Stock Update

Godrej Consumer Products Ltd.

April 11, 2023

RETAILRESEARCH

HDFC securities
Click. Invest. Grow.
20 YEARS

Godrej Consumer Products Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
FMCG	Rs. 965	Buy in Rs. 958-974 band and add more on dips in Rs. 859-873 band	Rs. 1056	Rs. 1119	2 -3 quarters

HDFC Scrip Code	GODCON
BSE Code	532424
NSE Code	GODREJCP
Bloomberg	GCPL:IN
CMP (April 10, 2023)	965
Equity Capital (RsCr)	102
Face Value (Rs)	1
Equity Share O/S (Cr)	102
Market Cap (RsCr)	98680
Book Value (Rs)	124
Avg. 52 Wk Volumes (in '000s)	1270
52 Week High	978.5
52 Week Low	708.6

Share holding Pattern % (December, 2022)	
Promoters	63.21
Institutions	30.77
Non Institutions	6.02
Total	100.0

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Harsh Sheth
Harsh.Sheth@hdfcsec.com

Our Take:

Godrej Consumer Products Ltd (GCPL) is a part of the 124-year-old Godrej Group; it was formed by the de-merger of the consumer products division of the erstwhile Godrej Soaps Ltd in April 2001. Although it was formed in its current form in 2001, it has been operating as Godrej Soaps for over 100 years, in the personal care segment. GCPL, today, has a strong presence in the FMCG industry—across three core categories - personal care, home care and hair care – with focus on three geographies - Asia, Africa and Latin America.

GCPL's inorganic expansion over the past decade plus in Asia, Africa, the US and Latin America has enabled it to enjoy a diversified revenue profile, with international operations driving ~44% of its consolidated revenue in FY22. This expansion has helped the company in extracting synergies in terms of product cross-pollination and stronger distribution network, besides being able to diversify its product portfolio and geographical reach. Also, at a consolidated level, in FY22, GCPL derived 41% of its revenue from the home care segment, 33% from hair care segment and 26% from personal care segment, reflective of a diversified segmental presence. Its brands such as Goodknight and Hit in home care, Godrej Expert in the hair colouring segment and Cinthol and Godrej No 1 in the personal care segment enjoy market leading positions in the domestic market. Similarly, in international markets, its brands Darling in the dry hair care segment in Africa and Mitu wet wipes and Stella air fresheners in Indonesia enjoy established market positions in their respective regions.

GCPL has a consistent track record of introducing new products to cater to shifting consumer preferences and we expect that, going forward, its revenue growth will be driven by stable demand growth and introduction of new products across geographies. Supported by its portfolio of strong brands, constant innovation, and brand repositioning, the company has managed to maintain its competitive position in these key product categories and geographies. It will continue to benefit from its established position in domestic and international FMCG markets.

Valuation & Recommendation:

After consecutive quarters of subdued performance with runaway RM inflation, demand slowdown and mounting troubles in Indonesia, turbulence seems to have stabilized in Q3FY23, as the company witnessed volume growth in its India business despite the macro issues. We believe, with the inflation pressure abating, a recovery in consumption and gross margin is expected. To our satisfaction, GCPL continues to gain share in most categories. Africa business is likely to improve on better growth prospects and strategic initiatives like simplifying business and improving governance while reducing pipeline inventory and media spends in Indonesia business to improve performance from Q3FY23 onwards. HI growth is likely to recover after the recent volatility with increasing penetration, marketing spends and category innovation; share gains should continue in soaps and other categories should see steady growth. New CEO, Mr. Sitapati has taken cognizance of strengths in its portfolio and revamped the company's strategy to undo mistakes made in the past. We believe the management's target of double-digit volume growth is achievable, given: a) increasing investments to drive penetration levels, b) rising marketing spends, and c) reduction in current complexity caused by a large portfolio. Palm oil and its derivatives prices, the key raw material in soaps (~25% of raw material costs) rose by 60% in FY22 and impacted the gross and operating margins. This was one of the main reasons for the 220 bps fall in OPM in FY22. While healthy correction in palm oil prices from its peak led to some recouping of margins in Q3FY23, we believe that the full impact of lower RM would be felt in the ensuing quarters. We continue to believe that revenue recovery will be gradual but margin recovery will be faster. **We think the base case fair value of the stock is Rs 1056 (42x FY25E EPS) and the bull case fair value is Rs 1119 (44.5x FY25E EPS). Investors can buy the in stock Rs 958-974 band (38.4x FY25E EPS) and add more on dips in Rs 859-873 band (34.5x FY25E EPS).**

