

CREDENCE CAPITAL

(Investment Club of IIM Lucknow)

FMCG Sector report



Table of Contents

1. INTRODUCTION TO FMCG INDUSTRY	3
2. SEGMENTATION AND VALUE CHAIN	5
<i>Value Chain & its Components.....</i>	<i>5</i>
<i>Sales & Distribution Process</i>	<i>6</i>
3. MAJOR INDIAN PLAYERS.....	7
<i>Constituents of Nifty FMCG index (as of 4th Sept, 2021).....</i>	<i>7</i>
4. EMERGING TRENDS AFTER COVID-19	8
<i>Consumer confidence is returning post-“Unlock India”</i>	<i>8</i>
<i>Consumers are showing signs of engaging in “revenge spending”</i>	<i>8</i>
<i>Conglomerates are using the COVID-19 crisis to consolidate their position</i>	<i>8</i>
<i>Other major deals:.....</i>	<i>9</i>
5. STRATEGIES ADOPTED BY TOP PLAYERS	10
<i>Strengthen rural network:</i>	<i>10</i>
<i>Direct-to-consumer channels.....</i>	<i>10</i>
<i>New market entry.....</i>	<i>10</i>
<i>E-commerce</i>	<i>10</i>
<i>Green initiatives.....</i>	<i>11</i>
<i>Analytics</i>	<i>11</i>
6. RECENT NEWS	12
7. POLICY MEASURES UNDERTAKEN BY THE GOVERNMENT	13
<i>New goods and service tax (GST) would simplify tax structure:.....</i>	<i>13</i>
8. SECTOR OUTLOOK AND CATEGORY OUTPERFORMERS AND UNDERPERFORMERS (LTM BASIS).....	14
9. REFERENCES	15

1. Introduction to FMCG Industry

FMCG stands for Fast-moving consumer goods and can also be called consumer packaged goods. This industry covers products and goods that are generally priced at a **relatively low cost and are sold quickly**. Products under FMCG includes **non-durable household** goods such as packaged foods, beverages, toiletries, candies, cosmetics, over-the-counter drugs, dry goods, and other consumables.

Multiple players both in unorganised and organised segments operate in FMCG sector in India. With manifold products manufactured, each product category has several brands and varieties and low consumer switching cost which leads to intense competition among players operating in this sector. Therefore, FMCG companies operate on **low margin and sales volume** remains the key to survival.

Sector overview

- FMCG sector is a vital contributor to India's GDP and the 4th largest sector in the Indian economy
- It is forecasted to grow from \$110 billion in 2020 to \$220 billion in 2025 registering a CAGR of 14.9%
- According to Nielsen, the Indian FMCG industry grew 9.4% in January-March quarter of 2021, supported by consumption led growth and value expansion from higher product prices, particularly from staples. The rural market registered an increase of 14.6% in same quarter and metro markets recorded positive growth after 2 quarters
- One of the key factors which will drive growth in this sector is expected to be rise in **rural consumption**. Currently, it contributes ~45% to the overall FMCG industry
- According to recent reports, the pandemic has accelerated **ecommerce** transition by five years in India; we find that the Indian consumer has got very comfortable transacting online and within 6-12 months, we expect ecommerce contribution to FMCG sales hit double digits



Source: IBEF (in \$USD billion)

Summary of COVID impact in FMCG sector

FMCG faces structural change as stay-at-home consumption, health & wellbeing and sustainability dominate the strategic agenda. COVID-19 has further muddied the waters.

Whilst most FMCG sub-sectors have benefitted from **favourable consumption trends** in the initial stages of lockdowns there have been some exceptions. Alcohol, for instance, is expected to face a relatively protracted recovery weighed down by on-trade and travel retail exposure.

