbar	Improving penetration and premiumisation		High single to low double digit
Deodorant		Low	7-10%	Vini, ITC	Improving penetration		Mid single digit
Liquid soaps	6%	Low	23-28%	RB, GCPL, ITC	Improving penetration		Mid to high single digit
Body Powder		Low	48-53%	Emami, J&J, CavinKare	Building functionality and penetration		Mid single digit
Body wash		Low	30-35%	ITC, Colgate	Improving penetration		Mid to high single digit
F&R							
Tea	10%	High	21-23%	TCPL, Waghbakri, Society	MS gains from regional, unorganised player; Product introduction in economy segment		Mid to high single digit
Coffee	2%	Low	35-40%	Nestle, TCPL	Improving penetration and distribution		High single digit
HFD	10%	Low	53-58%	Mondelez, Zydus Wellness, Danone	Improving penetration and distribution		High single to low double digit
RTE		Low	NA	Marico, MTR, Nestle	Improving penetration, offering value to consumers		Low to mid teens
Jams, Sauces	5%	Low	60-65%	Nestle, Heinz, Veeba	Improving penetration and awareness		Low to mid teens
Ice creams		Low	8-12%	Amul, Havmor	Increasing distribution		Low to mid teens

Source: Euromonitor International Limited 2021 © All rights reserved, Ambit Capital research, Note – Penetration: Low = between 1-25%; Medium = between 26-65%; and High = >65%

Thus from a strategy, RTM and execution perspective, we believe HUL is amongst the best in the FMCG space. But in the context of categories in which it is present we expect HUL to be able to clock 10-11% YoY revenue growth sustainably even after factoring in long-term positives of penetration improvement as well as premiumisation. However, on the flip side, the portfolio offers better growth predictability; this gets stronger as we add elements such as distribution network, superior use of data analytics, etc. This we believe is HUL's core strength.

What can take HUL's growth rate beyond ~11% estimated by us?

HUL's growth rate is an outcome of both macroeconomic tailwinds as well as company-specific strategic & tactical decisions. Thus, for HUL to accelerate its growth rate beyond ~11%, the following need to play out:

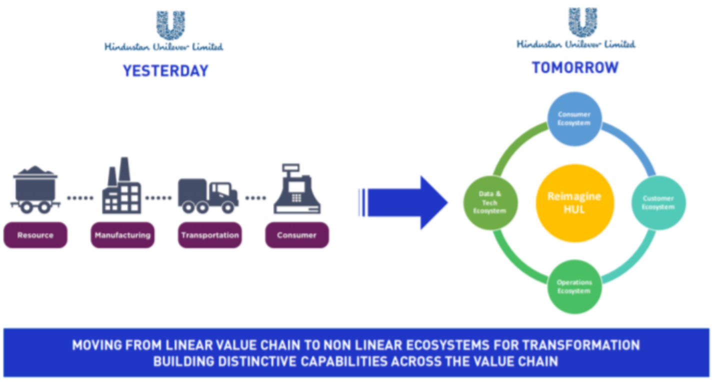
- Nominal GDP/capita growth in double digits, higher private and government capex vs the pace seen over the last five years. Both of these will lead to higher disposable incomes especially in the hands of rural India.
- Acceleration in premiumisation + consumer loyalty. E.g. consumers who upgrade should remain within HUL's brands and not shift to other brands. i.e. consumers upgrading from Dove shampoo should move to Tresemme and not to Lotus, WoW, etc. Historically, HUL has maintained that their premium portfolio has grown faster than company average; this pace needs to get accelerated.
- Foray into the wider home hygiene range such as toilet cleaners, floor cleaners etc. or any other launch/M&A that would expand TAM.
- Rapid share gains from unorganized/regional players.
- Distribution expansion by leveraging tie-ups with new age companies such as Udaan, Shop Kirana, Storeking, etc.
- Scale-up of own D2C models, subscription-based platforms etc.

At present while estimating revenue growth over FY21-25E, we are already factoring benefits from rural buoyancy, premiumisation as well as macro tailwinds.

Runs on unique and best-in-class ecosystem

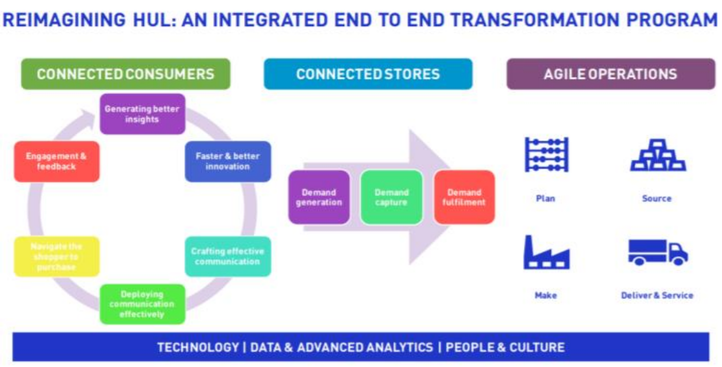
Amongst FMCG companies, we believe HUL operates on a best-in-class integrated system across customers, operations and data. These ecosystems aid HUL in superior demand generation, demand capture and demand fulfillment.

Exhibit 18: Streamlining operations and value chain by leveraging data and analytics



Source: Company, Ambit Capital research

Exhibit 19: Inter-linkages between customer, operations and data ecosystems lead to faster and quicker RTM



Source: Company, Ambit Capital research

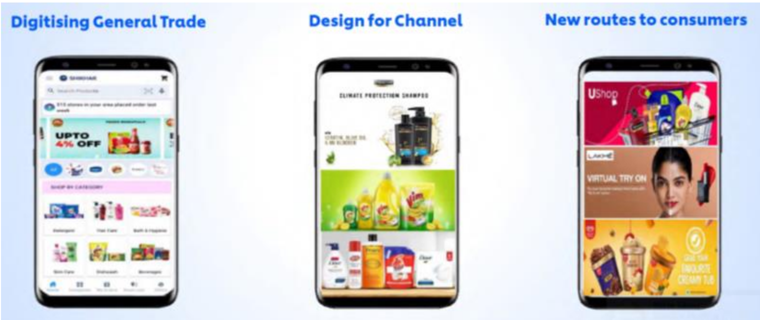
Differentiated distribution architecture

HUL has amongst the widest distribution coverages - it reaches >8mn outlets out of the overall GT retail coverage of ~10mn outlets. HUL also has amongst the highest direct coverage of >3mn outlets. This gives HUL a unique advantage in an environment where new FMCG companies are struggling to reach direct retail coverage of ~1mn outlets. Apart from this, HUL has already embarked on a differentiated distribution model which serves the twin benefits of: (i) serving across strata of customers and consumers and (ii) obtaining first-hand consumer data and insights almost instantaneously.

HUL with is distribution scale as well as niche retailer & consumer connectivity modules, is ahead of its peers.

- **Shikhar app:** This app is for retailers. Retailers can order directly through the app thereby trying to save the time of distributor/company salesperson personally going to the store and taking orders. Through this app, HUL is able to: (i) offer better schemes to retailers; (ii) track real time sales of its products; (iii) obtain real time data of consumer buying preferences across region/locality, price points, etc. As per FY21 AR, HUL has >600,000 retailers on-boarded to Shikhar.
- **Shakti entrepreneurs:** Women's empowerment program in rural areas. HUL has over 135,000 shakti entrepreneurs as at FY21, up from 120,000 in FY20. This model keeps HUL in good stead for its rural expansion.
- **D2C platforms:** Keeping in line with the trend of scale-up of D2C companies, HUL too has moved to D2C across different product profiles: (i) Lakme shop for beauty portfolio; (ii) Kwality Walls for ice cream portfolio; and (iii) Ushop for overall HUL's portfolio. HUL is amongst the first movers to set up its own D2C platforms across different parts of the portfolio. All these platforms will help HUL garner real time data, understand consumer preferences across the price pack pyramid, recruit consumers for their premium product range, etc. Refer pages 24 to 26 of the thematic section.

Exhibit 20: Adopting and investing in future channels of distribution



Source: Company, Ambit Capital research

Thus, HUL is packed with a wide portfolio of product assortments, right product price architecture, ecosystem of innovation and new product launches akin to consumer needs etc. which offer both penetration and premiumisation-led growth. HUL is also undertaking the right steps to expand its footprint across existing as well as new channels of distribution. This potentially makes HUL a leader in most of the categories in which it is present.

Strategic actions worth highlighting

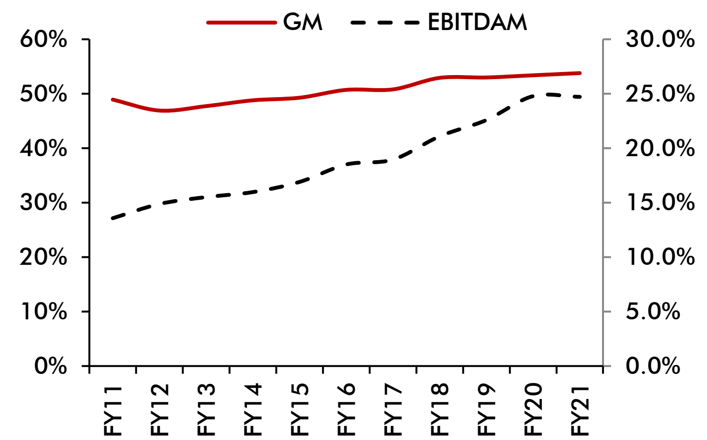
HUL's strategy change to focus on volume growth over margins is, according to us, the most appropriate strategy shift initiated. In light of (i) 490bps and 1,120bps gross and EBITDAM expansion over the last decade; (ii) aspiration to increase penetration, premiumisation drive whilst retaining affordability; (iii) sachetising HFD brands and (iv) attempt to improve market share in BPC portfolio, it is prudent for HUL to focus on volume growth. However, brand fatigue in BPC coupled with increasing competition from D2C brands in that space means HUL's premiumisation journey potentially will be difficult. On the positive side, despite being an MNC, HUL has better operating freedom in terms of NPDs, localization, M&A etc compared with other MNC FMCG companies. Thus, operationally HUL can use multiple levers to address the threat of rising competition – key is WHAT, HOW and WHY!

Shifting shaft from margin expansion to volume growth

Best of GM and EBITDAM expansion achieved

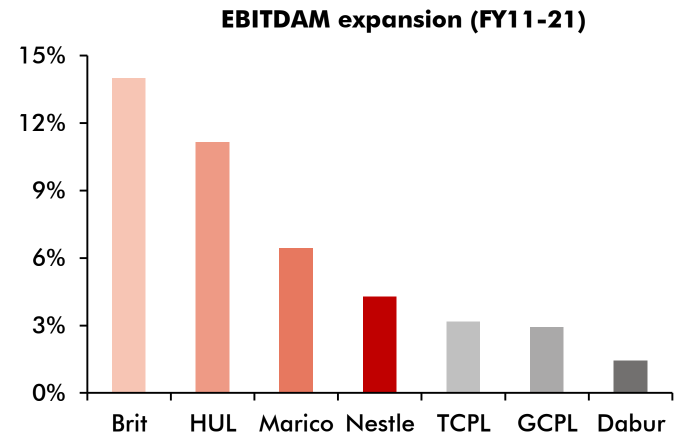
Over the last decade (FY11-21), HUL has posted 490bps GM expansion aided by premiumisation across categories, cost savings through reformulating production process as well as vendor rationalization. However, the defining factor for HUL has been 1,120bps EBITDAM expansion led by conscious cost saving initiatives through zero-based budgeting, realigning logistics & distribution costs from depots directly to retailers, higher adoption of technology, and leveraging benefits across employee cost and other expenditures. This EBITDAM expansion has been amongst the highest that any FMCG company has seen over the last decade (refer exhibit 22).

Exhibit 21: EBITDAM expansion has been more than double of GM expansion on ppt basis



Source: Company, Ambit Capital research

Exhibit 22: HUL has seen second highest EBITDAM across large FMCG companies over the last decade

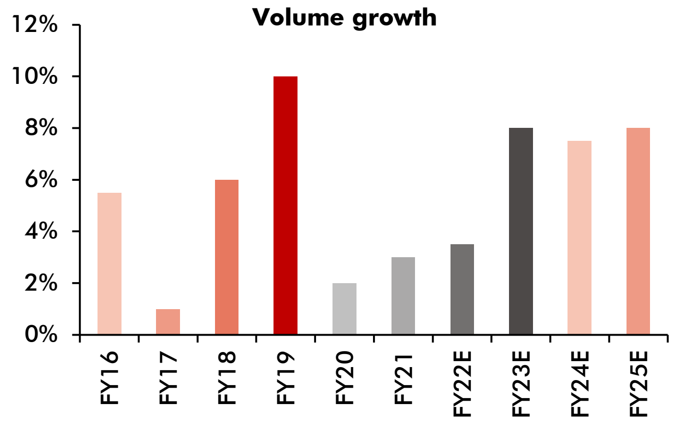


Source: Company, Ambit Capital research

Focus on volume growth over margins for now

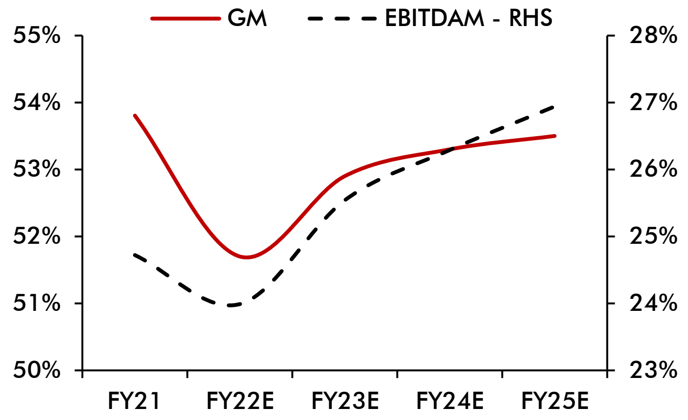
From 2QFY21, HUL has tweaked its strategy to focus on volume growth over margin expansion. This we believe is the right strategy since HUL already has amongst the top quartile GM and EBITDAM. Any further improvement will potentially give competition an opportunity to seep in and take market share by either pricing products lower or by giving higher commission to channel intermediaries. Further, HUL's quest to gain market share, premiumise categories and expand coverage into rural areas will naturally gain heft only if the product-price architecture is set to either attract more consumers or increase frequency of consumption. Thus, HUL's strategy of prioritising volume growth over margins is prudent.

Exhibit 23: Against 5% average volume growth over FY16-21, expect ~7% volume CAGR over FY21-25E



Source: Company, Ambit Capital research

Exhibit 24: -30bps/220bps GM/EBITDAM expansion (synergy benefits from GSK acq + operating leverage)



Source: Company, Ambit Capital research

Sachetising of HFD brands underwhelming

HUL's acquisition of GSK portfolio gave them an entry into the HFD category. The Indian HFD category is ~₹78bn and has grown at 6-7% CAGR over FY15-20. Horlicks and Boost together have ~55% market share and are by far the market leaders followed by Bournvita/Complan with ~15%/~6% market shares. Thus, HUL in HFD will need to act as market leader, expand market size by improving category relevance, product launches, product awareness, recruit consumers across age group, and improve penetration. This is especially important since overall penetration of the HFD category is just ~24%. In order to improve penetration, HUL introduced ₹5/₹2 sachets in various markets. While it is a good strategy, we differ owing to the following reasons:

- HFD is a nutritional category unlike tea, coffee, shampoo etc. and hence cannot be merely sachetised to recruit long-term users. Consumers will enter the category only when they see benefits of the product for which consumption duration needs to be longer and not mere once or twice through sachets.
- Grammage in ₹2 sachets may not suffice even one full glass of milk for a kid. This will not serve the purpose of the product.
- ₹2 and ₹5 sachets if available in the same markets will lead to cannibalization.
- Sachets are inherently low gross margin products, and we remain concerned on F&R GM if the share of sachets rises. While HUL has offsetting levers in place (have already stated ability to expand margins in GSK portfolio incrementally by ~300bps and we remain confident of HUL achieving it), if consumers do not upgrade in a timely manner from sachets to larger packs, medium-term cost pressures will impact segmental margins structurally.

Thus, while it is prudent for HUL to have sachets to improve penetration, prudence needs to be adhered to ensure its saliency does not reach a critical size, say >20% (current share ~15%).

Need to accelerate growth in BPC portfolio

HUL's BPC portfolio includes skin cleansing, skin care, hair care, oral care and color cosmetics. In some BPC categories like skin care and oral care, HUL has lost market share. This is owing to reducing investments in mass/economy segment end brands, increasing focus on mid and premium ranges (e.g. soaps) and consumer's shift to competing brands vs that of HUL (e.g. oral care) among others. Add to that, we believe there is limited innovation that HUL has done in this category. This has led to whitespaces in a lot of BPC categories which are getting filled by startups/D2C ecosystem (refer exhibit 25). While we acknowledge that a lot of D2C companies have yet to prove scale and profitability, the way the premium market is evolving, we believe that for HUL to retain consumers within its brands, absent innovation and filling whitespaces, it could be relatively difficult to HUL to maintain shares.

Exhibit 25: Illustrative list of potential D2C companies which are competing with HUL's brands

Brand name	Category	Sub-category	Competing HUL brands
Nykaa	BPC	Cosmetics, hair care, skin care	Laxme, Love Beauty and Planet, Tresemme, Ponds, Clinic Plus, Sunsilk
Purplle			
Sugar Cosmetics			
Plum			
Wow Skin Science		Skin care, hair care	Love Beauty and Planet, Tresemme, Ponds, Clinic Plus, Sunsilk
Mama Earth		Skin care, hair care	
Sleepy Owl	F&B	Coffee	Bru
Rage Coffee			
Blue Tokai			
MyFitness		Peanut Butter	Kissan
Veeba		Sauces, Dips, Spreads	Kissan, Hellman's

Source: Ambit Capital research

To counter this, HUL has launched its own D2C portals like Ushop, Smartpick, Lakme, etc. However, D2C companies clearly have the first mover advantage and hence for incumbents such as HUL to gain consumers' mind share, they will need to undertake one or many of the following measures: (i) spend more towards marketing; (ii) offer higher margins for product placements; (iii) create a differentiated product with better proposition; and/or (iv) acquire some of the D2C companies. Absent this, in the long term, HUL's BPC portfolio may remain relevant only for economy and mid-range products rather than seamlessly straddling across economy to premium and across all distribution platforms.

Market loss concerns cannot be overlooked

Theoretically, we assume that large organized players usually gain market share in the categories in which they are dominant. But that may not be the case across all categories for HUL. While, management has been commenting on gaining share in 75-80% of their overall portfolio, share loss in 20-25% of their portfolio (largely in BPC category, refer below exhibit) is something that we worry. Add to that, increasing competitive intensity in BPC portfolio (as highlighted earlier), would mean that potential premiumisation led share gain narrative may be at risk if HUL were not to address the emerging threat from other entrenched players as well as D2C companies.

Exhibit 26: HUL has lost share in some of the key BPC categories

Categories	Market Size (₹. Mn)	Historical CAGR (2015-20)	Projected CAGR (2020-25)	Key Players	Key Brands	Company MS (%) - 2020	MS movement over last 5 yrs
Bar Soap	232,071	5.9%	4.2%	Hindustan Unilever	Lifebuoy, Lux, Pears, Dove	36.4%	↓
				Wipro Consumer Care	Santoor	11.8%	↑
				Godrej Consumer Products	Godrej No 1, Cinthol	11.5%	↔
				Reckitt Benckiser	Dettol	9.4%	↑
				ITC	Fiama Di Wills, Vivel	4.6%	↔
Hair Care (Hair oil, Shampoo, Conditioners, Colorant, etc)	231,783	4.9%	7.6%	Marico	Parachute	16.7%	↓
				Hindustan Unilever	Clinic Plus, Dove	16.5%	↔
				Loreal	Loreal, Garnier	9.2%	↔
				Dabur	Vatika	6.7%	↓
				Procter & Gamble	Head & Shoulders, Pantene	6.2%	↓
Skin Care	151,659	8.5%	9.5%	Hindustan Unilever	Fair & Lovely, Ponds, Vaseline	39.0%	↓
				Himalaya Drug	Himalaya Herbals	7.2%	↑
				L'Oréal India	Garnier Skin Naturals	5.6%	↓
				Nivea India	Nivea	3.8%	↔
Oral Care	127,748	5.4%	4.9%	Colgate-Palmolive	Colgate	42.4%	↓
				Hindustan Unilever	Closeup, Pepsodent	16.3%	↓
				Dabur India	Dabur Red, Meswak, Babool	11.0%	↑
				Patanjali	Patanjali	10.2%	↑
Men's Grooming (Shavings, Toiletries & Fragrance)	114,366	7.0%	8.9%	Gillette India	Gillette Vector, Mach3	14.8%	↓
				Vini Cosmetics	Fogg	6.6%	↑
				Hindustan Unilever	Axe/Lynx	6.1%	↓
Colour Cosmetics	88,297	11.8%	13.3%	Hindustan Unilever	Lakme, Elle 18	14.9%	↓
				L'Oréal India	Maybelline New York	8.8%	↔
				Elca Cosmetics	Mac	4.0%	↑
				Colorbar Cosmetics	Colorbar	3.6%	↑
Baby and Child-specific Products	43,706	12.4%	11.9%	Johnson's Baby	Johnson & Johnson	43.4%	↓
				Himalaya Herbals	Himalaya Drug Co	20.9%	↑
				Dabur Lal Tail	Dabur India	4.7%	↔
				Sebamed	Sebapharma	3.3%	↑
Deodorants	39,005	7.7%	9.8%	Vini Cosmetics	Fogg	21.1%	↑
				ITC Ltd	Engage	11.4%	↑
				Hindustan Unilever	Axe/Lynx	8.7%	↓
				Nivea India	Nivea	7.3%	↓
Liquid Soap	15,488	22.9%	14.2%	Reckitt Benckiser	Dettol	48.6%	↔
				Hindustan Unilever	Lifebuoy	25.5%	↔
				Dabur India	Fem	11.7%	↔
				Colgate-Palmolive	Palmolive	2.8%	↔
Body Powder	13,715	-0.2%	-0.9%	Hindustan Unilever	Pond's	49.4%	↓
				Emami Ltd	Navratna	21.3%	↑
				Johnson & Johnson	Johnson's Baby	11.8%	↓
				CavinKare	Spinz	5.8%	↑

Source: Euromonitor International Limited 2021 © All rights reserved, Ambit Capital research; Note – 2015-2020 category growth CAGR for hair care, skin care, oral care, men's grooming, color cosmetics, body powder, air care is lower by ~150-200bps owing to soft CY2020 on account of Covid lockdown

3% rev CAGR for BPC portfolio over FY16-20 vs 4.5% rev CAGR for HUL too signifies slower growth of BPC portfolio.