Financial Summary

Particulars (in Rs Cr)	Q3FY23	Q3FY22	YoY-%	Q2FY23	QoQ-%	FY21	FY22	FY23E	FY24E	FY25E
Operating Income	3599	3303	9%	3392	6%	11,029	12,277	13,439	14,566	15,843
EBITDA	768	699	10%	574	34%	2,388	2,395	2,536	3,038	3,397
APAT	553	500	11%	366	51%	1,715	1,702	1,772	2,258	2,571
Diluted EPS (Rs)	5.4	4.9	11%	3.6	51%	16.8	16.6	17.3	22.1	25.1
RoE-%						19.8	16.5	14.9	16.6	16.5
P/E (x)						57.5	58.0	55.7	43.7	38.4
EV/EBITDA						46.3	41.2	40.9	38.0	31.1

(Source: Company, HDFC sec)

Key Triggers:

Innovation as turnaround strategy for HI business

HI witnessed extremely strong sales growth (19% CAGR) over FY10-16 while growth tapered off in the latter half, falling to just >2% CAGR over FY16-22. The category had been under pressure due to exponential growth in the illegal incense sticks market and irregular and poor monsoon, which resulted in low mosquito infestation. However, the company has been reporting an improved performance over past couple of quarters. Further, with goal to democratize the category, the company has recently announced disruptive innovations in Q3FY23, in HI category namely, 'Goodnight mini liquid vaporizer' and 'Mini hit spray'. Goodnight mini liquid vaporizer is priced at Rs 50 compared to Rs 95 of regular size and refill is priced at Rs 35 compared to regular refill of Rs 76. The mini Hit spray is priced at Rs 50 i.e 1/5th price of a regular spray. The pricing is very close to that of illegal incense sticks and will potentially lead to uptrading from burners and coils to vaporizers and sprays.

Continued growth momentum in soaps business:
On the back of its micro-market strategy, GCPL, over past decade has consistently gained market share, which now stands around the mid-teens from single digit in the last decade. In Q3FY23, Godrej No. 1 became the second largest brand by volume.

Prices of palm oil which increased sharply from mid-2020 have stabilised post handsome correction over past quarter. With high cost inventory already liquidated, the gross margins here are further expected to improve. A part of savings on the account of lower palm oil prices have been directed towards higher ad-spends leading to increased competitiveness and continued market share gains.

Strong GM recovery in India business: India business GM expanded by 248/582bps YoY/QoQ to 54%, after seeing 11 quarters of margin contraction. Domestic GM was ~60% prior to COVID-19; sustained RM inflation impacted the margin severely.

International business on the path to recovery:
Indonesia: Indonesia business is witnessing gradual recovery. Sales declined by 3% on CC basis in Q3FY23, however ex-hygiene it was up 2% on CC basis. EBITDA declined due to higher marketing spends and scale deleverage. In Q3FY23, GCPL has taken write-offs in Indonesia inventory and has held off the heavy promotions and discounting, which has affected growth. Another simplification has happened in Indonesia where GCPL has moved to a distributor model vs. earlier when company salesmen were selling to 60,000 stores. The macro environment in Indonesia has turned around and we expect Indonesia business to deliver sustainable margin improvement over next 3-4 years. The margins can potentially move up to mid-20s to late-20s over next three–four years in Indonesia.

GUAM (Godrej Africa, the US, and the Middle East): GUAM business has undergone a tough phase from FY17-20 with sales CAGR of 3% YoY and EBITDA CAGR of -11%, largely due to weak macroeconomic conditions and liquidity challenges. However, it has shown a tremendous recovery over the past few quarters, a part of which can be attributed to the appointment of Mr. Dharnesh Gordhon as CEO of GUAM in April 2020. He has built a strong van distribution model. In Africa, GCPL has been moving away from wholesale and this has yielded great results in its FMCG business. The objective for GUAM is to pivot further towards the FMCG business in terms of salience. This will entail focusing on the braids part of the hair extension business to achieve scale.

Focus on Africa will be on pricing-led growth, up front investments in FMCG, and driving profitability. Overall volume growth in Africa was in mid-single digits while the volume growth of FMCG categories was close to double-digits. The company witnessed a meaningful margin expansion, and in the medium-term, margin improvement will be meaningful, and margins should be in the mid-teens in 2-3years.