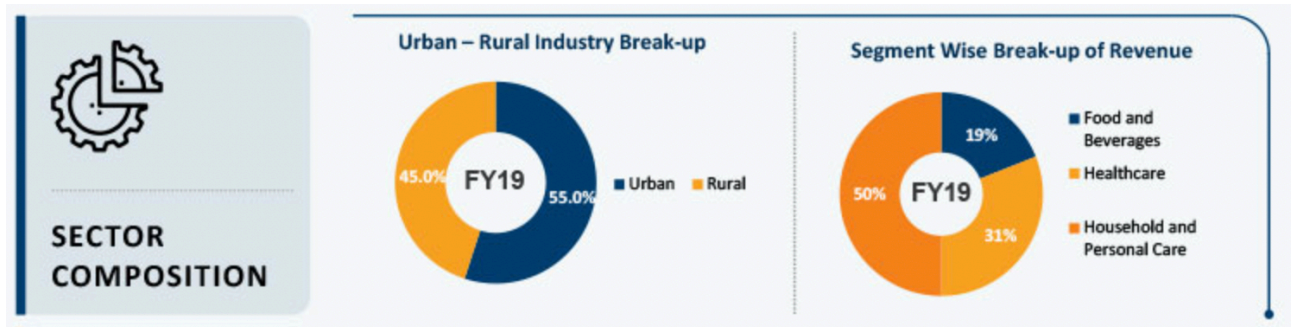
In either instance, **margin expansion** is set to become tougher as negative portfolio mix and higher one-off costs prove obstructive. Many corporates have already executed multi-year efficiency programmes, making it harder to squeeze further savings.

Importantly, the pandemic has asked serious questions of yesterday's supply chain philosophy which prioritised low cost production and stretching supplier terms. Today, corporates are managing disruption risk through localising production whilst supporting liquidity needs of key suppliers. All of these require cash – and there are other claimants in line. Three to be precise:

- **Investment:** Enhancing digital capabilities across the supply chain
- **Acquisitions:** Corporates with capital may set out to acquire an incumbent, expertise or access to new market verticals
- **Shareholder returns:** Shareholders have gotten used to a high and consistent level of cash returns