Recent talent attrition worth highlighting

HUL has been winning award for best places to work over the past few years by various surveys. HUL still remains amongst top employer at India's top B-schools. However with emerging job opportunities with new age tech companies such as D2C, Flipkart, Amazon, etc there has been a talent shift that is witnessed from incumbent FMCG companies to such new age companies. Add to that HUL, being acclaimed as the CEO factory has also seen talent moving out to other entrenched FMCG cos. (refer below exhibit). HUL still is able to attract talent, but as talent now has wider opportunities makes us but worried about talent outflow seen at HUL.

Exhibit 27: Expecting 10% revenue CAGR over FY21-25E vs ~6% over FY16-21 (ex GSK acquisition)

Name	Role in HUL	Years with HUL	Exit date	New Company	Position
Sudhir Sitapati	Executive Director - Foods & Refreshment	21 years	Oct'21	Godrej Consumer	Managing Director & CEO
Geetika Mehta	General Manager Home & Hygiene, India & Regional Brand Director, South Asia	22 years	July'21	Hershey India	Managing Director
Deepika Bhan	Global Category Director, Hair Care, South Asia	17 years	April'21	Tata Consumer	President - Packaged Foods
Vikas Gupta	General Manager, Home Care division, Vice President – Digital Transformation	21 years	Jun'19	Flipkart	Head of Marketing
P B Balaji	CFO and Executive Director, Finance and IT	24 years	Nov'17	Tata Motors	Group CFO
Punit Misra	Executive Director and Vice President, Sales and Customer Development	20 years	Sep'16	Zee Entertainment	CEO - Broadcast

Source: Ambit Capital research

Independence while being subsidiary of an MNC

It is optically noticed that the Indian subsidiary of an MNC usually operates in a constrained environment, viz.: (i) their pace of innovation is slower since any new product launch requires multiple global approvals; (ii) foray into new categories should be within boundaries of the global product basket; (iii) limited scope of localization; (iv) ingredient sourcing and vendor approval takes time; (v) strategic decisions taken at global HQ vs Indian HQ, etc. A case in point being that during Covid when most Indian consumer staple companies swiftly moved to launch sanitisers and other home hygiene products, HUL in spite of having the finest R&D capabilities, manufacturing capacities and distribution network could not seize the opportunity and were relatively late to launch products owing to some of the above mentioned constraints. This said, within MNC FMCG companies operating in India, HUL has higher independence in its business operations, which is reflected in its recent M&A acquisitions (refer the below exhibit).

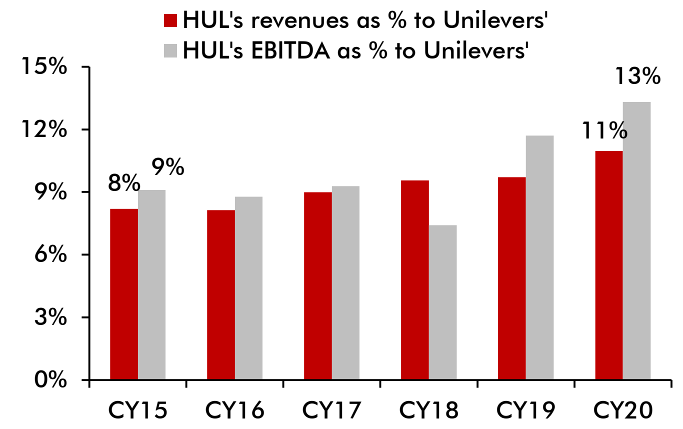
Exhibit 28: Recent acquisitions by HUL

Acq. Year	Company Acq.	Description	Comments
April'16	Induekha	Ayurvedic hair care product	The product has limited saliency in geographies outside India, still HUL got the go ahead from Unilever Plc to acquire and scale up India specific ayurvedic play.
Sep'18	Adityaa	Regional ice-cream brand	HUL is looking to improve its ice cream offerings in the value segment. For that, it acquired a regional ice cream player.
April'20	GSK India	Health Food Drinks (HFD) brands	The largest acquisitions in the consumer staples sector. Acquisition of GSK's India brands gave HUL an entry into the ₹78bn HFD category.
June'20	Vwash	Female hygiene brand	Like acquisition of Indulekha and Adityaa ice cream, this acquisition too helped HUL fill white space in personal care segment and improved negotiating power in chemist channel.

Source: Ambit Capital research

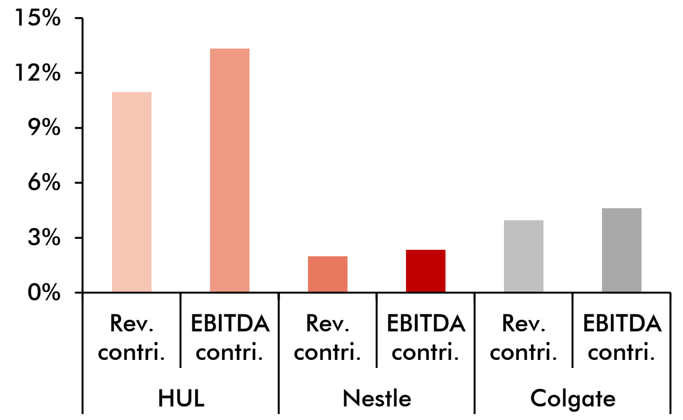
The above example convinces us that while new product and category introductions may take time within Unilever-HUL's operating environment, HUL does have higher independence to localize its products, allocate capital to bridge whitespaces to address consumers demand and undertake what is right for HUL's growth. This independence could also be an outcome of HUL's increasing contribution to Unilever Plc's revenues/margins. This according to us weighs as a strategic asset for HUL.

Exhibit 29: Consistently improving trend of HUL's revenue and EBITDA contribution to Unilever Plc



Source: Company, Ambit Capital research

Exhibit 30: HUL's share within global pie is >2x share for other FMCG cos



Source: Company, Ambit Capital research

Basis our expected growth rate of HUL and last five years average growth rate of Unilever, we expect HUL's revenue share within Unilever Plc to double by CY28E.

Unilever Plc too has been acquisitive

Over the last three years, Unilever too has done 15-17 acquisitions across different geographies (ex-India). Most of the acquisitions seem to be towards either premium PC or wellness or healthy eating. As the D2C space gallops in the Indian context, it would be crucial to see how HUL is competing organically and/or inorganically.

Exhibit 31: Unilever too has been acquisitive over the last three years

Date		Country	Acquisition	Description
2020	Apr-20	India	HFD portfolio of GSK India	Acquisition of Horlicks and Boost - health food drink brands
	Jun-20	India	Vwash	Intimate hygiene business
	Jun-20	Bangladesh	GSK Bangladesh	Acquired 82% of GSK Bangladesh, a health food drink business
	Oct-20	USA	Liquid IV	Health-science nutrition and wellness company
	Dec-20	USA	SmartyPants Vitamins	A vitamin, mineral and supplement company
2019	Jan-19	USA	Laundress	Premium eco-friendly laundry care business
	Feb-19	UK	Graze	Healthy snacking business
	Apr-19	France	Garancia	Derma-cosmetic business
	May-19	USA	Oily Nutrition	Vitamins, minerals and supplement
	Jun-19	France & Spain	Fluocaril and Parogencyl	Oral care business
	Jul-19	USA	Tatcha	Prestige skin care business
	Aug-19	Bolivia	Astrix	Personal and home care business
	Oct-19	Japan	Lenor	Premium skin care business
	Oct-19	Romania	FruFru	Healthy food business
2018	Feb-18	Latin America	Quala	Beauty & personal and home care business
	Sep-18	India	Adityaa Milk	Ice cream business
	Oct-18	Italy	Equilibra	Personal care and wellbeing business
	Nov-18	Romania	Betty Ice	Ice cream business
	Dec-18	Bulgaria	Denny Ice	Ice cream business
	Dec-18	Netherlands	Butcher	Vegetarian meat replacement foods business

Source: Ambit Capital research

Valuations: Premium for predictability and longevity, but how much?

HUL has historically traded at ~15% premium to FMCG peers on the back of: (i) wide portfolio, leadership and share gains across most of categories offering growth predictability and longevity; (ii) seeking to expand category size, improve penetration and premiumisation; (iii) M&A activities to bridge whitespaces and TAM expansion; (iv) higher EBITDAM expansion vs peers (>1,100bps over last decade vs <500bps for peers); and (v) cutting edge usage of technology, data and AI. This said, with >55% portfolio in highly penetrated categories, we expect FY21-25E revenue/EBITDA/PAT growth at 10%/12%/14%. For a long term (FY21-41E), we are building 10%/12%/15% revenue/EBIT/FCF CAGR which takes into account share gains, category expansion and benefits of premiumisation. This said, our DCF-based TP of ₹ 2,424, does not leave any upside. Our TP implies FY24E P/E of 47x, ~10% premium to peers.

Revenue/EBITDA/PAT CAGR of 10%/12%/14% over FY21-25E

Aggression in its quest towards category development, premiumisation drive and consumer-focused distribution expansion would remain revenue growth drivers. Acquisition of GSK brands (Horlicks, Boost etc.) will boost HUL's revenues in F&R. We expect HUL to see GM compression of 30bps over FY21-25E since focus is on volume growth and sharp inflationary pressures. EBITDAM expansion of 220bps over the said period will be an outcome of operating leverage, cost savings and synergy benefits from GSK acquisition.

Exhibit 32: Expecting 10% revenue CAGR over FY21-25E vs ~6% over FY16-21 (ex GSK acquisition)

₹ mn, unless specified	FY21	FY22E	FY23E	FY24E	FY25E	Comments
P&L						
Revenue	470,280	511,338	566,340	625,176	690,172	Building 10% revenue CAGR over FY21-25E
Revenue growth (%)	18.2%	8.7%	10.8%	10.4%	10.4%	Price hike and premiumisation led benefits to take revenue growth to ~10-11%
- HC	2.3%	9.0%	9.5%	9.5%	9.5%	Growth pick up in laundry care + premiumisation drive across categories
- BPC	3.1%	6.0%	11.0%	10.0%	10.0%	Growth revival in discretionary portfolio; re-positioning products in BPC to lend to overall growth
- F&R	77.2%	12.0%	11.5%	11.5%	11.5%	Acquisition of HFD to pave way for double digit growth in F&R category
Gross margin (%)	53.8%	51.7%	52.9%	53.3%	53.5%	Conscious strategy of calibrated price hikes to result in ~30bps GM compression over FY21-25E
Ad spends (%)	10.1%	10.0%	9.8%	9.7%	9.5%	SOV to improve but changing avenues for ad spends to result in ad spends as % of sales slightly moderation by ~30-50bps
Royalty (%)	2.6%	2.6%	2.6%	2.6%	2.6%	Maintaining royalty at an existing rate
EBITDA	116,260	123,180	144,642	164,358	185,931	
EBITDA growth (%)	17.9%	6.0%	17.9%	13.6%	13.1%	
EBITDA margin (%)	24.7%	24.1%	25.5%	26.3%	26.9%	EBITDAM expansion to come from operating leverage, synergy benefit from integration of HFD and cost rationalisation initiatives
PAT growth (%)	18.3%	5.9%	20.5%	15.0%	13.9%	
EPS	35.1	37.1	44.5	51.2	58.3	Estimating 14% EPS CAGR over FY21-25E
Cash flow statement						
Operating cash flow	91,630	107,502	124,291	140,988	159,067	
Free cash flow	50,970	98,553	114,380	130,673	147,680	High OCF to FCF conversion owing to lower capex
Ratios						
Gross asset turnover (x)	2.3	2.4	2.6	2.7	2.8	Pre-acquisition of GSK, asset turnover was >5x, reduced to ~2.5x owing to recognition of brand of ₹ 277bn
RoCE (%)	37.9%	21.3%	26.0%	30.7%	36.0%	
RoE (%)	29.5%	18.4%	22.2%	25.1%	28.1%	RoE too dropped from >75% has dropped to ~20; expect steady improvement to ~28% by FY25E

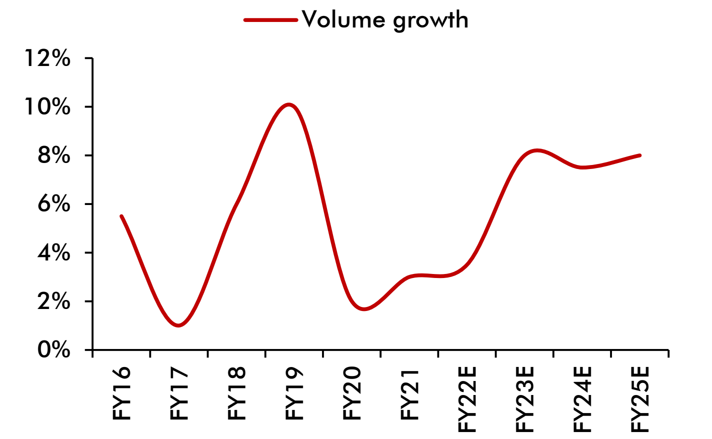
Source: Company, Ambit Capital research

Exhibit 33: We are broadly in line with consensus across revenue, EBITDA and PAT

₹ mn	Ambit estimates			Consensus estimates			vs consensus		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues	511,338	566,340	625,176	510,976	568,683	627,769	0%	0%	0%
EBITDA	123,180	144,642	164,358	126,834	147,573	167,631	-3%	-2%	-2%
PAT	87,249	104,667	120,369	89,411	105,962	121,130	-2%	-1%	-1%

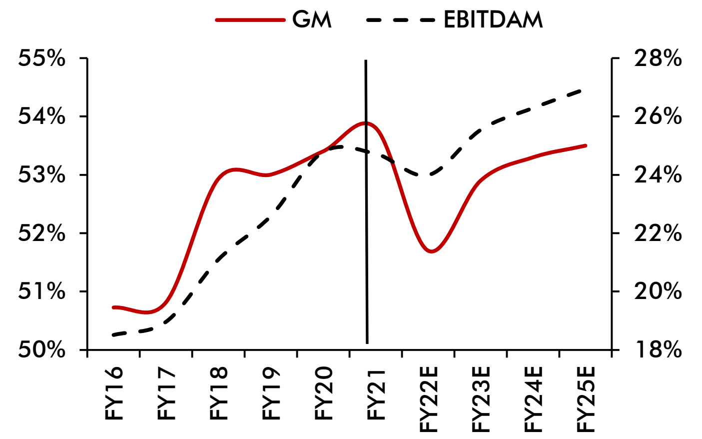
Source: Bloomberg, Ambit Capital research

Exhibit 34: Volumes to recover as discretionary portfolio should also see recovery



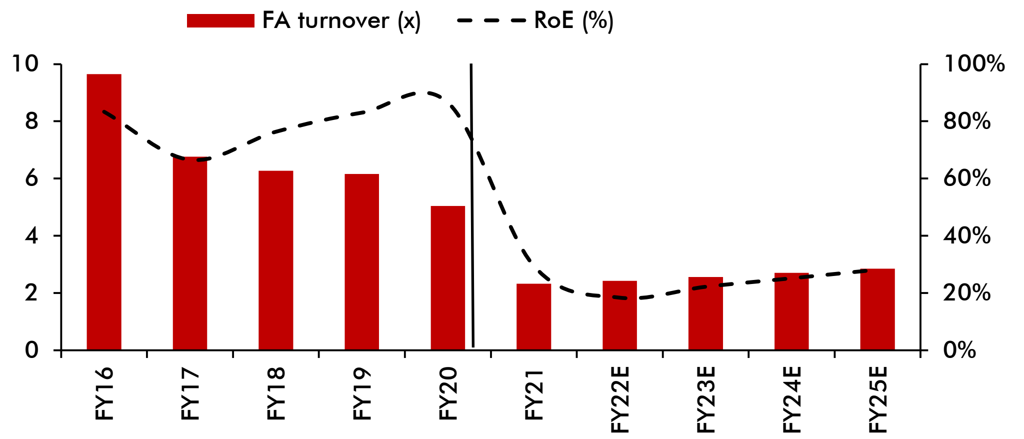
Source: Company, Ambit Capital research

Exhibit 35: (30)/220bps GM/EBITDAM expansion over FY21-25E vs 310/620bps seen over FY16-21



Source: Company, Ambit Capital research

Exhibit 36: Acquisition of GSK consumer led dip in FA turnover to 2.3x from >6x and RoE to ~20% from >75%; gradual improvement expected as we estimate 2% NW/balance sheet growth vs ~10%/14% revenue/PAT growth



Source: Company, Ambit Capital research

Absolute valuations: DCF adequately captures long-term value accretion

Levers to gain market share in overall FMCG market persists

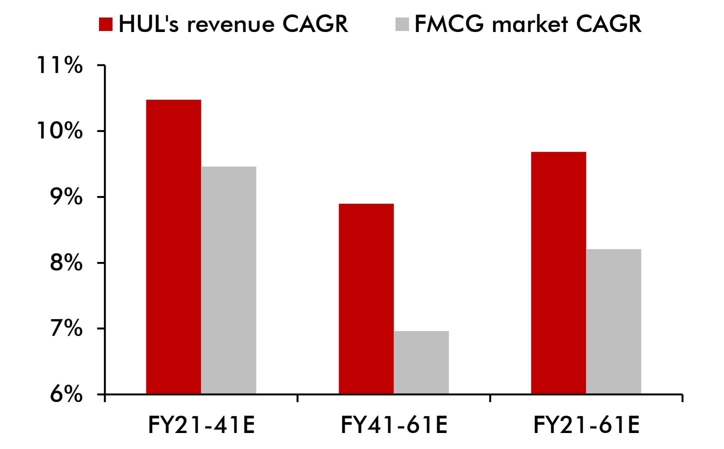
Our FY21-25E revenue, EBITDA and PAT estimates of 10%, 12% and 14% are in line with consensus on revenue but marginally below consensus on EBITDA/PAT. In our DCF-based valuation model, we build 10%/12%/14% revenue/EBIT/FCF CAGR over FY21-41E. After FY41E, we build in two-stage terminal growth – 8.4% over FY41-61E and 6% beyond FY61E. Long-term estimates are based on:

- macro tailwinds to aid in GDP per capita growth of CAGR of 9% and FMCG per capita spends CAGR of 7%;
- HUL to clock market share gains from improving penetration, premiumisation, and product placement;

- TAM expansion by building newer brands across BPC and F&R segments;
- Share gains from regional and unorganized players.

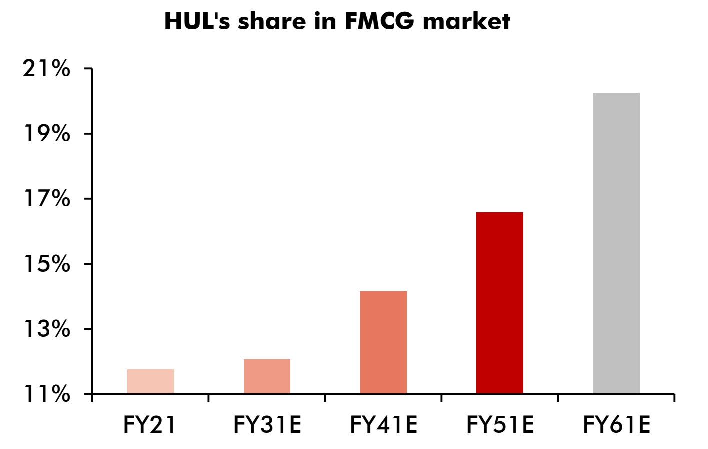
These will push HUL's share in FMCG from ~12% currently to ~20% by FY61E.

Exhibit 37: Expect HUL to clock ~100bps/190bps faster revenue growth vs FMCG (expected to grow at 150-200bps lower than GDP growth)...



Source: Company, Ambit Capital research

Exhibit 38: ...which will lead to HUL's share in FMCG market improving from ~12% to 17% by FY61E



Source: Company, Ambit Capital research; Note: For detailed calculation of FMCG market sizing, refer thematic section

Exhibit 39: Revenue growth estimates an outcome of HUL's strategic initiatives coupled with macro tailwinds

	Growth rate	Comments
FY21-25E	10.1%	Growth aided from soft base of FY21 as well as low double digit growth from GSK portfolio
FY21-31E	10.6%	With focus shifting to revenue growth, expect penetration and premiumisation led revenue growth
FY21-41E	10.4%	With GDP/capita likely to cross USD5,000 from FY31, expect pick up in premium portfolio across categories

Source: Company, Ambit Capital research

Capital allocation

As of FY21, HUL's cash and liquid investments stood at ₹71.8bn. We expect FCF CAGR of 14% over FY21-41E. In spite of building a dividend payout ratio of 95% over the period, HUL will likely see strong cash accumulation (refer below exhibit) over the forecast period. This means, from a valuation standpoint, capital allocation plays a very crucial role.