Renewed philosophy to drive the growth

Innovation has been a key strategy of growth for GCPL with new launches driving revenue growth over the past five years. After an intense period of innovation in FY21, characterised by the pandemic GCPL undertook a strategic reset of product innovation and new brand development activities. Leveraging its RIDE (R&D + Innovation + Design + Expertise) structure it intends to drive innovation by adopting following key principles:

- A 'less is more' approach: fewer, bigger, better innovations
- Even more consumer-centric: deeper insights, prioritising the voice of our consumers in decision-making
- 100% objectivity: rigorous stage-gate process, right governance
- Become truly global: efficiently delivering synergies
- Sustainability

While new brand development will continue to be an important capability and driver of value, GCPL aims to discontinue with smaller brands where it makes sense from a better parentage/value realisation perspective.

GCPL in its India business had over 500 SKUs which led to higher inventory levels. So far, GCPL has been able to rationalize its SKU by 25% over last 6 months in India and by 1/3rd in GUAM. The working capital continued to reduce led by simplification efforts. Initiatives towards simplification are 1) to reduce inventory and receivable – already in place and 2) simplification of distributor margins – where some work is remaining. Going ahead, these efforts are expected to yield positive results on overall operations. In 9MFY23, cash from operations increased by Rs 300 Cr. Inventory plus receivables have declined from 97 days at the start of FY23 to 79 days at the end of Q3FY23.

Key Concerns

Competition risk can arise in the form of product pricing strategy, aggressive pricing by competitors, entry of new players, emergence of e-com/digital first brands and dependency on a few product categories to drive sales. The likely disruption in the grocery retail market and the growth of the hyper-local formats of Reliance Retail and the new e-commerce hypermarkets pose a risk to the industry dynamics in the medium term.

The company faces currency risk as it has over 40% of its revenue from foreign operations and has a presence in five continents. Currency fluctuations in its key international markets, including Africa and Indonesia, will affect its earnings performance.

Commodity risk exists as volatility in commodity prices (like palm oil, crude oil derivatives etc.) can impact GCPL's revenue and margins.

Business slowdown risk exists. GCPL saw muted sales, EBITDA and PAT growth in FY18-20 due to a combination of factors (including consumer spending slowdown/downtrading in various geographies, volatility in raw material prices, geopolitical issues in some countries, nil growth/degrowth in insecticides business for some quarters, heightened competition in some categories, etc.) and, hence, its stock price underperformed. Any resurgence of such a slow-growth scenario could hurt its growth, going forward.

Structural fall in demand for HI in India could be a risk for the company.

Godrej group is reportedly undergoing a family split. This may result in impacting valuation of the groups' companies depending on the outcome and timing thereof.

Financials

Income Statement

Particulars (in Rs Cr)	FY20	FY21	FY22	FY23E	FY24E	FY25E
Net Revenues	**9911**	**11029**	**12277**	**13439**	**14566**	**15843**
Growth (%)	***-3.9***	***11.3***	***11.3***	***9.5***	***8.4***	***8.8***
Operating Expenses	7768	8640	9881	10903	11528	12446
EBITDA	**2143**	**2388**	**2395**	**2536**	**3038**	**3397**
Growth (%)	***1.2***	***11.4***	***0.3***	***5.9***	***19.8***	***11.8***
EBITDA Margin (%)	***21.6***	***21.7***	***19.5***	***18.9***	***20.9***	***21.4***
Depreciation	197	204	210	227	245	258
Other Income	112	67	90	148	183	252
EBIT	**1946**	**2184**	**2185**	**2309**	**2793**	**3139**
Interest expenses	217	127	110	165	119	96
PBT	**1760**	**2080**	**2155**	**2175**	**2754**	**3247**
Tax	264	360	372	435	600	725
PAT	**1497**	**1721**	**1783**	**1740**	**2258**	**2571**
Share of Asso./Minority Int.	-69	-37	-8	-25	-24	-6
Adj. PAT	**1473**	**1715**	**1702**	**1772**	**2258**	**2571**
Growth (%)	***0.5***	***16.5***	***-0.8***	***4.1***	***27.4***	***13.9***
EPS	14.4	16.8	16.6	17.3	22.1	25.1