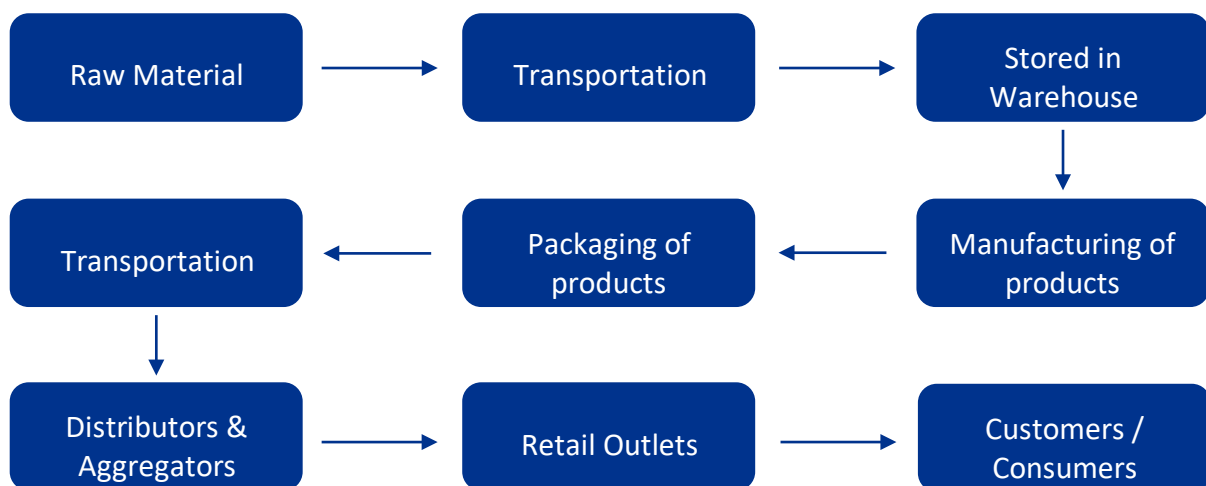
Source: Standard Chartered report

2. Segmentation and Value chain

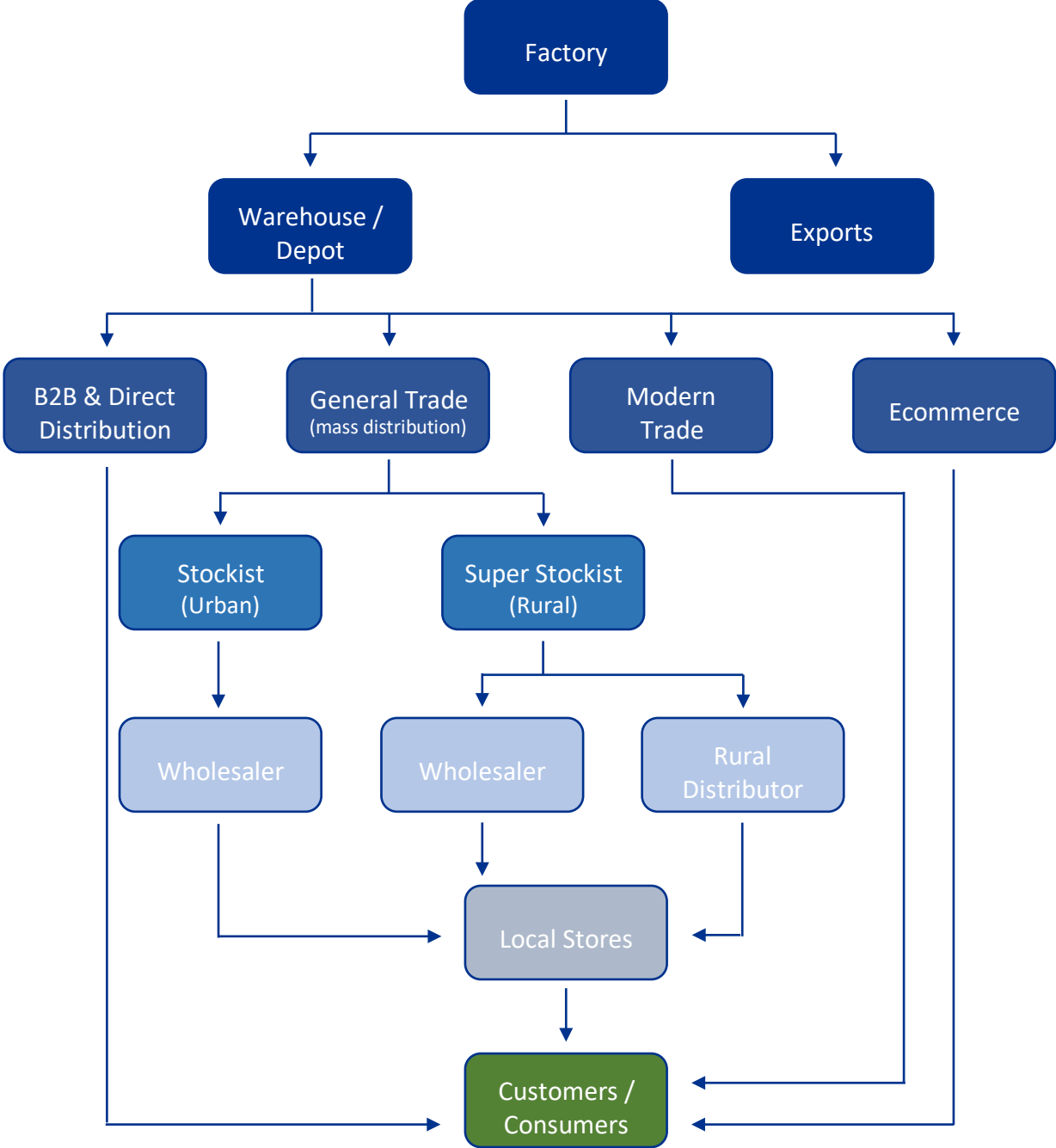


- Urban segment is the largest contributor to the overall revenue generated by the FMCG sector in India accounting for a revenue share of around 55%.
- Rural segment is growing at a rapid pace and accounted for a revenue share of 45% in the overall revenues recorded by FMCG sector in India.
- In the last 5 years, the FMCG market has grown at a faster pace in rural India compared to urban India. The rural segment is estimated to reach \$220 billion by 2025, with modern trade expected to grow at 20-25% per annum
- Improved distribution channels of manufacturing and FMCG companies have increased the demand for quality goods and services in rural areas. Low penetration levels in the rural market offer room for growth