Exhibit 40: Strong cash flow accumulation would mean taking a second guess on HUL's capital allocation

₹ bn	FY22E	FY23E	FY24E	FY25E
Operating cash flow	107	124	141	159
Less:				
Capex	(9)	(10)	(10)	(11)
Free cash flow	98	114	131	148
Dividends	(94)	(100)	(112)	(129)
Annual cash surplus	4	15	19	18
Opening cash balance	72	76	90	110
Closing cash balance	76	90	110	128

Source: Company, Ambit Capital research

Exhibit 41: Expect M&A activities to accelerate for HUL followed by potential buyback of shares

Capital allocation strategy	Prob-ability	Remarks
Capex		Last decade capex as % of sales was 1.8%; expect this pace to sustain over coming years
M&A		Considering HUL has undertaken four acquisitions over last five years; strong possibility of capital being deployed towards inorganic acquisitions
Dividend payout		Already building 95% payout ratio (~94% average payout ratio maintained over last decade)
Buyback of shares		Last buyback done in 2013; Strong chances of buyback getting announced in the next 2-3 years

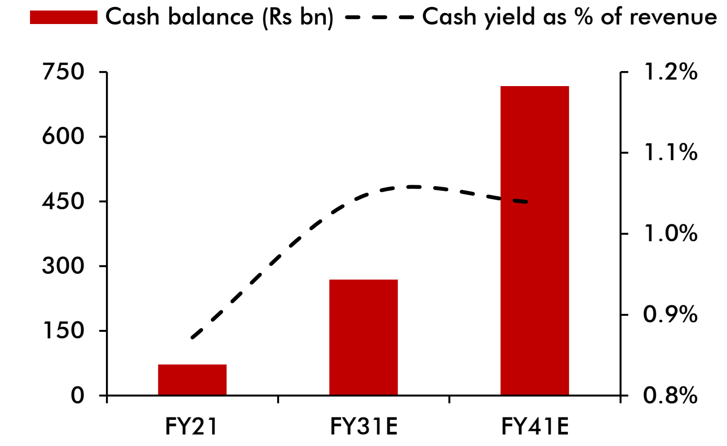
Source: Company, Ambit Capital research;

That said, while building DCF, we are not factoring any potential M&A. Hence, cash accumulation is factored into valuations by increasing other income.

EBIT margin expansion & capital allocation

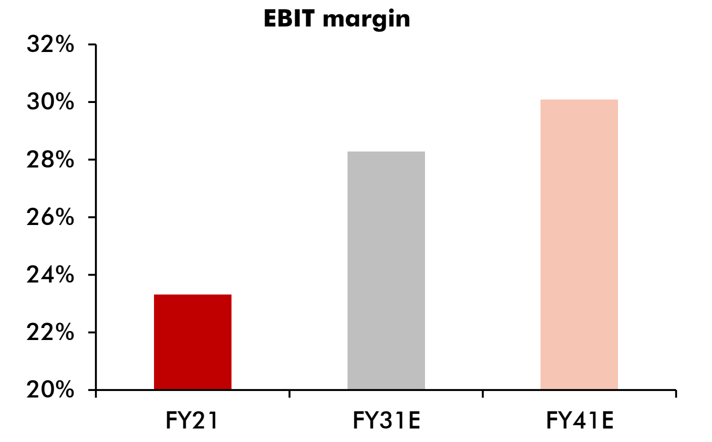
Over the past decade (FY11-21), HUL has posted EBIT margin (including other income) expansion of 950bps YoY. From FY21-41E, we expect EBIT margin (including other income) expansion of 680bps YoY. This expansion will be an outcome of not only EBITDAM expansion but also increasing cash yield.

Exhibit 42: Higher cash accumulation → increase in other income despite declining interest rates from 6% to 4%...



Source: Company, Ambit Capital research

Exhibit 43: ...coupled with EBITDAM expansion to aid in 680bps EBIT margin expansion till FY41E



Source: Company, Ambit Capital research

Exhibit 44: Scenario analysis of TP basis different CoE and TG levels

		Cost of Equity				
		10.0%	**10.5%**	**11.0%**	**11.5%**	**12.0%**
	5.0%	3,241	2,816	2,474	2,195	1,964
	5.5%	3,364	2,901	2,534	2,238	1,995
TG	**6.0%**	3,517	3,005	2,606	2,289	2,032
	6.5%	3,715	3,135	2,694	2,350	2,075
	7.0%	3,978	3,301	2,804	2,424	2,126

Source: Ambit Capital research

What can change valuations?

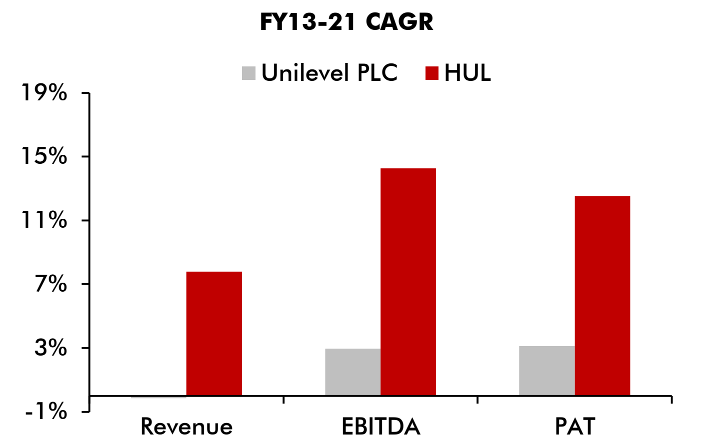
While building DCF valuations, we have currently not factored in certain structural events that are likely to play out over the next few years. This is because, at the current juncture, we are unable to quantify the impact of certain events in HUL's financial statements. This said below exhibit summarises the events, their likely impact on P&L and hence cash flow/valuations along with the probability of the event materialising.

Exhibit 45: These events can potentially change long-term valuation estimates; but quantifying them is difficult at the current juncture

Event	Impact on P&L	Impact on Cash flow	Probability
Distribution moving towards eB2B channels	☹	☹	◕
Extension of credit to eB2B channels	😐	☹	◕
Bargaining power vis-à-vis distribution platforms	☹	☹	◕
Inorganic acquisitions	☺	☺	●
Scale up of competing D2C brands impacting HUL's premiumisation	☹	☹	◑
Impact of factoring environment & sustainability initiatives	☹	☹	◑

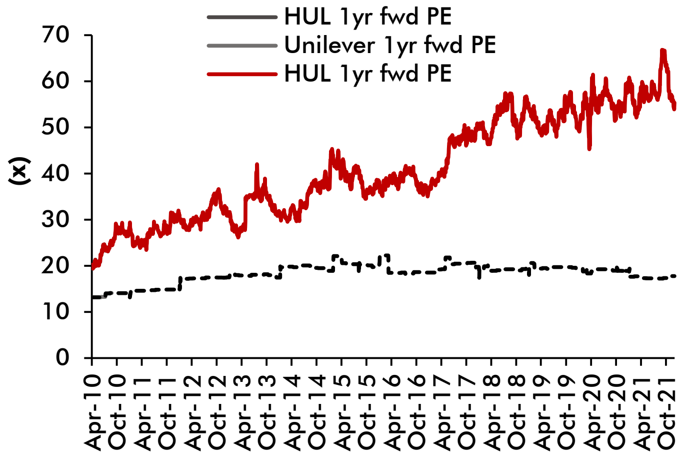
Source: Ambit Capital research Note: ● *- Strong;* ◕ *- Relatively Strong;* ◑ *- Average;* ◔ *- Relatively weak*

Exhibit 46: Unilever's EBITDA and PAT CAGR 1/3rd that of HUL's over the last 8 years…



Source: Company, Ambit Capital research

Exhibit 47: …which drove Unilever's flattish P/E multiple vs 3x re-rating at HUL



Source: Company, Ambit Capital research

Catalysts & risks

Catalysts

- **Share loss in BPC:** 9% CAGR growth in BPC builds in HUL being able to see growth revival in its skin cleansing and oral care portfolio. Any change to that can lead to downside risk to our 9% CAGR estimate.
- **Double digit growth in HFD category:** Double digit growth in HFD hinges on HUL's success in increasing penetration of HFD category. To us sachet is not an appropriate strategy and hence in case of subdued penetration led growth will mean revenue and margin pressure in HFD category vs estimated.
- **Growth bounce back in FY23E:** FY23E revenue growth estimate of 10.8% YoY implies rural distress will not continue in FY23E. Any continuation of stress in rural India will lead to cut in FY23E revenue estimates for us and consensus.
- **Inflationary pressures:** Recent inflationary pressures will lead to 200bps YoY GM compression in FY22E. Elevation to current RM prices will further put to risk GM for FY22E.
- **Aggression from D2C companies:** Multiple D2C companies are getting aggressive especially in BPC and F&R categories. Inability of HUL to seize the premiumisation play in those two categories can put MT to LT revenue growth and margin expansion at risk.

Risks

- **HUL's distribution revamp strategies**: HUL is taking pioneering steps in its distribution model through Shikhar app, 3.2mn+ direct reach, rural distribution through Shakti entrepreneurs, etc. This distribution revamp may lead to industry leading growth which can surprise us on revenue growth.
- **Macro tailwinds**: While estimating category wise growth rates, we are cognizant of government's initiative to spur GDP growth. However any efforts which can lift GDP/capita beyond 11% CAGR over FY21-25E can potentially lead to higher disposable income and thus acceleration in consumer spends.
- **M&A activities**: We highlight that prudent capital allocation strategy for HUL is to look for inorganic activities across its categories to weed off possible emerging competition, expand TAM, etc. If HUL is able to undertake few more large M&A acquisitions like GSK's brands, HUL's operating playbook will change significantly which can change the near to medium term growth dynamics for HUL.
- **Better than expected EBITDAM expansion:** In line with management's strategy of focusing on volume growth, we are factoring only 220bps EBITDAM expansion over FY21-25E. Higher margin expansion either coming from product mix led GM expansion or better cost savings can lead to earnings upgrade.

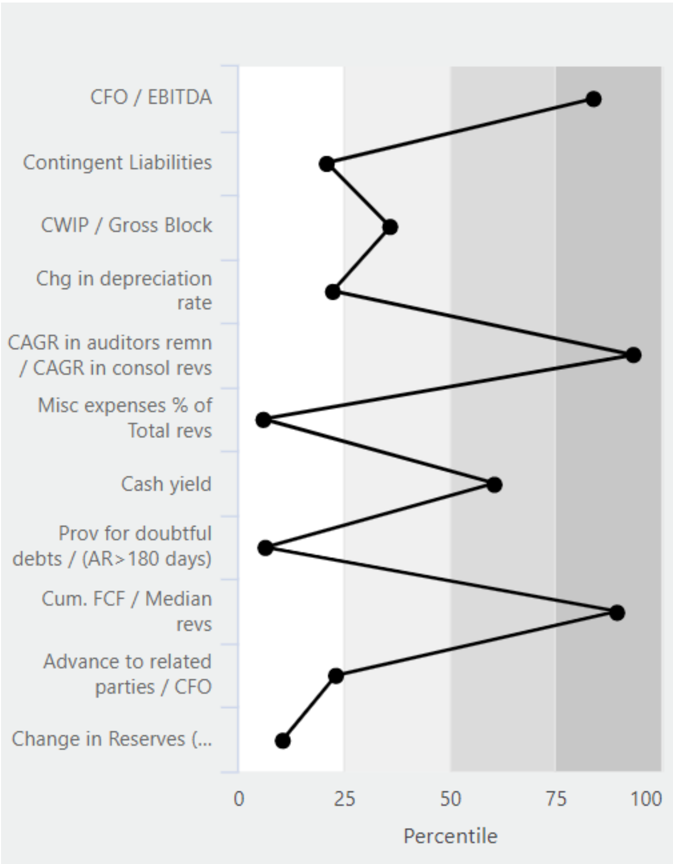
Ambit's HAWK Analysis

On our accounting framework, HUL features in D6, which falls under 'Zone of Pain'. HUL scores high on parameters such as CFO/EBITDA, CAGR in auditor remuneration to consolidated revenue and cum. FCF/median revenue. On our greatness framework HUL has consistently featured in the 'Good, but not great' zone over FY15-20 and ranks better than sector (64th percentile) and universe (72nd percentile) median percentile.

Key contributors to accounting scores

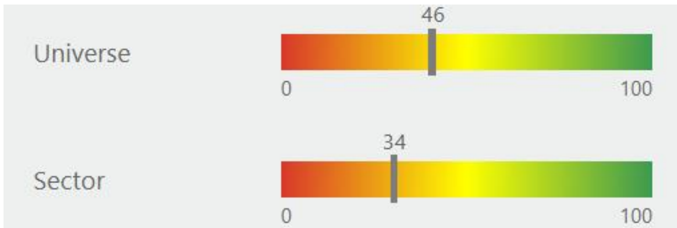
HUL has remained in D6 decile in FY19 and FY20 on our forensic accounting framework. Post-acquisition of GSK India, accounting ratios have been volatile. HUL scores high on parameters such as CFO/EBITDA, CAGR in auditor remuneration to consolidated revenue and cum. FCF/median revenue. However, it scores low on certain parameters such as misc. expenses, advances to related parties, contingent liabilities, and volatility in depr. rate and change in reserves. Our analysis of FY21 data suggests improvement in contingent liabilities as % of NW and CWIP/gross block. Volatility in deprecation rate increased due to acquisition of GSK India. HUL scores lower than its median accounting score for its sector (34th percentile) and universe (46th percentile).

Exhibit 48: Forensic accounting score contributors



Source: Company, Ambit Capital research

Exhibit 49: Forensic score percentile to universe and sector

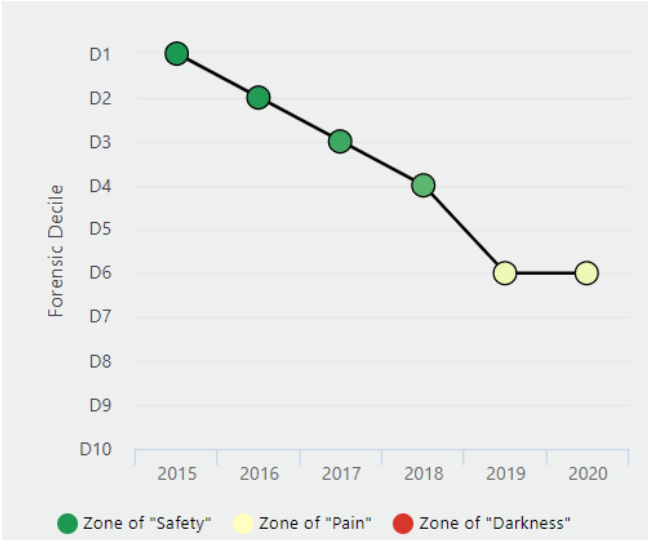


Source: Company, Ambit Capital research

Comments on evaluation of accounting scores

HUL's accounting score has deteriorated over FY15-20 from D1 ('Zone of Safety') in FY15 to D6 ('Zone of Pain') in FY20.

Exhibit 50: Forensic accounting score evolution



Source: Company, Ambit Capital research

Exhibit 51: Movement in accounting checks

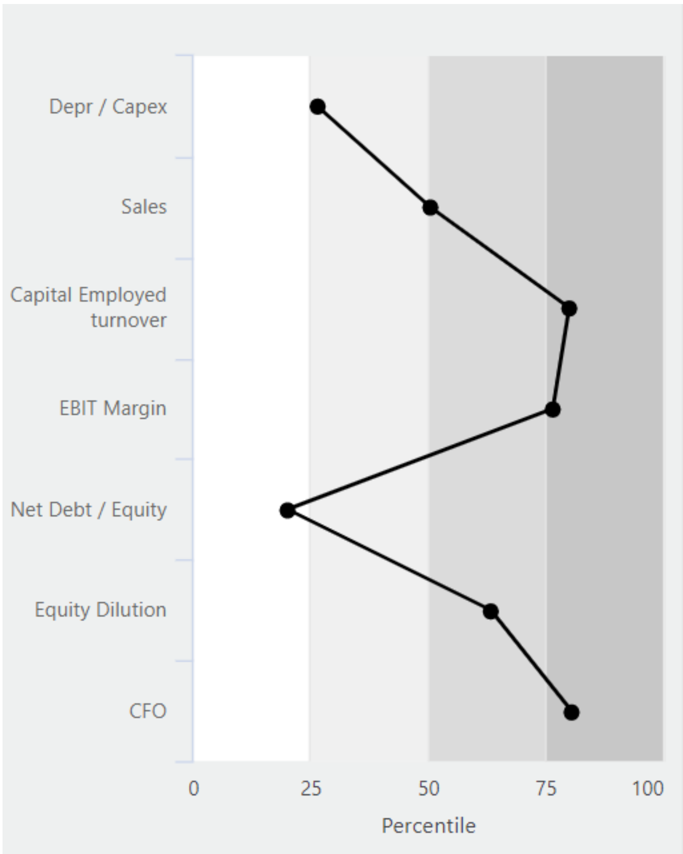
Category	Accounting ratios	FY19	FY20	FY21
P&L mis-statement check	CFO/EBITDA	96%	103%	100%
	Volatility in depreciation rate	18	458	886
	PFD - % of debtors beyond credit period	NA	NA	NA
Balance sheet mis-statement check	Cash yield	7%	7%	4%
	Change in reserves (ex-sec prem) / (PAT ex dividend)	0.15	0.09	(0.31)
	Cont liab - % of NW	25.0%	32.0%	5.0%
Pilferage checks	Misc exps - % of total revs	4.0%	4.0%	5.0%
	Adv to related parties / CFO	4%	3%	3%
	CWIP / Gross block	7.0%	8.0%	2.0%
	Cum. FCF / median revs	14%	24%	16%
Audit quality checks	Auditor's rem CAGR/revenue CAGR	(2.0)	(1.6)	(0.5)

Source: Company, Ambit Capital research;

Evolution of greatness score

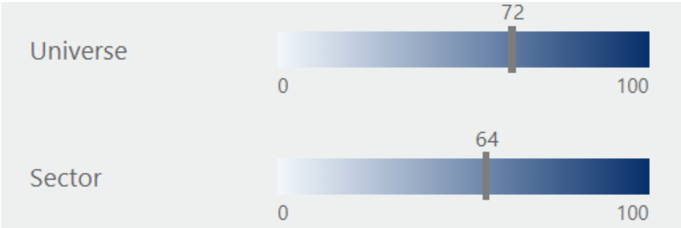
Our greatness framework evaluates companies on drivers of 'Greatness' (e.g. cash generation, incremental capex, efficiency in capital employed turnover, etc.). HUL has consistently remained in 'Good, but not great' zone in our greatness framework.

Exhibit 52: Greatness score contributors



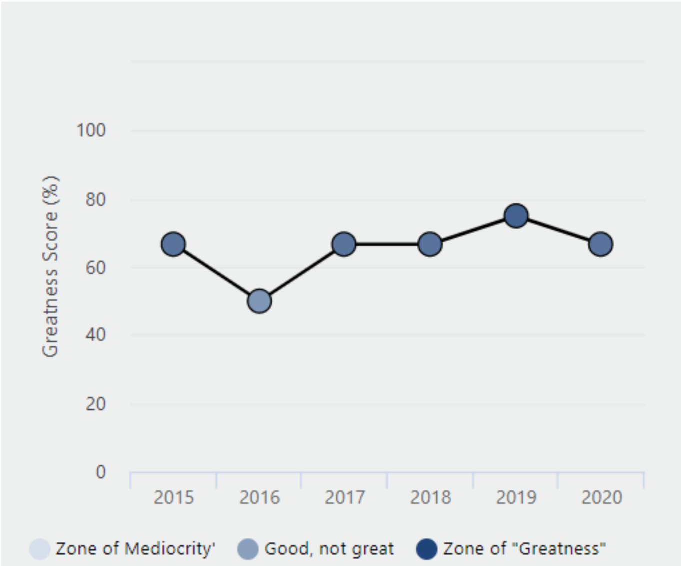
Source: Company, Ambit Capital research

Exhibit 53: Greatness score percentile to universe and sector



Source: Company, Ambit Capital research

Exhibit 54: Greatness score evolution



Source: Company, Ambit Capital research

Exhibit 55: Explanation to our flags

Segment	Score	Comments
Accounting	GREEN	HUL is in D6, zone of pain on our forensic accounting framework. HUL score high on CFO/EBITDA, CAGR in auditor remuneration to consol. revenue and cum. FCF/median revenue but scores low on misc. expenses, advances to related parties, contingent liab, and volatility in depr. rate and change in reserves.
Predictability	GREEN	HUL's portfolio includes items of daily necessities. Further with leadership in ~75% of portfolio also bring in higher revenue predictability.
Earnings momentum	AMBER	Consensus numbers have largely been downgraded.