Balance Sheet

Particulars (in Rs Cr) - As at March	FY20	FY21	FY22	FY23E	FY24E	FY25E
SOURCE OF FUNDS						
Share Capital	102	102	102	102	102	102
Reserves	7796	9337	11038	12606	14455	16412
Shareholders' Funds	**7898**	**9439**	**11141**	**12708**	**14557**	**16514**
Minority Interest	0	0	0	0	0	0
Total Debt	2664	1768	1608	1458	1278	748
Net Deferred Taxes	-570	-638	-680	-680	-680	-680
Other Non-Curr. Liablities	290	189	174	174	174	174
Total Sources of Funds	**10282**	**10759**	**12242**	**13660**	**15329**	**16756**
APPLICATION OF FUNDS						
Net Block & Goodwill	9233	8909	9221	9494	9550	9592
CWIP	56	53	115	115	115	115
Other Non-Curr. Assets	213	171	380	430	480	530
Total Non Current Assets	**9502**	**9134**	**9715**	**10038**	**10144**	**10236**
Inventories	1703	1716	2130	2172	2354	2561
Debtors	1157	1005	1116	1252	1357	1476
Cash & Equivalents	1407	1329	1537	2667	4150	5394
Other Current Assets	422	489	535	580	631	0
Total Current Assets	**4808**	**4472**	**5272**	**6627**	**8441**	**10062**
Creditors	2480	2012	2163	2368	2566	2791
Other Current Liab & Provisions	1547	835	582	637	690	751
Total Current Liabilities	**4028**	**2847**	**2745**	**3005**	**3257**	**3542**
Net Current Assets	780	1625	2527	3622	5185	6520
Total Application of Funds	**10282**	**10759**	**12242**	**13660**	**15329**	**16756**

Cash Flow Statement

Particulars (in Rs Cr)	FY20	FY21	FY22	FY23E	FY24E	FY25E
Reported PBT	1,841	2,080	2,155	2,175	2,754	3,247
Non-operating & EO items	-50	61	-35	43	11	-78
Interest Expenses	217	127	110	165	119	96
Depreciation	197	204	210	227	245	258
Working Capital Change	-261	-45	-695	36	-80	-91
Tax Paid	-344	-397	-372	-435	-600	-725
OPERATING CASH FLOW (a)	**1,601**	**2,030**	**1,373**	**2,211**	**2,449**	**2,707**
Capex	-152	-164	-564	-500	-300	-300
Free Cash Flow	1,449	1,866	809	1,711	2,149	2,407
Investments	-438	-211	-313	-176	-158	-124
Non-operating income	57	59	-111	0	0	0
INVESTING CASH FLOW (b)	**-533**	**-316**	**-989**	**-676**	**-458**	**-424**
Debt Issuance / (Repaid)	-128	-1,619	-161	-150	-180	-530
Interest Expenses	-152	-159	-110	-165	-119	-96
FCFE	1,169	88	538	1,396	1,850	1,781
Share Capital Issuance	0	0	0	0	0	0
Dividend	-986	0	0	-205	-409	-614
Others	-30	0	0	0	0	0
FINANCING CASH FLOW (c)	**-1,295**	**-1,778**	**-271**	**-519**	**-708**	**-1,239**
NET CASH FLOW (a+b+c)	**-228**	**-64**	**114**	**1,015**	**1,283**	**1,044**

One-year share price chart

Key Ratios

Particulars	FY20	FY21	FY22	FY23E	FY24E	FY25E
Profitability Ratios (%)						
EBITDA Margin	21.6	21.7	19.5	18.9	20.9	21.4
EBIT Margin	20.8	20.4	18.5	18.3	20.4	21.4
APAT Margin	14.9	15.6	13.9	13.2	15.5	16.2
RoE	19.4	19.8	16.5	14.9	16.6	16.5
RoCE	19	19.8	18.1	17.5	20.6	23
Solvency Ratio (x)						
Net Debt/EBITDA	0.6	0.2	0	-0.5	-0.9	-1.4
Net D/E	0.2	0	0	-0.1	-0.2	-0.3
PER SHARE DATA (Rs)						
EPS	14.4	16.8	16.6	17.3	22.1	25.1
CEPS	16.3	18.8	18.7	19.6	24.5	27.7
Dividend	6	0	0	2	4	6
Book Value	77.3	92.3	108.9	124.3	142.4	161.5
Turnover Ratios (days)						
Debtor days	43	33	33	34	34	34
Inventory days	60	57	57	59	59	59
Creditors days	91	67	64	64	64	64
Valuation (X)						
P/E	67	57.5	58	55.7	43.7	38.4
P/BV	12.5	10.5	8.9	7.8	6.8	6
EV/EBITDA	47.1	46.3	41.2	40.9	38	31.1
EV / Revenues	10	8.9	8	7.2	6.5	5.8
Dividend Yield (%)	0.6	0	0	0.2	0.4	0.6

(Source: Company, HDFC sec)

HARSH RAJENDRA SHETH

Digitally signed by HARSH RAJENDRA SHETH
Date: 2023.04.11 09:04:48 +05'30'

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.