Source: Company, Ambit Capital research

Financials

Balance Sheet

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Shareholders' equity	2,350	2,350	2,350	2,350	2,350
Reserves & surpluses	474,390	467,639	472,431	481,175	489,000
Total networth	**476,740**	**469,989**	**474,781**	**483,525**	**491,350**
Minority Interest	200	-	-	-	-
Debt	-	-	-	-	-
Deferred tax liability	60,920	60,920	60,920	60,920	60,920
Total liabilities	**537,860**	**530,909**	**535,701**	**544,445**	**552,270**
Gross block	202,110	211,058	220,969	231,285	242,673
Net block	341,270	339,269	337,840	336,396	335,580
Deferred tax assets	185,040	183,670	182,500	181,330	180,160
CWIP	7,450	7,450	7,450	7,450	7,450
Investments	**27,090**	**27,090**	**27,090**	**27,090**	**27,090**
Cash & equivalents	44,710	50,433	66,108	86,325	105,925
Debtors	17,580	18,212	20,171	22,267	24,581
Inventory	35,790	36,424	40,342	44,533	49,163
Loans & advances	2,510	2,729	3,023	3,337	3,684
Other current assets	13,500	14,679	16,258	17,947	19,812
Total current assets	114,090	122,477	145,901	174,408	203,165
Creditors	88,020	95,705	105,999	117,011	129,176
Current liabilities	28,210	30,673	33,972	37,502	41,400
Provisions	20,850	22,670	25,109	27,717	30,599
Total current liabilities	137,080	149,048	165,080	182,230	201,175
Net current assets	**(22,990)**	**(26,571)**	**(19,179)**	**(7,822)**	**1,990**
Total assets	**537,860**	**530,909**	**535,701**	**544,445**	**552,270**

Source: Company, Ambit Capital research

Income statement

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Operating income	**470,280**	**511,338**	**566,340**	**625,176**	**690,172**
% growth	18.2%	8.7%	10.8%	10.4%	10.4%
Operating expenditure	354,020	388,158	421,698	460,819	504,241
EBITDA	**116,260**	**123,180**	**144,642**	**164,358**	**185,931**
% growth	17.9%	6.0%	17.4%	13.6%	13.1%
Depreciation	10,740	10,949	11,341	11,759	12,204
EBIT	**105,520**	**112,231**	**133,302**	**152,599**	**173,727**
Interest expenditure	1,170	1,170	1,170	1,170	1,170
Non-operating income	4,100	4,500	6,500	8,000	9,000
Adjusted PBT	**108,450**	**115,561**	**138,632**	**159,429**	**181,557**
Tax	26,060	28,313	33,965	39,060	44,481
Adjusted PAT/ Net profit	**82,390**	**87,249**	**104,667**	**120,369**	**137,075**
% growth	18.3%	5.9%	20.0%	15.0%	13.9%
Extraordinaries	(2,400)	-	-	-	-
Reported PAT / Net profit	79,990	87,249	104,667	120,369	137,075
Share of associates	-	-	-	-	-
Adjusted Consolidated net profit	**79,990**	**87,249**	**104,667**	**120,369**	**137,075**
Reported Consolidated net profit	**79,990**	**87,249**	**104,667**	**120,369**	**137,075**

Source: Company, Ambit Capital research

Cash flow statement

Year to March (₹. Mn)	FY21	FY22E	FY23E	FY24E	FY25E
EBIT	105,520	112,231	133,302	152,599	173,727
Depreciation	10,740	10,949	11,341	11,759	12,204
Others	2,440	3,330	5,330	6,830	7,830
Tax	(26,060)	(28,313)	(33,965)	(39,060)	(44,481)
(Incr) / decr in net working capital	(1,010)	9,304	8,283	8,860	9,788
Cash flow from operations	**91,630**	**107,502**	**124,291**	**140,988**	**159,067**
Capex	(40,660)	(8,948)	(9,911)	(10,315)	(11,388)
(Incr) / decr in investments	23,370	-	-	-	-
Others	-	-	-	-	-
Cash flow from investments	**(17,290)**	**(8,948)**	**(9,911)**	**(10,315)**	**(11,388)**
Net borrowings	-	-	-	-	-
Issuance of equity	-	-	-	-	-
Interest paid	(1,170)	(1,170)	(1,170)	(1,170)	(1,170)
Dividend paid	(88,110)	(94,000)	(99,875)	(111,625)	(129,250)
Others	(3,810)	2,340	2,340	2,340	2,340
Cash flow from financing	**(93,090)**	**(92,830)**	**(98,705)**	**(110,455)**	**(128,080)**
Net change in cash	(16,740)	5,723	15,675	20,218	19,600
Closing cash balance	44,710	50,433	66,108	86,325	105,925
Free cash flow	**50,970**	**98,553**	**114,380**	**130,673**	**147,680**

Source: Company, Ambit Capital research

Ratio analysis

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Gross margin (%)	53.8%	51.8%	52.9%	53.3%	53.5%
EBITDA margin (%)	24.7%	24.1%	25.5%	26.3%	26.9%
EBIT margin (%)	22.4%	21.9%	23.5%	24.4%	25.2%
Net profit margin (%)	17.5%	17.1%	18.5%	19.3%	19.9%
Dividend payout ratio (%)	119.0%	107.7%	95.4%	92.7%	94.3%
Net debt: equity (x)	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)
Working capital turnover (x)	(6.9)	(6.6)	(6.6)	(6.6)	(6.6)
Gross block turnover (x)	2.3	2.4	2.6	2.7	2.8
RoCE (%)	37.9%	21.3%	26.0%	30.7%	36.0%
RoE (%)	29.5%	18.4%	22.2%	25.1%	28.1%

Source: Company, Ambit Capital research

Valuation parameters

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
EPS (₹)	35.1	37.1	44.5	51.2	58.3
Diluted EPS (₹)	35.1	37.1	44.5	51.2	58.3
Book value per share (₹)	220.5	217.3	219.6	223.6	227.2
Dividend per share (₹)	40.5	40.0	42.5	47.5	55.0
P/E (x)	68.2	64.4	53.7	46.7	41.0
P/BV (x)	10.8	11.0	10.9	10.7	10.5
EV/EBITDA (x)	47.9	45.2	38.4	33.6	29.6
Price/Sales (x)	11.9	11.0	9.9	9.0	8.1

Source: Company, Ambit Capital research

AMBIT
Acumen at work

Marico

BUY

INITIATING COVERAGE	MRCO IN EQUITY	January 18, 2022

Widening growth levers

Marico is transitioning from a hair oil company to a hair care and health foods company. Success in oats took time, but playbook for expansion into health food (opportunities galore!) is in place. It found success in Beardo and, with changing times, is getting aggressive on its D2C journey too, organically and inorganically. In the international business, Bangladesh is key with scale-up of non-coconut oil portfolio and cross-pollination opportunities reflecting growth longevity. Our DCF-based TP of ₹580 (11%/9% rev/FCF CAGR over FY21-41E) implies 43x FY24E P/E (in line with median FMCG valuations), 10% premium to last 3-year average owing to improved breadth of portfolio. Risks: Softening growth in edible oil and limited scale-up of foods portfolio.

Competitive position: STRONG   Changes to this position: NEUTRAL

Strengthening core portfolio

Despite higher penetration of coconut oil and 62% market share, Parachute has delivered 11% revenue CAGR over FY13-21. Parachute still has room to gain share, thereby clocking ~8% revenue CAGR over FY21-25E (5-7% volume-led). Addressing past concerns (product portfolio gaps across different price strata's), value-added hair oil's (VAHO) course correction should help it clock 13% revenue CAGR over FY21-25E, albeit on a low base.

Shift towards healthy eating

Increasing preference and penetration of Saffola edible oil (82% share in premium edible oil) should help it clock 12% revenue CAGR over FY21-25. Riding on Saffola's health-focused brand equity, Marico is foraying in established health food categories (refer exhibit 35) with market size of ₹8-15bn with an aim to reach ~10% share to begin with vs building new categories. Looking at dynamics and growth potential of the categories it is exploiting (soya chunks, honey etc.), we see larger right to win for Marico and thus expect 37% revenue CAGR over FY21-25E.

Adept at managing inflationary pressures

Marico has high RM cyclicality compared to peers due to high dependence on copra (~50% of COGS). But in each copra inflation cycle, Marico has always gained share at the end of the cycle (refer exhibit 18,19). This showcases Marico's institutionalized approach to tackle sharp inflation pressures. As Marico implements this playbook in the current inflation cycle, it has higher chances of gaining share in other portfolios (edible oil, VAHO) too.

BUY for widening breadth of earnings

Penetration-led growth in edible oils, VAHO and scale up of health foods portfolio and share gains in Parachute should lead to 12%/14% revenue/PAT CAGR over FY21-25E. In the long term (FY21-41E), the same growth drivers coupled with premiumisation in hair care should help Marico clock 11%/9% revenue/FCF CAGR and 300bps EBIT margin expansion.

Key financials

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Net revenues (₹ mn)	80,480	91,922	102,424	114,424	127,161
EBITDA (₹ mn)	15,910	16,178	19,256	23,171	25,877
Net Profit (₹ mn)	11,990	12,124	14,517	17,566	19,714
Adjusted EPS (₹)	9.2	9.4	11.3	13.6	15.3
RoE (%)	37.9%	36.2%	40.5%	45.3%	46.8%
P/E (x)	54.5	53.3	44.5	36.8	32.8

Source: Company, Ambit Capital research

Consumer Staples

Recommendation

Mcap (bn):	₹648/US$8.7
6M ADV (mn):	₹1,160/US$15.6
CMP:	₹501
TP (12 mths):	₹580
Upside (%):	16%

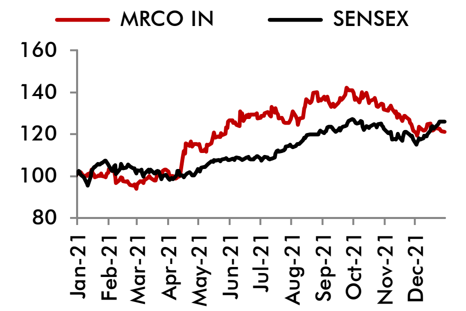
Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	GREEN

Catalysts

- 16%/11% YoY revenue growth in VAHO for FY22E/23E.
- 50%/40% YoY revenue growth in Saffola foods portfolio in FY22E/23E.

Performance (%)



Source: Bloomberg, Ambit Capital Research

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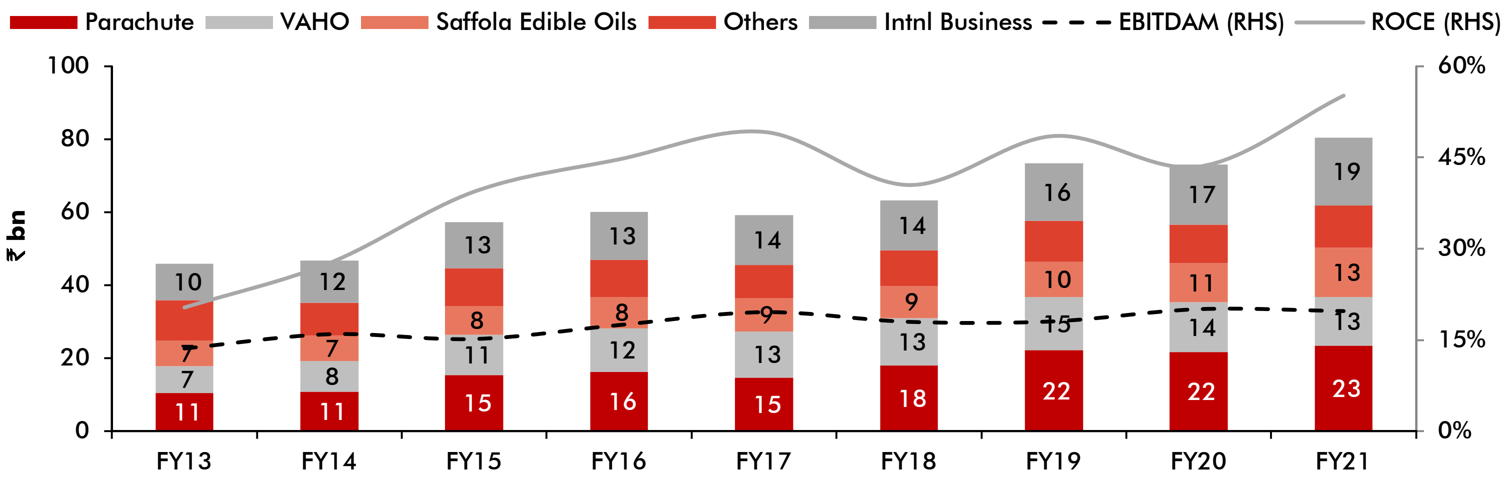
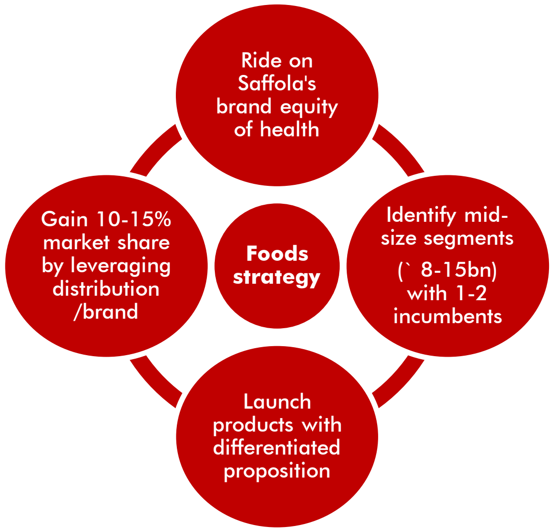
The Narrative in Charts

Exhibit 1: Despite leadership in penetrated hair oil, Parachute grew 11% over FY13-21; growth in VAHO, Saffola and IB has been steady at ~8%; despite RM cyclicality, EBITDAM expanded 620bps and RoCE has more than doubled



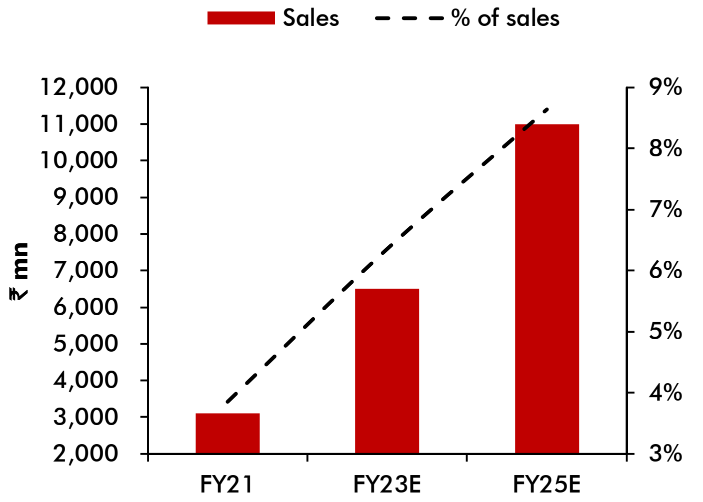
Source: Company, Ambit Capital research; Note – FY13 includes revenues from Kaya (included under others), Kaya was demerged w.e.f. on April 1st, 2013;

Exhibit 2: Management's new strategy and focus on healthy food under Saffola (ex-edible oil) should help…



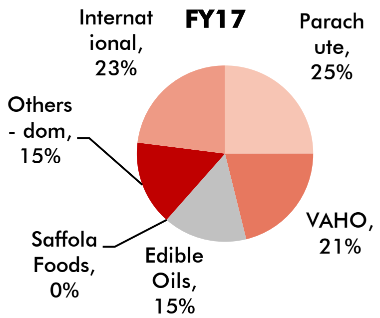
Source: Company, Ambit Capital research

Exhibit 3: …take foods category sales from ~₹3bn to ₹11bn by FY25; contribution to reach ~10% (~4% now)



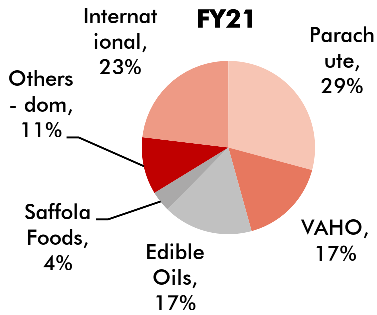
Source: Company, Ambit Capital research

Exhibit 4: Performance of VAHO and others lagged in the last five years…



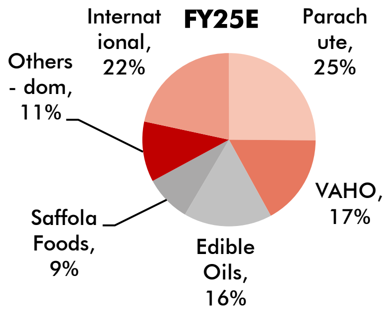
Source: Company, Ambit Capital research

Exhibit 5: …resulting in increasing saliency of Parachute & edible oils



Source: Company, Ambit Capital research

Exhibit 6: Course correction in VAHO, widening food play to normalize share of Parachute and IB



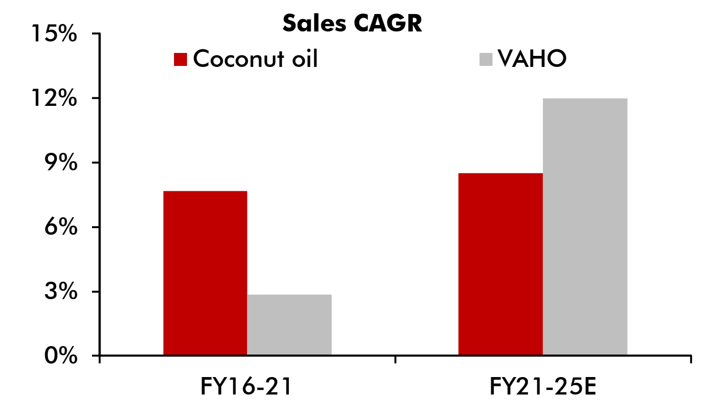
Source: Company, Ambit Capital research

Exhibit 7: Why foods portfolio can potentially grow at 37% CAGR over FY21-25E

Existing products	Remarks	Potential to cross ₹1.5bn by FY25	Likely category foray	Key Competition	Probability of success
Oats	Already >₹2bn brand		Chyawanprash	Dabur, Emami, Baidyanath	
Honey	By focussing on MT and e-com		Healthy spreads	Nutella, Hershey, Nutralite, Sundrop	
Oodles	Healthy proposition vs fried noodles of Maggi		In between RTE/RTC meals	MTR, Aashirvaad, Tata Sampann, Maggi	
Soya nuggets	Limited competition		Millets, Ragi based snacks	Kellogg's, Tata Soulfull, True Elements, Yoga Bar	

Source: Company, Ambit Capital research

Exhibit 8: VAHO products at bottom of pyramid + functional hair care products should aid growth of VAHO



Source: Company, Ambit Capital research

Exhibit 9: Portfolio now straddles price pyramid; expect more launches in functional problem solving hair oils

Marico VAHO Brands	₹./100ml	Category
Nihar Shanti Amla	32	Amla Oils
Parachute Jasmine	40	VACNO
Nihar Jasmine	41	VACNO
Parachute Advanced Aloe Vera Coconut Hair Oil	48	VACNO
Hair & Care with Aloe Vera, Olive Oil & Green Tea	50	Light Hair Oils
Parachute Advansed Ayurvedic Coconut Hair Oil	62	Anti-Hair Fall

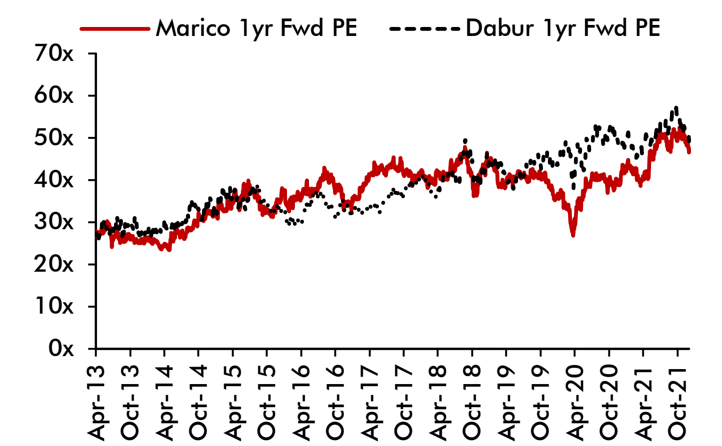
Source: Company, Ambit Capital research; Note – above are a few popular brands in the VAHO segment and prices are based on MRP (excluding any discounts); VACNO – Value added coconut hair oil

Exhibit 10: Marico likely to clock ~12% revenue CAGR over FY21-25E vs 6% over FY16-21 led by growth from foods, Saffola edible oil and VAHO

Geography	Categories	% of Sales	Growth Driver	Historical CAGR (FY16-21)	Estimated CAGR (FY22-25E)
India	Parachute	29%	Gains from unorganized sector, increase in market share in rural	8%	8%
	Edible oils	17%	Increasing shift towards healthy lifestyle	10%	10%
	VAHO	17%	Product for bottom of pyramid, Premiumisation, and increasing demand for functional products	2%	12%
	Foods	4%	Penetration, distribution expansion and new product launches	NA	33%
International		23%	Bangladesh and Vietnam to lead the growth	7%	10%

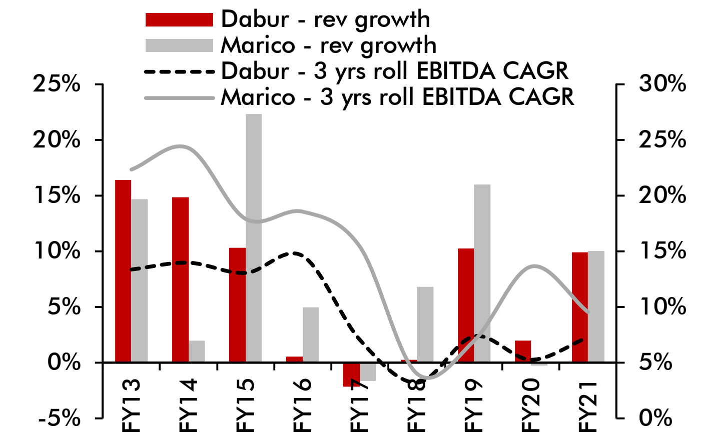
Source: Company, Ambit Capital research

Exhibit 11: Extent of Marico and Dabur's re-rating has been similar; higher re-rating of Marico in the past 18 months was due to TAM expansion



Source: Company, Ambit Capital research

Exhibit 12: Marico's revenue growth has outperformed Dabur in 6 of 9 years whereas its rolling 3-year EBITDA CAGR has been ahead of Dabur



Source: Company, Ambit Capital research

The past, in a nutshell...

Marico's key portfolio includes leadership in coconut hair oil through its brand *'Parachute'* (TAM at ₹55bn and market share 62%) and amla-based hair oil through brand *'Shanti Amla'* (TAM ₹22bn and market share 37%). Marico's other portfolio includes its leadership in premium edible oil category (TAM ₹22-25bn and market share of 82% in super premium) and other small (TAM ₹2-10bn) low-penetrated categories in which it enjoys leadership. Marico has grown at 7.3% CAGR over FY13-21. With ~50% of COGS dependent on copra, Marico remains highly susceptible to RM volatility (copra is a cyclical commodity). But in the past 15 years Marico has been able to improve market share in most RM inflationary cycles. This gives us confidence in its growth longevity in even the highly penetrated hair oil category. Rational capital allocation in IB post FY11 is a prudent strategy.

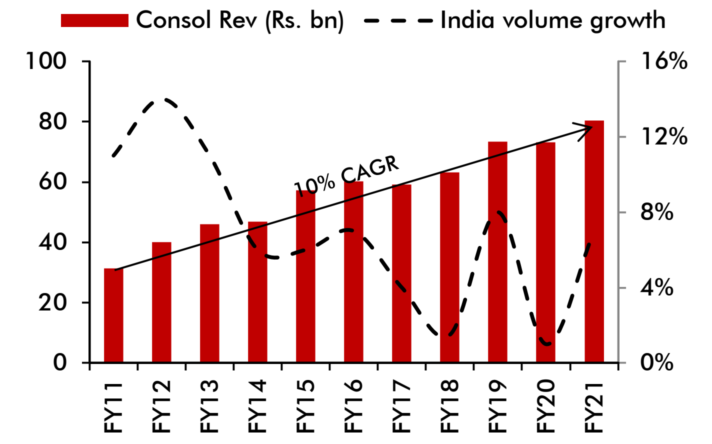
Journey thus far

Coconut oil & foods: Over the past decade, i.e. FY11-21, Marico delivered 10% revenue CAGR with an underlying average volume growth of 7% in its domestic business. Parachute coconut oil has led the growth with its contribution increasing from sub-23% a decade back to 29-30%. Saffola has also scaled up meaningfully, especially towards the second half of the decade (~10% CAGR over FY16-21) with its contribution to topline increasing by 250-300bps. Within foods, Marico largely had only oats which was launched a decade back, and growth was soft (scaled up to ₹2bn in just a decade). Recent repositioning of the product as something to eat between meals rather than just a breakfast item reinvigorated its growth trajectory with consumer acceptance improving.

VAHO, premium hair nourishment & male grooming: Within VAHO, Marico has products in the sub-categories of hair oil excluding almond and mentha-based. Over FY15-20 (FY21 excluded owing to Covid impact), VAHO posted ~5% CAGR owing to: (i) intensifying competition in amla-based hair oil from Dabur, (ii) slowdown in FMCG, especially in the Hindi belt, leading to softer growth in its regional products, and (iii) limited brands for consumers at the bottom of the pyramid. Premium hair nourishment and male grooming form a small portfolio for Marico (contributes 3% to domestic demand). While Marico experimented by launching a few products in VAHO and hair nourishment, we believe the company was quick in pulling it off the shelves without adequately investing in them. Also, most of the products were those in which Marico was trying to seed the categories and hence should have potentially invested more behind the brands. This thus led to serums & gels market size of just ₹2.5-3bn (Marico has >50% market share).

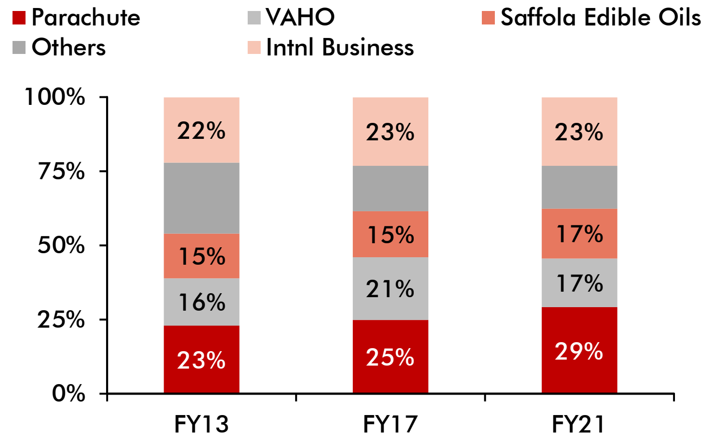
International business (IB): Contribution of IB has remained in the range of 22-23% over the last decade. IB began initially by exporting products followed by organic growth expansion. However, between FY07-11, Marico began acquiring companies to rapidly scale up its IB portfolio (refer exhibit 15). But since Marico got limited success (growth in IB ex-Bangladesh was 4% over FY16-21 vs 7% overall IB growth), Marico scaled back on its international acquisition-led growth strategy. Within IB, Bangladesh has led growth, contributing more than ~50% of IB revenues.

Exhibit 13: 10% revenue CAGR over FY11-21 on the back of 7% average volume growth



Source: Company, Ambit Capital research

Exhibit 14: Contribution of Parachute & edible oils has increased whereas that of VAHO has been volatile



Source: Company, Ambit Capital research; Note – FY13 includes revenues from Kaya (included under others), Kaya was demerged w.e.f. on April 1st, 2013

Exhibit 15: Pace of IB acquisitions has slowed down initial acquisition spree between FY07-11

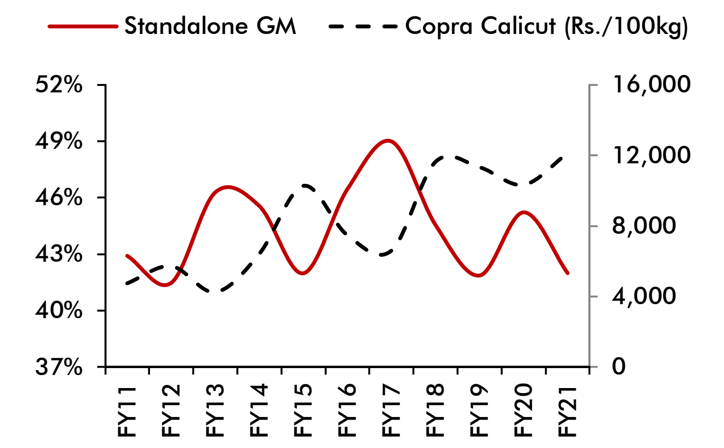
Year	Acquired Co.	Country	Product Category	Acq cost (₹ bn)
2006	Fiancee	Egypt	Hair creams and hair gels for women	1.7bn
2006	HairCode	Egypt	Hair creams and hair gels for men	NA
2007	Enalemi Pharma	South Africa	Wet hair care and healthcare segments	0.5bn
2009	Code10	Malaysia	Male hair styling	NA
2010	Ingwe	South Africa	OTC healthcare	0.1bn
2011	ICP	Vietnam	Male grooming	NA
2017	Isoplus	South Africa	Ethnic hair styling	0.4bn

Source: Company, Ambit Capital research

How Marico has made most of RM adversities

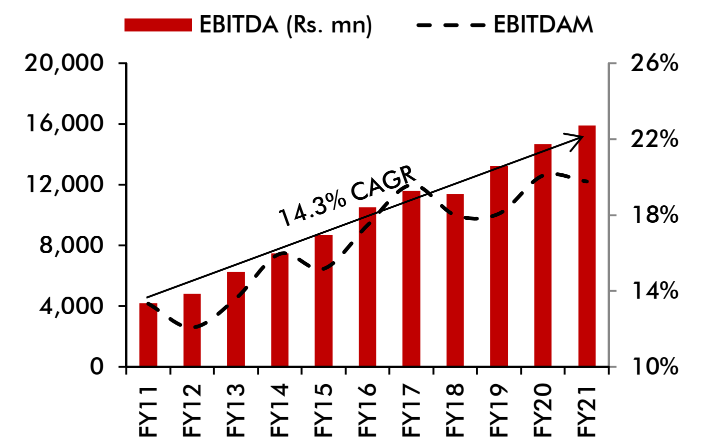
Marico has some of the most volatile gross margins in the FMCG sector owing to volatility in copra prices. This is because Marico's hair oil (~45% of portfolio) is largely coconut-based and hence dependence on a single commodity is high (~50% of COGS). Owing to 18-24 months copra cycle seen over the last 15 years, Marico's standalone GMs have remained in a wide band of 41% to 49% over FY11-21. That said, it is critical to highlight that Marico has used every inflationary cycle to weed out loose and unorganized players and gain market share in coconut hair oil (refer exhibit 19). Despite GM volatility, the company has been able to maintain and improve EBITDAM by 640bps over the said period. From FY21, Marico initiated cost saving initiatives across domestic and IB businesses; it achieved cost savings of ₹2bn (₹1.5bn in domestic and ₹0.5bn in IB) in FY21. We expect the company to be able to achieve ~1% cost savings over the coming few years. This will, however, be ploughed back into higher ad spends considering Marico's focus on expanding the foods portfolio.

Exhibit 16: GM has remained in a wide band owing to cyclicality in copra prices…



Source: Company, Ambit Capital research

Exhibit 17: ..but EBITDAM has expanded 640bps on the back of cost savings & ad spend rationalisation

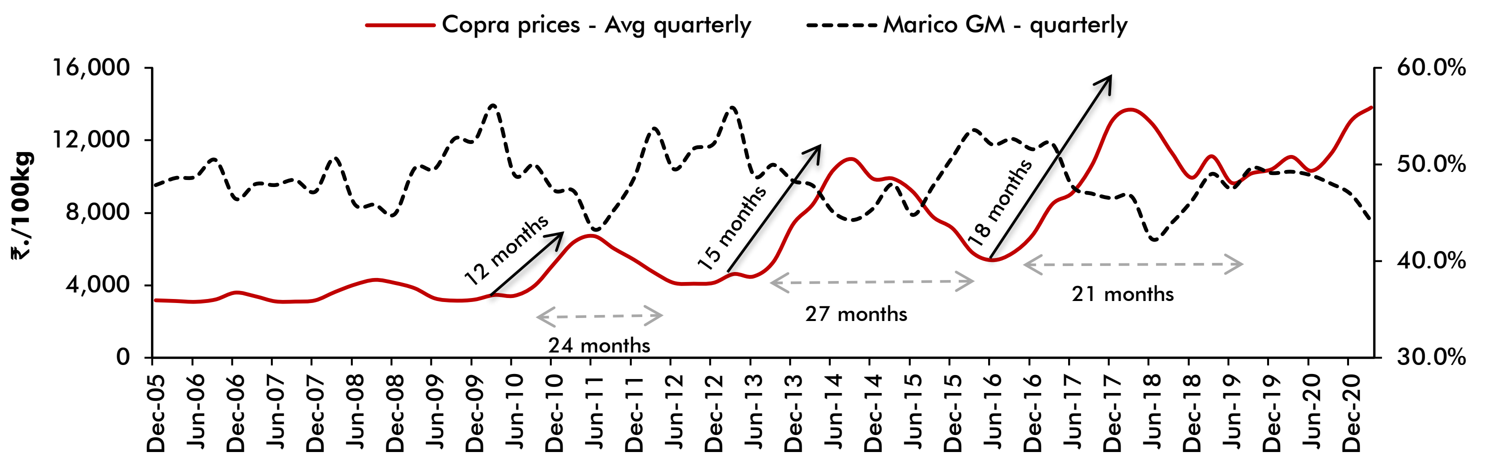


Source: Company, Ambit Capital research

Emerged stronger post inflationary cycles

Marico's GM is inversely correlated to inflation in copra prices. Empirical data suggests that inflationary cycle in copra lasts for 12-18 months, during which GM contracts 500-600bps. But what is important is that after each inflationary cycle, Marico has not only been able to regain lost gross margin but also gain share. This is a strong moat of the company, in our view (refer exhibits 18 and 19). Given the successful playbook to withstand RM cycles, we expect this market share gain story for Marico to sustain over the coming years too. We expect Marico to potentially display the same trait in edible oils in FY22E/23E considering edible oil RM is up 60-70% with an outlook of moderation in the coming quarters.

Exhibit 18: GM contraction during inflationary cycles is regained during deflationary periods; the inflationary cycle has restarted in Sep'20



Source: Company, Ambit Capital research

Exhibit 19: Marico has gained market share in 3 out 4 inflationary cycles in the past decade

	Jun-10	Jun-11	% change	Jun-13	Sep-14	% change	Sep-16	Mar-18	% change	Mar-20	Mar-21	% change
Copra prices	3,428	6,724	96.1%	4,493	10,966	144.0%	5,784	13,697	136.8%	11,094	13,819	24.6%
GM movement	49.0%	43.3%	-570bps	48.9%	44.3%	-460bps	52.7%	46.6%	-610bps	49.3%	44.1%	-520bps
Coconut oil market share	53.3%	55.2%	**190bps**	57.6%	57.0%	**-60bps**	58.0%	59.0%	**100bps**	59.0%	61.0%	**200bps**

Source: Company, Ambit Capital research

Present and future – A changed Marico

Marico in its new avatar has undertaken portfolio and strategy correction (expanding in existing categories vs building new categories) and has forayed into new categories with higher right to win. FY21-25E estimated revenue growth of 12% would be led by Parachute (5-7% volume growth), VAHO (low double-digit growth), Saffola edible oil (low double-digit growth) and Foods (37% led by TAM expansion and scale-up of new launches). From looking to seed categories (under healthy food through brand Fittify) to participating in existing healthy food categories (honey, soya chunks etc.) reflects Marico's changed approach. IB is another crown jewel (higher-EBITDAM business vs domestic), which should clock ~10% revenue CAGR over FY21-25E led by strengthening position in Bangladesh (No. 2 PC brand after Unilever). Steps towards scaling its D2C brands (organically & inorganically), having its separate team and P&L is an apt strategy since that offers higher liberty and authority required to scale D2C venture.

Widening growth pillars

Marico, a formidable player in hair oil and edible oil, is now widening its presence in healthy foods. As Marico looks to introduce more offerings in foods, we expect 37% revenue CAGR over FY21-25E vs domestic revenue growth of ~12%.

Exhibit 20: Edible oils and foods portfolios to lead growth for Marico's domestic business over FY22-25E

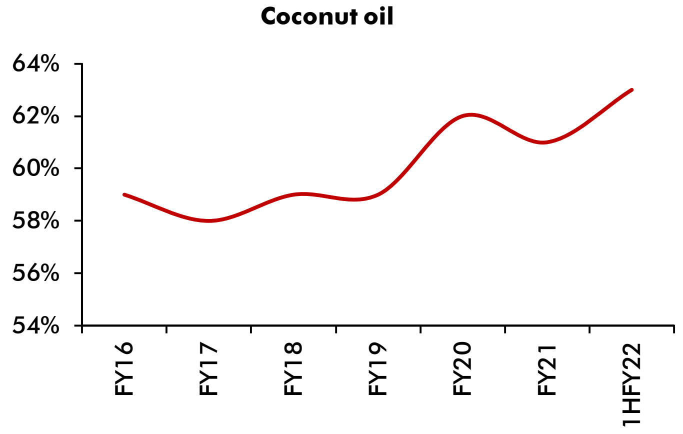
Categories	Market size (₹)	Market share	Penetration	Competition	Growth drivers	Probability of success	Revenue growth potential (FY22-25E)
Coconut oil	55bn	62%	High	Dabur, Bajaj Consumer, Emami	Gain share from unorganized & increase distribution in rural	●	Mid-single digit
VAHO	82bn	Amla hair oil - 37%			Play bottom of pyramid, Premium range and introduce functional products	◕	Low double digit
Edible oil	1,940bn	Super premium - 82%	Overall edible oils - High Premium edible oils - low	Fortune, Sundrop, Gemini, Emami oil	Shift towards healthy eating, penetration increase	●	High single to low double digit
Foods	Oats - 5bn Honey - 17.5bn Soya nuggets - 9bn Instant noodles - 90bn	Oats - 39%	Oats - <10% Honey - ~18-22%	Quaker Oats, Dabur Honey, Patanjali, Nestle Maggi, Yippee	Shift towards healthy eating, distribution expansion, market share gains from unorganized	●	High double digit
Premium personal care	Premium hair nourishment - 2.5bn Hair Gels/ Creams - 3.5bn	Post wash Leave-on Serums - 63% Hair Gels/Waxes/Creams - 58%	Low	L'Oreal, Streak, Gatsby, Wow Skin, Mama Earth	Pick up in discretionary spends & out of home events/gathering	◑	High single digit to low double digit

Source: Ambit Capital research, Company; Note – Overall edible oil market is ₹1,940bn but premium and super premium edible oil market is ~₹22-25bn in which Marico operates Note: ● - Strong; ◕- Relatively Strong; ◑- Average; ◔- Relatively weak

Continue to strengthen leadership in hair oil

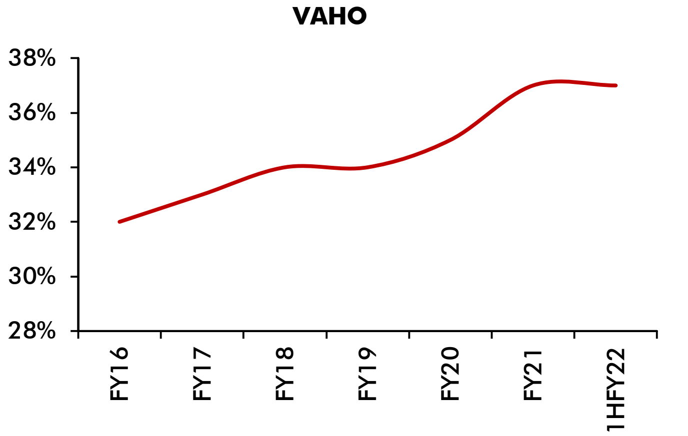
Marico has been strengthening its leadership in the hair oil category by gaining market share not only in coconut hair oil but also in VAHO. Marico has built a strong brand in coconut oil through 'Parachute' whose market share increased from 59% in FY16 to 63% in 1HFY22. Its market share in VAHO increased from 32% in FY15 to 37% in 1HFY22.

Exhibit 21: Gained market share in coconut oil and...



Source: Company, Ambit Capital research

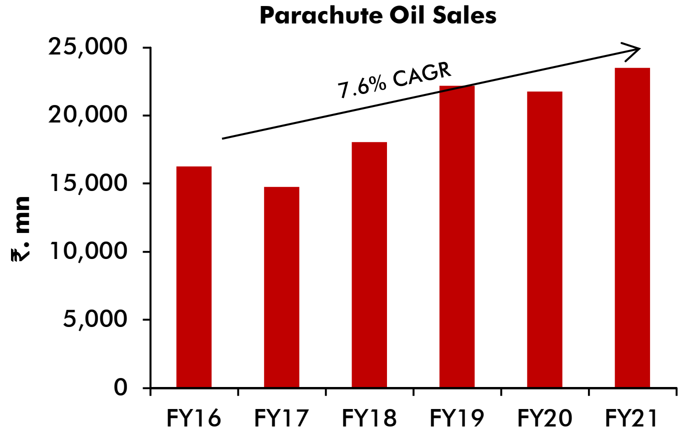
Exhibit 22: ...VAHO over FY16-1HFY22



Source: Company, Ambit Capital research

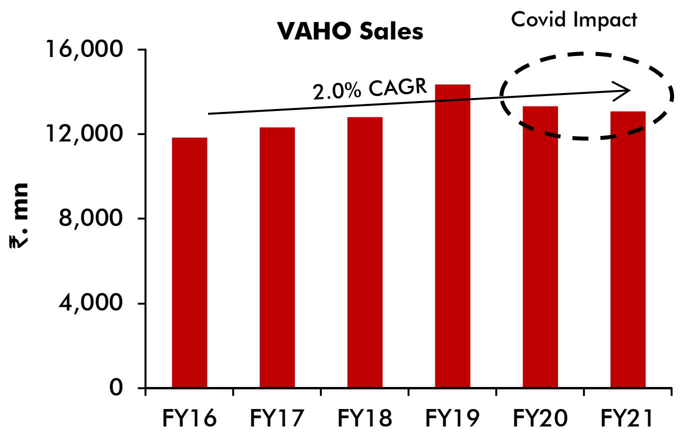
Hair oil contributes 45-48% to Marico's consolidated revenues (coconut oil contributes ~29%). Parachute straddles across price points and pack sizes, including low units packs (sachets) catering to both rural and urban consumers. Parachute has grown at 7.6% CAGR over FY16-21 on the back of shift from unorganized to organized, new pack sizes and increasing penetration in rural. While coconut oil is a highly penetrated category, nearly one third of the market is still unorganized, providing headroom for organized players like Marico to grow further. We expect Parachute to be able to maintain 5-7% volume growth trajectory on the back of increasing market share, steady recruitment of new consumers and distribution expansion, especially in rural areas.

Exhibit 23: Parachute has grown steadily over FY16-21



Source: Company, Ambit Capital research

Exhibit 24: VAHO has underperformed FY20 onwards



Source: Company, Ambit Capital research

While growth of the coconut oil segment is restricted considering penetration levels, appeal to a few states of India and Marico's leadership, VAHO provides more headroom to grow due to better product proposition vs traditional hair oil as well as large loose/unorganized presence. VAHO is non-sticky, scented and offers functional benefits (e.g. reduces breakage, softens hair, improves shine etc.), hence is a preferred product for young consumers. Marico participates in sub-segments of VAHO such as amla, VACNO etc. Currently, VAHO contributes ~17% of Marico's topline but has grown slower than coconut oil in FY20 and FY21 due to underperformance of mid and premium segment of hair oil (Marico's presence was skewed to that segment), limited product placements at the bottom of the pyramid (this was growing amidst hair oil market) and disruption caused by the pandemic (growth from FY16-19 was ~7%). Marico has addressed concerns through higher presence in the bottom of the pyramid (launched two more brands), distribution expansion in rural areas (25% jump in rural stockists) and introduction of functional products in premium segment (aloe vera, anti-hairfall, etc.). Add to that, steady gains from loose/regional players across sub-categories of hair oil and distribution expansion through higher focus on chemist, wellness and specialty beauty channels should help Marico clock ~12% revenue CAGR over FY21-25E.

Exhibit 25: Marico is present across VAHO categories &...

VAHO Categories and its share	Light Hair Oils (24%)	Amla Oils (27%)	VACNO (18%)	Cooling Oils (14%)	Anti-Hair Fall (14%)
Marico	✓	✓	✓	×	✓
Dabur	✓	✓	✓	×	×
Bajaj Consumer	✓	✓	×	✓	✓
Emami	✓	×	×	✓	✓

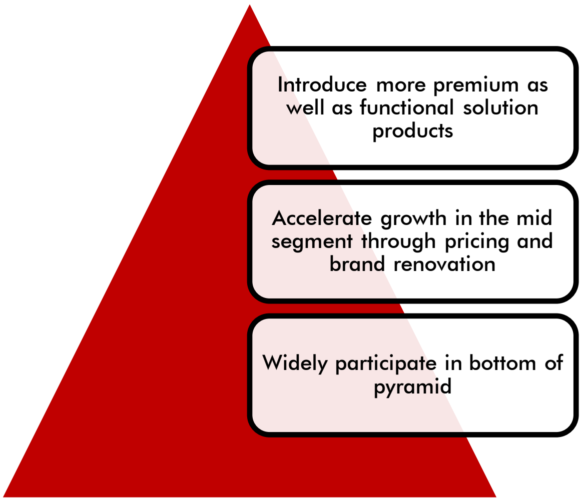
Source: Company, Ambit Capital research; Note - Green highlight indicates market leadership in respective categories; Marico is the volume market leader in Amla Oils;

Exhibit 26: ...is now straddling across price pyramid also

Marico VAHO Brands	₹./100ml	Category
Nihar Shanti Amla	32	Amla Oils
Parachute Jasmine	40	VACNO
Nihar Jasmine	41	VACNO
Parachute Advansed Aloe Vera Coconut Hair Oil	48	VACNO
Hair & Care with Aloe Vera, Olive Oil & Green Tea	50	Light Hair Oils
Parachute Advansed Ayurvedic Coconut Hair Oil	62	Anti-Hair Fall

Source: Company, Ambit Capital research; Note – above are a few popular brands in the VAHO segment and prices are based on MRP (excluding any discounts);

Exhibit 27: Marico has adopted a three-pronged strategy to grow the VAHO franchise over the medium term



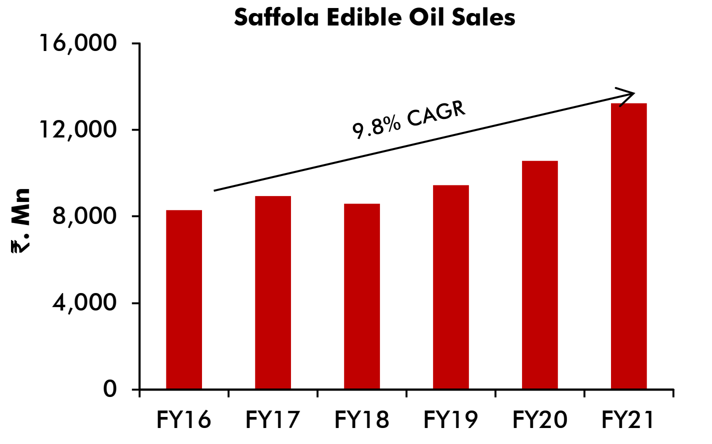
Source: Company, Ambit Capital research

Wider food play through edible oils & healthy food

Saffola edible oil – Sustaining growth through improved penetration

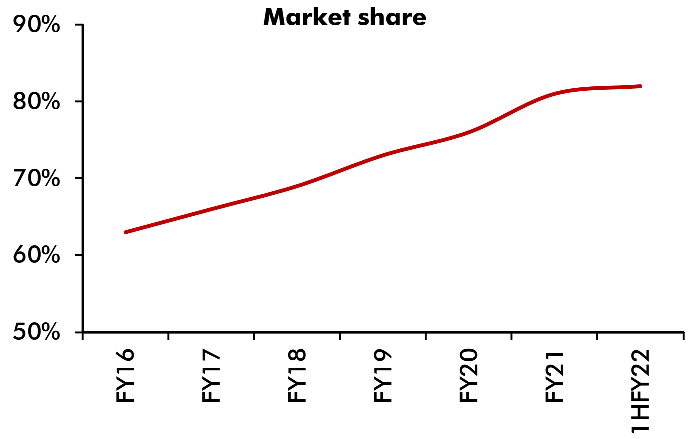
Within edible oil, Marico's strategy has been to only play the branded edible oil segment. Owing to that Marico has remained in a small (₹22-25bn TAM) but profitable premium and super premium edible oil segment. To that end, Marico has been riding on the shift towards healthy eating habits through its franchise, *Saffola*. As at 1HFY22, Marico had garnered ~82% market share in the super premium refined edible oils market through its positioning of Saffola as a superior product for the heart. Through this, Saffola edible oil contribution increased to ~16% in FY21 from 14% in FY16. Sales of Saffola did hit a relatively soft patch over FY17-20 with sales growth of 6% CAGR. Partially it was owing to external factors such as overall demand softness in FMCG, GST-led challenges and increasing price premium vs competition. While Marico did rectify the pricing concern, more importantly post Covid it posted a sharp jump in penetration. Saffola also benefitted from the inflationary situation (FY21 and YTDFY22) in edible oil when it took calibrated price hikes compared to inflation and higher price hikes taken by competition. Management's commentary suggests that as edible oil prices cool off, the company will maintain only a reasonable and sustainable price premium vs competition, thereby looking to retain most of the penetration-led gains into the future. With this, we expect Marico's Saffola edible oil to post ~12% revenue growth over FY21-25E despite normalization of in-home consumption-led demand.

Exhibit 28: Despite slowdown in FY18 and FY19, Saffola edible oils saw healthy growth over FY16-21…



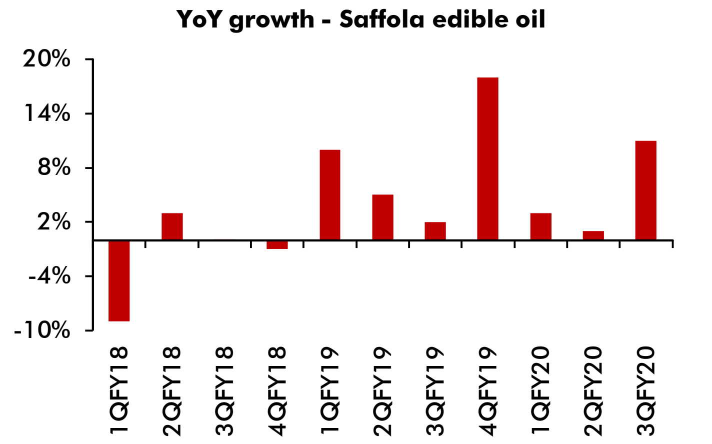
Source: Company, Ambit Capital research

Exhibit 29: ..along with consistent increase in market share in super premium refined oils



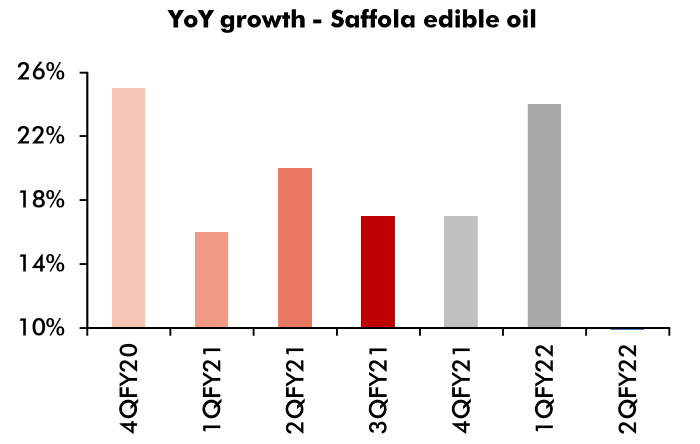
Source: Company, Ambit Capital research

Exhibit 30: Saffola edible oil saw 4% average volume growth 11 quarters before Covid…



Source: Company, Ambit Capital research

Exhibit 31: …which shot up to 17% average volume growth over the last 7 quarters



Source: Company, Ambit Capital research

Rise of Saffola foods – New sword in the sheath

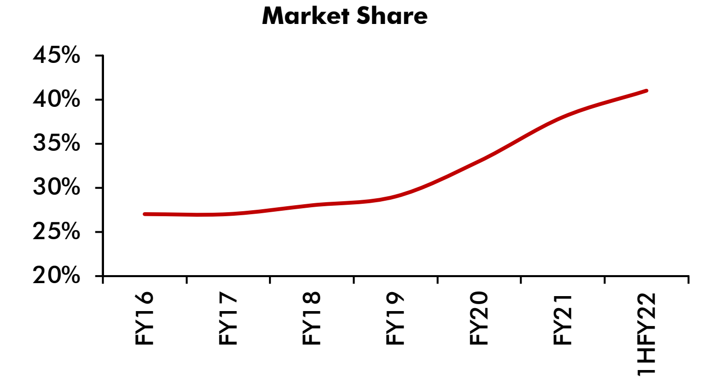
The Saffola brand stands for health & wellness. Riding on this brand equity, Marico is looking to scale up its healthy foods portfolio. History of scale-up of the foods portfolio has been poor. After almost a decade of being in the oats business, it managed to reach a brand size of just ₹2bn. That could be possibly because Marico being the market leader was entrusted with the responsibility of creating a category. As a departure from that strategy and to grow exponentially, Marico is looking to participate in existing healthy food categories of ₹8-15bn size with just 1-2 incumbents where there is a potential right to win through brand Saffola. This way the company is thinking of achieving 10-15% market shares in those new categories which can help it clock revenues of ₹1-1.5bn. As simple as it may sound, it will be critical to identify those categories, evaluate back-end and distribution synergies, etc. However, as highlighted in exhibit 35-37, current forays and likely future ones (in our view) does show room for Marico to clock ~37% revenue CAGR over FY21-25E in its healthy foods category. Beyond that, Marico will need to find other medium size categories to sustain double-digit growth in the foods portfolio over the medium term.

Exhibit 32: Marico's success strategy for foods

Source: Company, Ambit Capital research

This together with acceleration of growth in oats (repositioned as food between meals vs a breakfast product) has led to increasing market share from 27% in FY16 to 41% in 2QFY22 and ~94% market share in the masala oats category. All of this along with consumer preference for healthy eating bode well for the overall scale-up of Saffola's foods brand.

Exhibit 33: Steadily increasing share in oats...



Source: Company, Ambit Capital research

Exhibit 34: ...and extension of portfolio to aid expansion of market size

Source: Company, Ambit Capital research

Riding on Saffola's brand equity of health, Marico launched several healthy food products such as honey, soya chunks, noodles etc. (refer below exhibit). Most of these were launched last year and, basis our channel checks and management commentary, majority of the new launches have been well-received. Case in point – Saffola honey has gained significant market share in MT and e-com (~25% in e-com and MT, which contributes ~40% to honey sales).

Exhibit 35: Good success rate with 4 of 7 products ready to be scaled up

Products	Performance	Hit/Miss
Saffola Oats	94% MS in flavoured oats and 39% MS in overall oats	✓
Saffola Honey	MS in key MT chains hit double digits and 25%+ in the E-Commerce channel. Brand is on track to clock ~₹.1bn in FY22	✓
Saffola Mealmaker Soya Chunk	~14% share in MT since launch in Q3FY21. After success in West Bengal in GT the brand was extended to the rest of East and select regions in the North	✓
Saffola Oodles	Scaling up well in GT & MT, and is among the top 5 Bestsellers in the Pasta and Noodles category on Amazon	✓
Saffola Arogyam Chyawan Amrut	Not scaled up as per expectations	×
Saffola ImmuniVeda	Tactical play launched during Covid, not much traction	×
Saffola Fittify	Did not pick up as expected	×

Source: Company, Ambit Capital research

What next in foods?

Basis management's strategy, we expect Marico to possibly look at entering some or all of the below categories:

Exhibit 36: Potential food categories Marico could enter with a health proposition

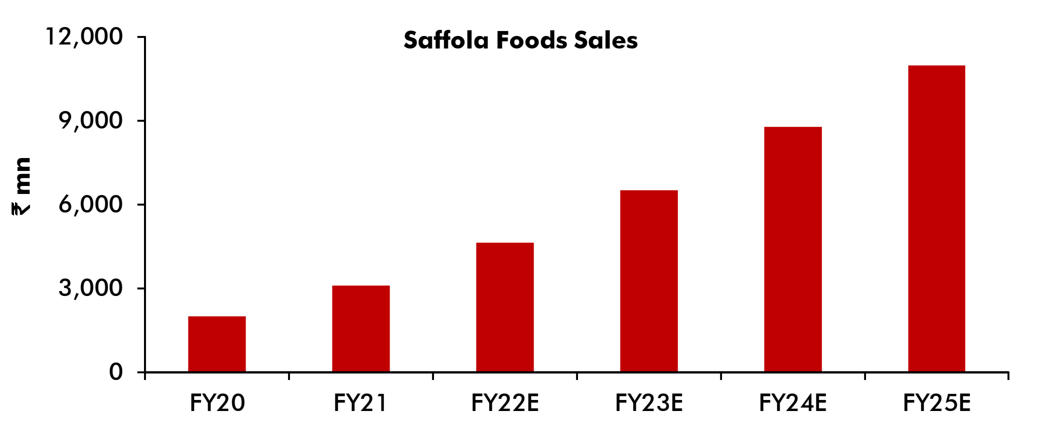
Potential Food Categories	Key Competition	Probability of success
Healthy spreads (Peanut butter, Choco spread)	Nutralite, Nutella, Hershey's, Sundrop	
RTE Breakfast/In between meals (poha, upma, pasta etc.)	MTR, Aashirvaad, Tata Sampann, Maggi	
Oat bars/Healthy snack bars	Nature Valley, Kellogg's, Yoga Bar	
Breakfast Cereals (Millets/Ragi based)	Kellogg's, Tata Soulfull, True Elements, Yoga Bar	
Ragi based snacks	Tata Soulfull	

Source: Company, Ambit Capital research

Expect foods business to reach ₹11bn by FY25 from ₹3bn currently

Marico's revenues from the food business (ex-Saffola edible oil) was slightly ahead of ₹3bn (grew ~50% in FY21) as at FY21. With increasing penetration-led growth of oats, scale-up of recent launches (honey and soya nuggets), and potential foray into new categories, we expect the foods business to reach ₹11bn by FY25E (management's commentary is of reaching ₹8.5-10bn by FY24E). Optically this means growth of ~37% CAGR over FY21-25E, but on an absolute basis we are looking at an addition of ₹7bn over four years. Even if honey, soya nuggets and 1-2 new launches can each contribute ₹0.75-1bn p.a. each, this target can be achieved (considering oats itself is currently >₹2.5bn). With Marico's foods portfolio distribution of 0.2mn outlets vs direct reach of >1mn and overall reach of 5.3mn, we expect distribution enhancement for foods to also benefit Marico in achieving this target for its foods business.

Exhibit 37: Estimating foods business to grow at 37% CAGR over FY21-25

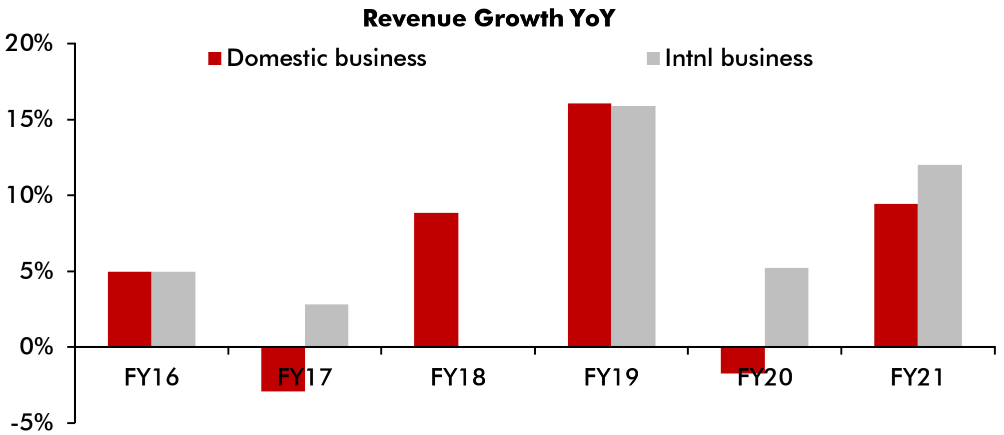


Source: Company, Ambit Capital research

Scaling IB through Bangladesh & Vietnam

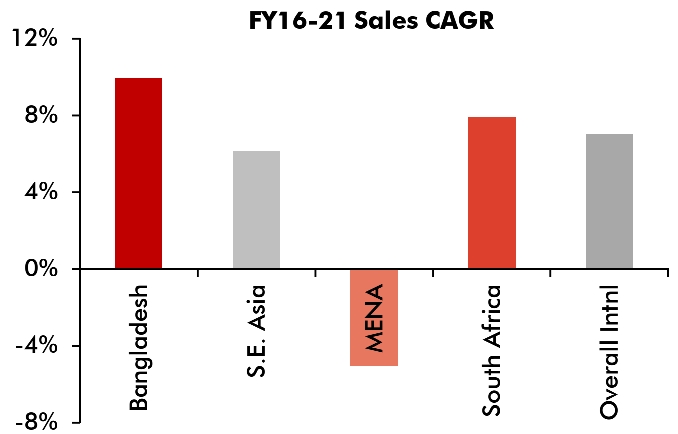
International business contributes 23% to overall revenue. While the domestic business has grown at 6% CAGR over FY16-21 (refer below exhibit), IB has grown slightly faster at 7% CAGR.

Exhibit 38: IB has grown faster at 7% CAGR vs 6% CAGR for the domestic business and is margin-accretive also



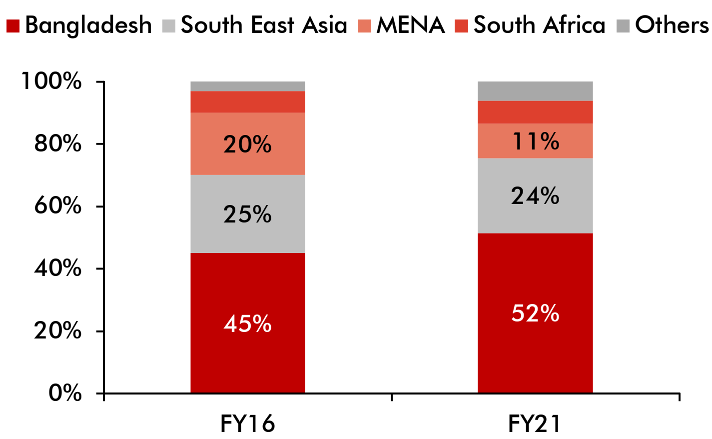
Source: Company, Ambit Capital research

Exhibit 39: Growth in Bangladesh outpacing other geographies…



Source: Company, Ambit Capital research

Exhibit 40: …leading to increased contribution of Bangladesh in overall IB



Source: Company, Ambit Capital research

Exhibit 41: Pace of IB acquisitions has slowed down considerably post acquisition spree during FY07-11

Year	Acquired Co.	Country	Product Category	Acq cost (₹. Bn)
2006	Fiancee	Egypt	Hair creams and hair gels for women	1.7bn
2006	HairCode	Egypt	Hair creams and hair gels for men	NA
2007	Enalemi Pharma	South Africa	Wet hair care and healthcare segments	0.5bn
2009	Code10	Malaysia	Male hair styling	NA
2010	Ingwe	South Africa	OTC healthcare	0.1bn
2011	ICP	Vietnam	Male grooming	NA
2017	Isoplus	South Africa	Ethnic hair styling	0.4bn

Source: Company, Ambit Capital research

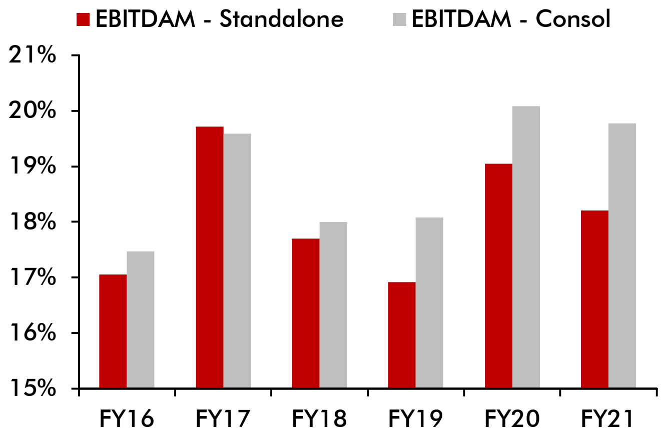
Exhibit 42: Overall IB can grow at high single digits – double-digit growth in Bangladesh and SEA will be offset by mid-single digit growth in MENA and South Africa

Geography	Categories	Organic/ Inorganic led growth	Outlook	% of IB	Revenue growth potential (FY22-25E)
Bangladesh	Coconut Oil, Hair Care, Skincare, Babycare, Male Grooming, Edible Oils & Hygiene	Organic	▪ Positive view given expanding non-coconut portfolio ▪ Potential to cross pollinate from India portfolio ▪ Leverage distribution strength	52%	Low double digit
South East Asia	Hair Care, Male Grooming & Foods	Majorly Inorganic	▪ Improving macros ▪ Correcting business fundamentals in Vietnam ▪ Opportunity to expand market and MS in shampoo/shower gels	24%	Low double digit
MENA	Coconut Oil, Hair Care, Male Grooming & Styling	Majorly Inorganic	▪ Improving macros on the back of rise in crude oil price ▪ Need to gain back lost share in hair oils, creams/gels in ME & grow core market in Egypt.	11%	Mid single digit
South Africa	Hair Care, Healthcare & Skincare	Inorganic	▪ Need to keep weak macro-economic environment in context ▪ Build more scale	7%	Mid single digit

Source: Company, Ambit Capital research

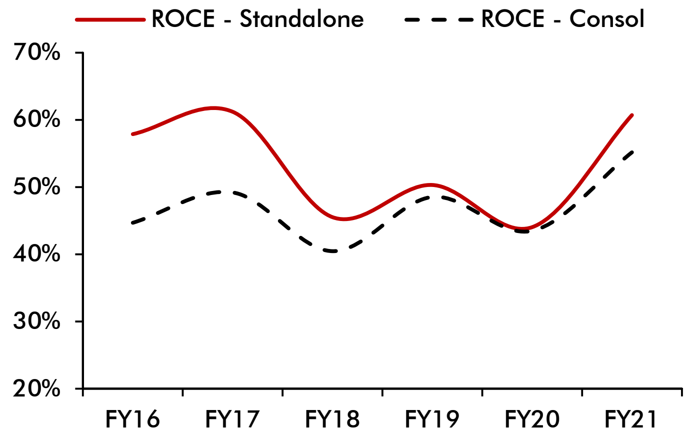
Despite a wide portfolio in different geographies, we see cross-pollination possibility largely only between India and Bangladesh owing to homogeneity in consumer habits and preferences.

Exhibit 43: Standalone EBITDAM lags cons. EBITDAM



Source: Company, Ambit Capital research

Exhibit 44: Higher goodwill leads to lower cons. ROCE

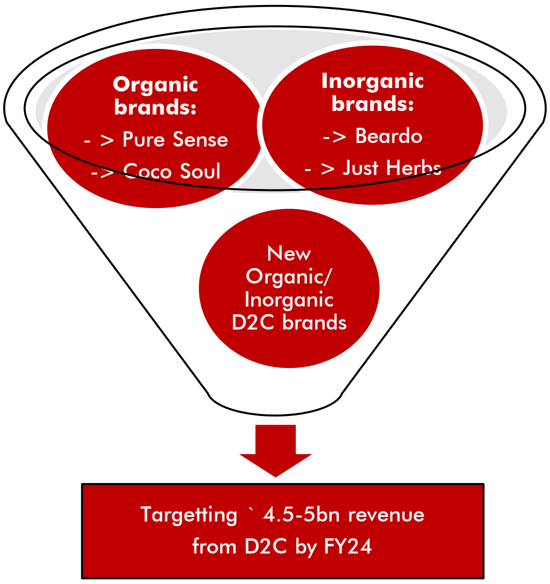


Source: Company, Ambit Capital research

Aggression through D2C

Marico is getting aggressive in building new-age Direct-to-Consumer (D2C) businesses given recent success of startups such as Mama Earth, Wow Science etc. Marico recently acquired two digital first brands - Just Herbs (FY22), an ayurvedic beauty brand, and Beardo (initial investment in FY17 followed by subsequent stake purchase in FY21), a male grooming brand. Apart from this they have two internal digital only personal care brands – Pure Sense and Coco Soul. Management has carved out a separate business unit within the organization to allow these digital brands to operate independently. We believe this is the right move as it will allow the brands to function independently with an entrepreneurial mindset. Management commentary suggests Beardo is on track to achieve ₹1bn exit run-rate in FY22. Further, management aspires to replicate Beardo's success by building three to five digital first brands, either organically or inorganically and touch ₹4.5-5bn turnover at these brands by FY24. Marico should also be able to reap synergy benefits (technology, logistics, knowhow etc.) from running three to four of these digital brands. While Marico is taking the right steps on D2C, contribution of D2C will still be small (~4% by FY24) to have any major impact on overall topline growth.

Exhibit 45: Aspiration to organically/inorganically scale up three to five digital brands to ₹1bn+ each by FY24E



Source: Company, Ambit Capital research

Thus, we believe Marico has ample revenue catalysts in place which should keep consolidated revenue growth CAGR over FY21-25E at ~12%.

Diversity in earnings at play

Marico's 1-year fwd P/E re-rated from ~39x (in Apr'21) to ~45x now on the back of (i) strong performance of Saffola edible oils led by increased penetration and (ii) expanding TAM in foods portfolio and management's confidence in scaling it. As long as Marico is able to retain its high single-digit to low double-digit revenue growth in Saffola edible oil and expand revenues of foods (to ₹8.5-10bn by FY24E), we see no reason for de-rating. We build in 12%/13%/13% revenue/EBITDA/PAT CAGR over FY21-25E led by the above mentioned thesis. With diversity in portfolio, scale-up of new category forays and premiumisation in hair care, our DCF factors in 11%/9% revenues/FCF over FY21-41E. Unlike Dabur's TG at 7%, we assign TG of 6% for Marico since its portfolio is skewed towards high penetrated hair oil portfolio. At our DCF-based TP of ₹ 580, implied FY24 P/E multiple is 43x, largely in line with comparable FMCG peers.

Revenue/EBITDA/PAT CAGR of 12%/13%/13% over FY21-25E

Edible oils, VAHO and foods should lead growth for Marico over FY21-25E (double-digit revenue growth), while Parachute should continue delivering mid-single-digit volume growth. This will translate into 12% revenue CAGR over the said period. Over this period, we are building 90bps GM compression (345bps GM compression in FY22E and recovery thereon). However, EBITDAM expansion of 60bps is likely owing to cost savings, operating leverage and shift in ad spends to low-cost digital modes. This should lead to 13% PAT CAGR and ~1,000bps RoE expansion.

Exhibit 46: Building in ~12% revenue CAGR over FY21-25E vs 6% over FY16-21

₹ mn, unless specified	FY21	FY22E	FY23E	FY24E	FY25E	Comments
P&L						
Revenue	80,480	91,922	102,424	114,424	127,161	Building ~12% CAGR over FY21-25E
Revenue growth (%)	10%	14%	11%	12%	11%	
- Parachute	8%	9%	7%	8%	8%	Parachute to grow at 5-6% volume growth along with ~2% price hikes. Will reap benefits of unorganised to organised
- VAHO	-2%	16%	11%	12%	12%	Mid-teens growth in FY22E on a low base. With portfolio gaps filled, expect VAHO to grow in double digits till FY25E
- Edible oils	25%	17%	10%	10%	10%	Building gains from increased penetration and focus on healthy eating habits
- Foods	55%	50%	40%	35%	25%	Building 37% CAGR over FY21-25E factoring in NPDs, distribution expansion, scale up on low base
- IB	12%	11%	11%	10%	10%	Bangladesh and Vietnam to lead the growth
Gross margin (%)	47%	44%	45%	46%	46%	Not expecting GM recovery even till FY25E
Ad spends (%)	9%	8%	9%	8%	8%	Expecting ad spends as % of sales to remain in 8-9% band
EBITDA	15,910	16,178	19,256	23,171	25,877	Expecting 13% EBITDA CAGR over FY21-25E
EBITDA growth (%)	8%	2%	19%	20%	12%	
EBITDA margin (%)	20%	18%	19%	20%	20%	EBITDAM expansion to come from gradual GM expansion, cost savings and operating leverage
PAT growth (%)	15%	13%	14%	15%	16%	Expecting 13% PAT CAGR over FY21-25E
Cash flow statement						
Operating cash flow	20,680	10,796	15,649	18,781	21,043	Higher OCF in FY21 due to benefits from SKU rationalisation and credit control
Free cash flow	17,990	8,996	13,649	16,781	19,293	Low capex needs to yield better FCFF conversion
Ratios						
Gross asset turnover (x)	2.3	2.5	2.6	2.8	3.0	Asset turnover to improve with low capex needs
RoE (%)	38%	36%	40%	45%	47%	ROE to improve due to EBITDAM expansion

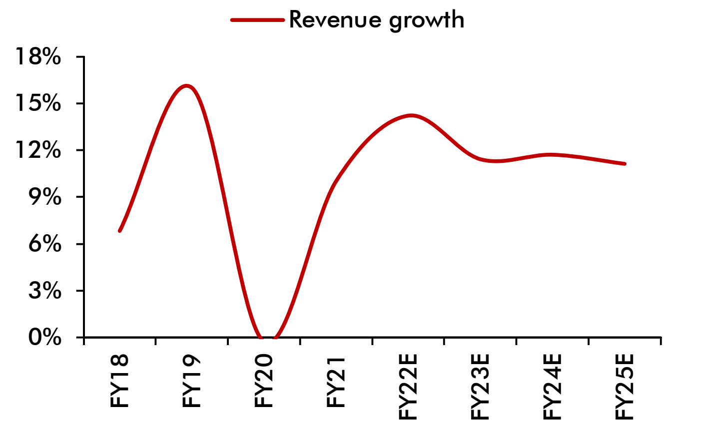
Source: Company, Ambit Capital research

Exhibit 47: We are behind consensus on FY22E/FY23E revenue, EBITDA and PAT (may be owing to lower growth in Saffola edible oil) but in line on FY24 numbers

₹ mn	Ambit estimates			Consensus estimates			vs. consensus		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenues	91,922	102,424	114,424	95,327	105,417	117,055	-4%	-3%	-2%
EBITDA	16,178	19,256	23,171	17,638	20,873	23,810	-8%	-8%	-3%
PAT	12,124	14,517	17,566	12,980	15,395	17,595	-7%	-6%	0%

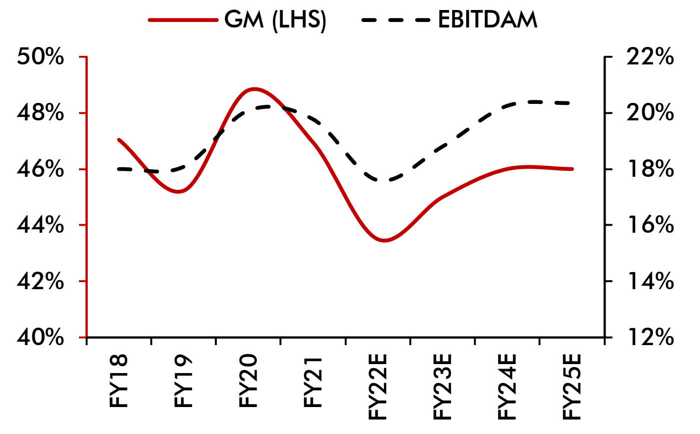
Source: Bloomberg, Ambit Capital research

Exhibit 48: Foods, recovery in VAHO and edible oil should drive double-digit revenue growth over FY21-25E



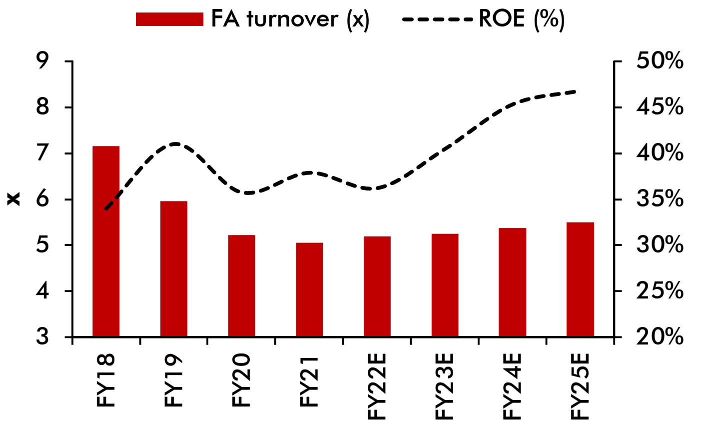
Source: Company, Ambit Capital research

Exhibit 49: Focus on growth may lead to slower GM expansion



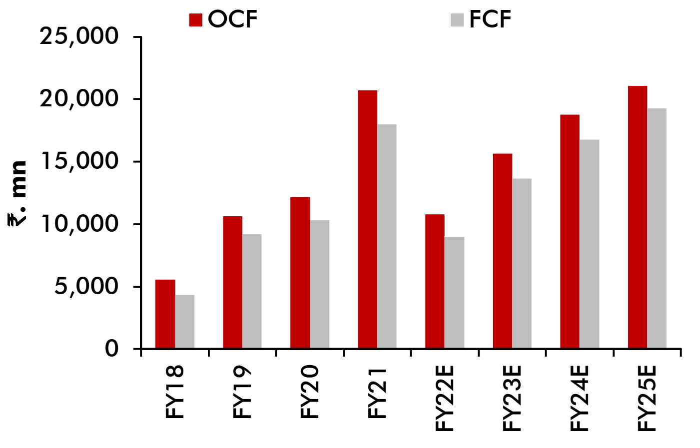
Source: Company, Ambit Capital research

Exhibit 50: RoE expansion to be led by margin expansion and improving FA turnover



Source: Company, Ambit Capital research

Exhibit 51: Healthy OCF to FCFF conversion due to limited capex needs



Source: Company, Ambit Capital research

DCF valuation to capture growth longevity

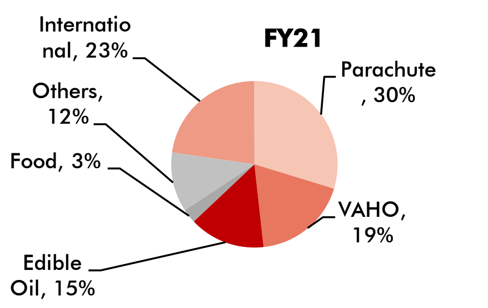
Building 11% revenue CAGR over FY21-41

To arrive at our LT revenue estimates for Marico, we looked at each category and its growth potential over the long term:

- We expect Parachute to maintain its market leadership and grow at industry growth rate of ~7% over FY21-41 (clocked 10.5% revenue CAGR over FY13-61). Management's 5-7% volume growth guidance should hold true at least for the next decade considering unorganized share is still ~30%. This coupled with 2-3% price hike should lead to at least 8% revenue growth over the next decade. However, over the longer run, revenue growth would be more value-led with volume growth decelerating to low single digits.
- We estimate VAHO to grow ~100bps above industry growth on the back of new launches, especially functional products. We are building in 11.5% CAGR over FY21-41E led by the premiumisation proposition and consumers urge to look for products offering solutions to hair care concerns etc.
- For edible oils, too, we expect growth to be 9.5-10% over FY21-41E on the back of improving penetration and shift towards healthy lifestyle.
- In foods, while we are estimating ~17.5% CAGR over FY21-41E, most of it front ended (37% CAGR over FY21-25E), post which we estimate ~12% CAGR. As Marico looks to enter new categories and the market sizes of existing categories expand, the foods portfolio should gain heft. We also expect foods to contribute ~14% of revenue by FY41E vs ~4% currently.

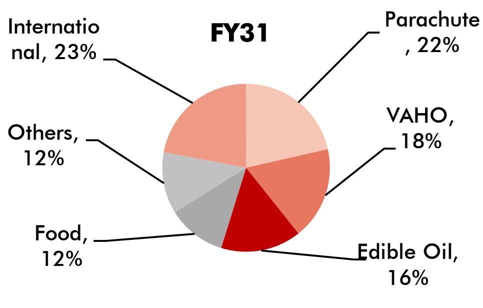
- We are not separately calculating revenue growth from D2C brands. D2C brands' revenue growth is implicitly built into VAHO and others-domestic segmental growth. This said, we also expect Marico to remain aggressive in its M&A activities; not built into our estimates.

Exhibit 52: Hair oil portfolio currently accounts for ~50%+ of sales which...



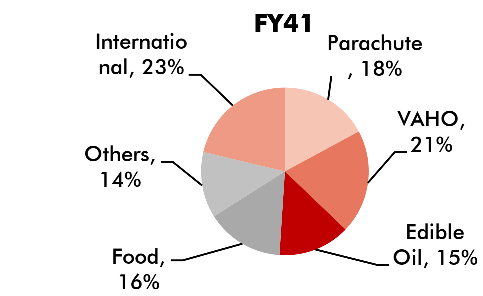
Source: Company, Ambit Capital research

Exhibit 53: ...will skew towards edible oil and foods by FY31...



Source: Company, Ambit Capital research

Exhibit 54: ...reducing dependence on hair oil to ~40% by FY41

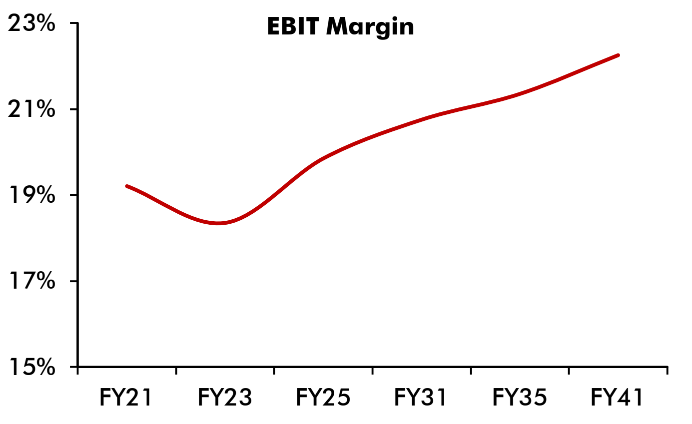


Source: Company, Ambit Capital research

Building EBIT margin expansion & lower capex needs

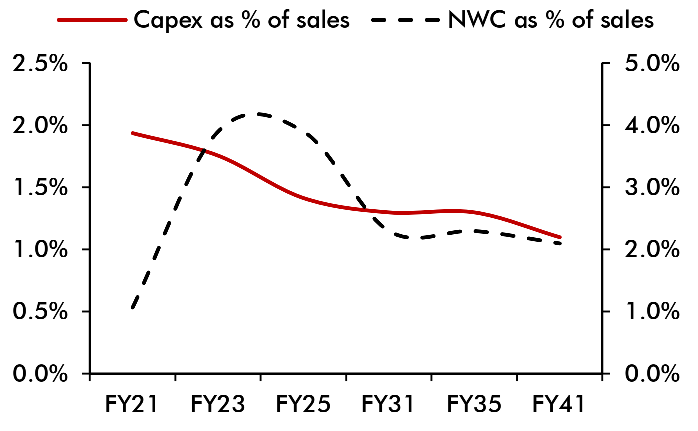
We are building 300bps EBIT margin expansion over FY21-41E, which is reasonable as Marico starts to benefit from GM improvement led by product mix shift (increasing saliency of VAHO and male grooming, etc.), cost savings and operating leverage. In terms of capex, we are building in 1.3-1.8% of sales whereas NWC capital as a % of sales is likely to remain in the range of ~3% (any change could be owing to RM volatility, which is hard to predict).

Exhibit 55: EBIT margin expansion to largely flow from GM expansion and structural cost savings initiatives



Source: Company, Ambit Capital research

Exhibit 56: Capex and NWC as % of sales will improve but won't go back to FY21 levels which had the best of WC days and capex owing to Covid lockdown



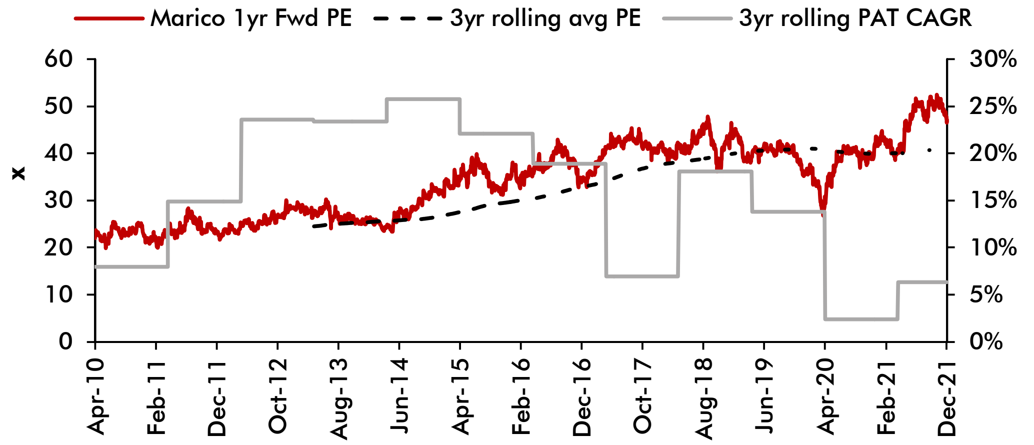
Source: Company, Ambit Capital research

Exhibit 57: Sensitivity table for TP based on COE and TG assumptions

		COE				
		11.0%	**11.5%**	**12.0%**	**12.5%**	**13.0%**
Terminal Growth	5.0%	628	556	497	447	405
	5.5%	644	567	505	453	409
	6.0%	662	580	514	460	414
	6.5%	685	596	525	468	420
	7.0%	714	616	539	477	427

Source: Company, Ambit Capital research

Exhibit 58: Historical 3-year rolling PAT CAGR has remained in double digit, pre-Covid; P/E re-rating from Apr'21 owing to double digit growth in edible oils, foods + TAM expansion; multiples to sustain on the back of 13% PAT CAGR over FY21-25E



Source: Company, Ambit Capital research

Catalysts & risks

Catalysts

- **Double digit growth in Saffola edible oil & VAHO:** Saffola edible oil & VAHO has grown at 10%/2% CAGR over FY16-21. Against this, we are now expecting them to grow at 16%/11% and 17%/10% respectively for FY22E/23E. This growth acceleration is amongst the key catalyst to the BUY rating.
- **TAM expansion:** Marico has called out its growth aggression in healthy foods segment through its brand Saffola. Saffola foods which was ~₹31bn as at FY21 is expected to become ₹45bn/65nb in FY22E/23E. This 50%/40% growth acceleration will help Marico clock double digit growth.
- **Synergies from acquired D2C brands**: As mentioned, Marico is focusing on building 3-5 D2C brands and has already acquired two brands, i.e. Beardo and Just Herbs. Management is also building brands in D2C organically and targeting overall D2C brands led revenue of ₹ 3.5-4.5bn by FY23E/24E.
- **Gross margin surprise:** Owing to RM inflation we are factoring 344bps GM compression in FY22E followed by 150bps FY23E. Marico has taken price hikes and hence there could be an upside risk to our GM estimates.

Risks

- **Fizzling of growth in Saffola edible oils:** Growth in Saffola edible oils is also a function of penetration led gains. As edible oil inflation settles, if Saffola does not drop its pricing which can lead to share loss then our double digit growth estimate comes to risk.
- **Inability to identify or expand new food categories:** We build in 37% CAGR in the healthy foods portfolio over FY21-25E based on scale-up of new categories and foray into more categories over the coming years. While entry into new categories will support revenue in the short term, inability of management to scale up the foods portfolio sustainably over the medium term will be a key risk.
- **Currency risk in IB:** Currency risk is an important consideration as the international business contributes ~23% of sales for Marico. Any adverse movement in currency will have a negative impact on revenues and profitability.

Ambit's HAWK Analysis

Marico features in D2 which is 'Zone of Safety' on our forensic accounting framework. Marico scores high on parameters such as CAGR in auditor remuneration to consolidated revenue, cash yield and cum. FCF/median revenue. On our greatness framework, Marico features in the 'Good, but not great' zone and ranks better than universe (59th percentile) median percentile but behind sector median percentile (48th percentile).

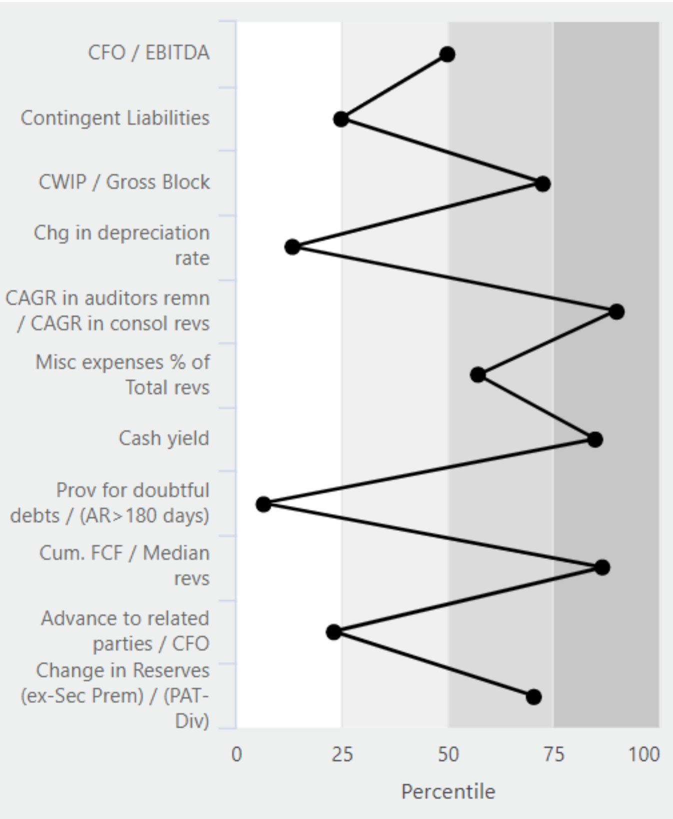
Key contributors to accounting scores

In FY19 and FY20, Marico featured in the D2 decile on our forensic accounting framework. Marico scores high on parameters such as CAGR in auditor remuneration to consolidated revenue, cash yield and cum. FCF/median revenue. However, it scores low on certain parameters such contingent liabilities, volatility in depreciation rate and advances to related parties.

Our analysis of FY21 data suggests improvement in CFO/EBITDA, advances to related party and CWIP/gross block. However, certain parameters such as misc. expenses and cash yield have deteriorated YoY.

Marico scores much higher than its median accounting score for its sector (79th percentile) and universe (87th percentile).

Exhibit 59: Forensic accounting score contributors



Source: Company, Ambit Capital research

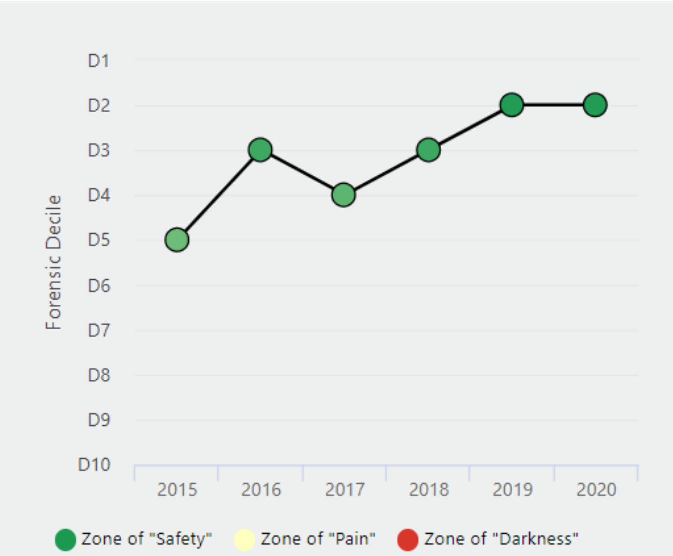
Exhibit 60: Forensic score percentile to universe and sector

Source: Company, Ambit Capital research

Comments on evaluation of accounting scores

Marico's accounting score has consistently improved over FY15-20 from D5 in FY15 to D2 ('Zone of Safety') in FY20.

Exhibit 61: Forensic accounting score evolution



Source: Company, Ambit Capital research

Exhibit 62: Movement in accounting checks

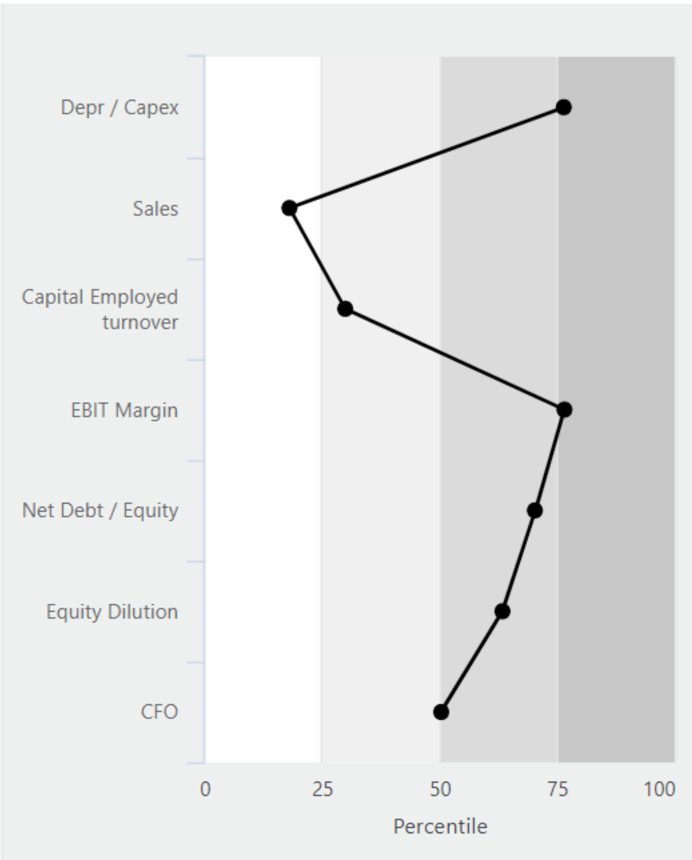
Category	Accounting ratios	FY19	FY20	FY21
P&L mis-statement check	CFO/EBITDA	104%	102%	147%
	Volatility in depreciation rate	207	94	86
	PFD - % of debtors beyond credit period	NA	NA	NA
Balance sheet mis-statement check	Cash yield	3%	3%	1%
	Change in reserves (ex-sec prem) / (PAT ex dividend)	1.02	(1.33)	0.97
	Cont liab - % of NW	18.0%	21.0%	18.0%
Pilferage checks	Misc exps - % of total revs	1.0%	1.0%	2.0%
	Adv to related parties / CFO	3%	3%	1%
	CWIP / Gross block	3.0%	3.0%	1.0%
	Cum. FCF / median revs	10%	16%	14%
Audit quality checks	Auditor's rem CAGR/revenue CAGR	(1.1)	(1.2)	(1.3)

Source: Company, Ambit Capital research;

Evolution of greatness score

Our greatness framework evaluates companies on drivers of 'Greatness' (e.g. cash generation, incremental capex, efficiency in capital employed turnover, etc.). Marico features in the 'Good, but not great' zone on our greatness framework.

Exhibit 63: Greatness score contributors

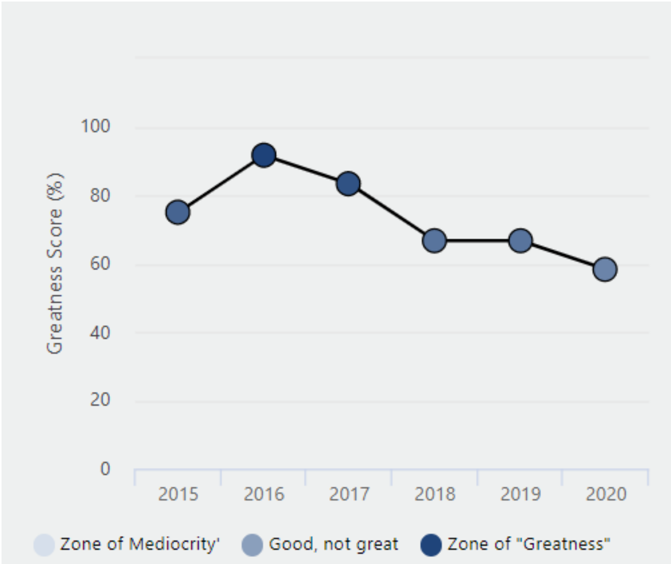


Source: Company, Ambit Capital research

Exhibit 64: Greatness score percentile to universe and sector

Source: Company, Ambit Capital research

Exhibit 65: Greatness score evolution



Source: Company, Ambit Capital research

Exhibit 66: Explanation to our flags

Segment	Score	Comments
Accounting	GREEN	Marico is in D2, zone of safety on our forensic accounting framework. Marico scores high on parameters such as CAGR in auditor remuneration to consol. revenue, cash yield and cum. FCF/median revenue and it scores low on parameters such contingent liab, volatility in depr. rate and advances to related parties.
Predictability	AMBER	Marico has higher volatility in its revenue and margins. This leads to relatively low earnings predictability vs peers.
Earnings momentum	GREEN	Consensus numbers have largely been met or upgraded

Source: Company, Ambit Capital research

Financials

Balance Sheet

Year to March (₹. Mn)	FY21	FY22E	FY23E	FY24E	FY25E
Shareholders' equity	1,290	1,290	1,290	1,290	1,290
Reserves & surpluses	31,110	33,292	35,905	39,067	42,616
Total networth	**32,400**	**34,582**	**37,195**	**40,357**	**43,906**
Minority Interest	180	180	180	180	180
Debt	3,480	3,080	2,580	1,580	180
Deferred tax liability	(860)	(860)	(860)	(860)	(860)
Total liabilities	**35,200**	**36,982**	**39,095**	**41,257**	**43,406**
Gross block	15,910	17,710	19,510	21,310	23,110
Net block	**9,990**	**10,391**	**10,650**	**10,766**	**10,740**
CWIP	240	240	240	240	240
Goodwill	6,130	6,130	6,130	6,130	6,130
Investments	8,540	10,040	10,040	10,040	10,040
Cash & equivalents	9,440	6,595	7,839	9,216	10,944
Debtors	3,880	6,296	7,015	7,837	8,710
Inventory	11,260	13,348	14,873	16,615	18,464
Loans & advances	240	274	305	341	379
Other current assets	2,960	3,526	3,929	4,389	4,877
Total current assets	27,780	30,038	33,961	38,399	43,374
Current liabilities	17,270	19,617	21,858	24,419	27,137
Provisions	210	240	267	299	332
Total current liabilities	17,480	19,857	22,126	24,718	27,469
Net current assets	**10,300**	**10,181**	**11,836**	**13,681**	**15,905**
Total assets	**35,200**	**36,982**	**38,895**	**40,857**	**43,056**

Source: Company, Ambit Capital research

Income statement

Year to March (₹. Mn)	FY21	FY22E	FY23E	FY24E	FY25E
Operating income	**80,480**	**91,922**	**102,424**	**114,424**	**127,161**
% growth	10.0%	14.2%	11.4%	11.7%	11.1%
Operating expenditure	64,570	75,744	83,168	91,253	101,283
EBITDA	**15,910**	**16,178**	**19,256**	**23,171**	**25,877**
% growth	8.3%	1.7%	19.0%	20.3%	11.7%
Depreciation	1,390	1,399	1,541	1,683	1,826
EBIT	**14,520**	**14,779**	**17,714**	**21,487**	**24,051**
Interest expenditure	340	383	323	271	158
Non-operating income	940	1,034	1,086	1,140	1,197
Adjusted PBT	**15,120**	**15,430**	**18,477**	**22,356**	**25,090**
Tax	3,240	3,307	3,959	4,791	5,377
Adjusted PAT/ Net profit	**11,880**	**12,124**	**14,517**	**17,566**	**19,714**
% growth	10.8%	2.1%	19.7%	21.0%	12.2%
Minority Interest	20	-	-	-	-
Extraordinaries	130	-	-	-	-
Reported PAT / Net profit	**11,990**	**12,124**	**14,517**	**17,566**	**19,714**
Adjusted Consolidated net profit	**11,860**	**12,124**	**14,517**	**17,566**	**19,714**

Source: Company, Ambit Capital research

Cash flow statement

Year to March (₹. Mn)	FY21	FY22E	FY23E	FY24E	FY25E
EBIT	14,520	14,779	17,714	21,487	24,051
Depreciation	1,390	1,399	1,541	1,683	1,826
Others	710	651	762	869	1,039
Tax	(3,240)	(3,307)	(3,959)	(4,791)	(5,377)
(Incr) / decr in net working capital	7,300	(2,727)	(410)	(468)	(497)
Cash flow from operations	**20,680**	**10,796**	**15,649**	**18,781**	**21,043**
Capex	(2,690)	(1,800)	(2,000)	(2,000)	(1,750)
(Incr) / decr in investments	(7,210)	(1,500)	-	-	-
Cash flow from investments	**(9,380)**	**(3,300)**	**(2,000)**	**(2,000)**	**(1,750)**
Net borrowings	130	(400)	(500)	(1,000)	(1,400)
Interest paid	(340)	(383)	(323)	(271)	(158)
Dividend paid	(10,290)	(9,942)	(11,904)	(14,404)	(16,165)
Others	(690)	383	323	271	158
Cash flow from financing	**(11,190)**	**(10,342)**	**(12,404)**	**(15,404)**	**(17,565)**
Net change in cash	110	(2,845)	1,245	1,377	1,727
Closing cash balance	9,440	6,595	7,839	9,216	10,944
Free cash flow	**17,990**	**8,996**	**13,649**	**16,781**	**19,293**

Source: Company, Ambit Capital research

Ratio analysis

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
Gross margin (%)	46.9%	43.5%	45.0%	46.0%	46.0%
EBITDA margin (%)	19.8%	17.6%	18.8%	20.3%	20.4%
EBIT margin (%)	18.0%	16.1%	17.3%	18.8%	18.9%
Net profit margin (%)	14.7%	13.2%	14.2%	15.4%	15.5%
Dividend payout ratio (%)	80.7%	82.0%	82.0%	82.0%	82.0%
Net debt: equity (x)	(0.2)	(0.1)	(0.1)	(0.2)	(0.2)
Working capital turnover (x)	93.6	25.6	25.6	25.6	25.6
Gross block turnover (x)	5.1	5.2	5.2	5.4	5.5
RoCE (%)	55.2%	59.7%	64.9%	75.7%	82.6%
RoE (%)	37.9%	36.2%	40.5%	45.3%	46.8%

Source: Company, Ambit Capital research

Valuation parameters

Year to March	FY21	FY22E	FY23E	FY24E	FY25E
EPS (₹)	9.2	9.4	11.3	13.6	15.3
Diluted EPS (₹)	9.2	9.4	11.3	13.6	15.3
Book value per share (₹)	26.3	28.1	30.2	32.8	35.7
Dividend per share (₹)	7.5	7.7	9.2	11.2	12.5
P/E (x)	54.5	53.3	44.5	36.8	32.8
P/BV (x)	19.0	17.8	16.6	15.3	14.0
EV/EBITDA (x)	40.2	39.7	33.3	27.6	24.6
Price/Sales (x)	8.0	7.0	6.3	5.6	5.1

Source: Company, Ambit Capital research

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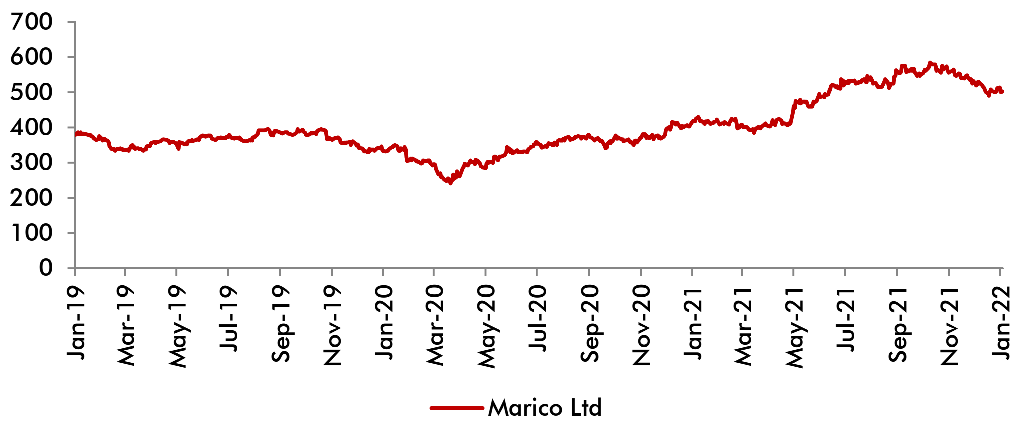
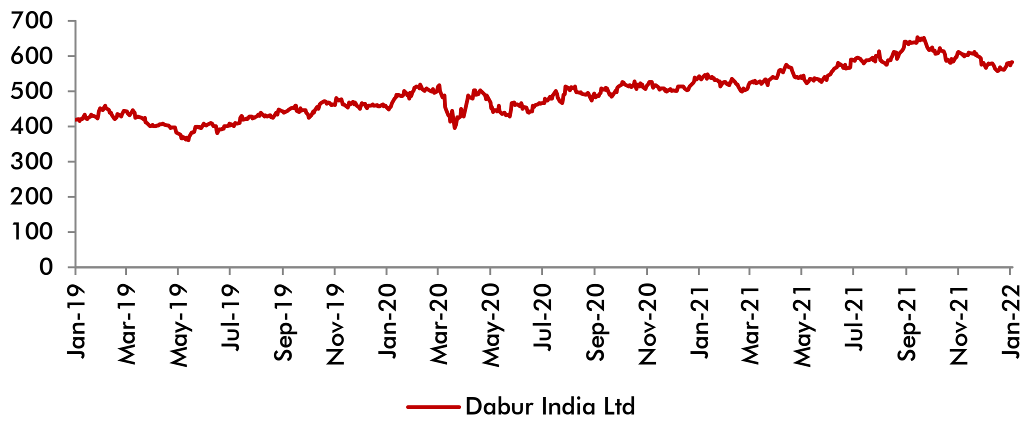
Marico (MRCO IN, BUY)



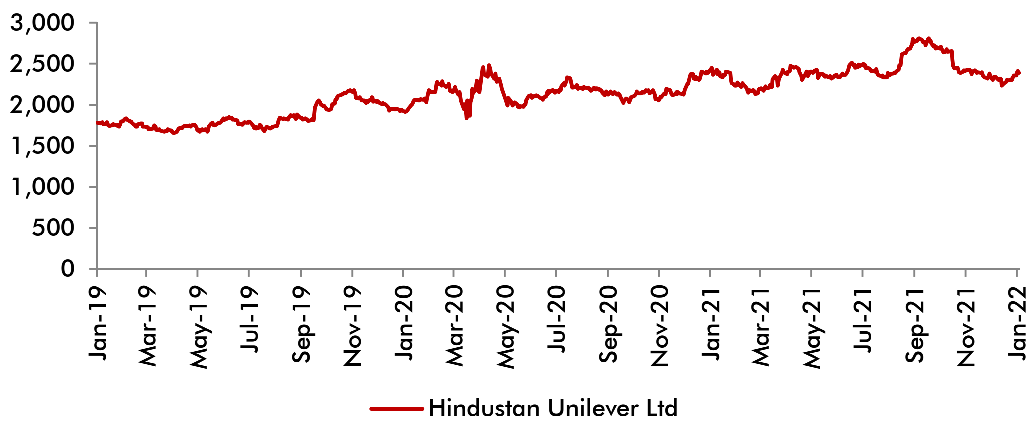
Source: Bloomberg, Ambit Capital research

Dabur India (DABUR IN, BUY)



Source: Bloomberg, Ambit Capital research

Hindustan Unilever (HUVR IN, SELL)



Source: Bloomberg, Ambit Capital research

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Investment Rating	Expected return (over 12-month)
BUY	We expect this stock to deliver more than 10% returns over the next12 month
SELL	We expect this stock to deliver less than or equal to 10 % returns over the next 12 months
UNDER REVIEW	We have coverage on the stock but we have suspended our estimates, TP and recommendation for the time being NOT
NOT RATED	We do not have any forward-looking estimates, valuation, or recommendation for the stock.
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NO STANCE	We have forward looking estimates for the stock but we refrain from assigning valuation and recommendation

Note: At certain times the Rating may not be in sync with the description above as the stock prices can be volatile and analysts can take time to react to development.

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