Value Chain & its Components



Sales & Distribution Process



3. Major Indian Players

Constituents of Nifty FMCG index (as of 7th Sept, 2021)

Stocks	1D change	Return attribution	↓ Index weight	Free float marketcap
NIFTY FMCG	▲ 0.30%	0.30%	100.00%	833.07
Hindustan Unilever Ltd HINDUNILVR	▼ 0.10%	-0.03%	29.66%	247.05
ITC Ltd ITC	▲ 1.17%	0.26%	22.00%	183.26
Nestle India Ltd NESTLEIND	▲ 0.72%	0.06%	8.75%	72.92
Tata Consumer Products Ltd TATACONSUM	▼ 0.20%	-0.01%	6.24%	51.95
Britannia Industries Ltd BRITANNIA	▲ 0.40%	0.02%	5.86%	48.78
Godrej Consumer Products Ltd GODREJCP	▼ 0.03%	-0.00%	4.88%	40.62
Dabur India Ltd DABUR	▲ 0.50%	0.02%	4.33%	36.07
Jubilant Foodworks Ltd JUBLFOOD	▼ 1.85%	-0.07%	3.72%	30.97
Marico Ltd MARICO	▲ 0.35%	0.01%	3.47%	28.93
Colgate-Palmolive (India) Ltd COLPAL	▲ 1.69%	0.05%	2.76%	23.02
United Spirits Ltd MCDOWELL-N	▲ 0.45%	0.01%	2.54%	21.17
Varun Beverages Ltd VBL	▼ 1.36%	-0.02%	1.65%	13.71
Procter & Gamble Hygiene and Health Care Ltd PGHH	▲ 2.67%	0.04%	1.59%	13.23
Emami Ltd EMAMILTD	▼ 2.02%	-0.03%	1.37%	11.44
United Breweries Ltd UBL	▼ 0.36%	-0.00%	1.19%	9.94

4. Emerging trends after COVID-19

Consumer confidence is returning post-“Unlock India”

Consumer confidence in India nosedived in May 2020, after Indian consumers had endured two months of strict, national lockdown measures aimed at curbing the spread of COVID-19. Consumer confidence in the current situation reached its all-time low in September 2020 before gradually improving in each subsequent survey as India began progressively rolling back restrictions as part of “Unlock India.” Consumers also breathed a collective sigh of relief as the number of new COVID-19 cases peaked in September 2020 before falling steadily, and India’s vaccination plan began in earnest in December 2020

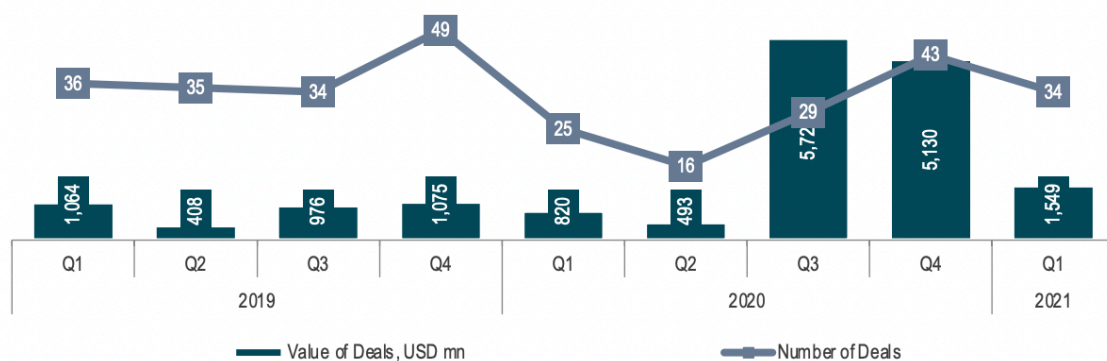
Consumers are showing signs of engaging in “revenge spending”

The rising consumer confidence post-Unlock India resulted in some early signs of “revenge spending”, in which consumers emerged from their lockdown-enforced austerity to spend on luxuries. FMCG producers ITC and Emami reported sales upticks in non-essentials spending categories like confectionery, deodorants, and apparel in Q3 2020 compared with the previous quarter, albeit at lower levels pre-COVID-19

Conglomerates are using the COVID-19 crisis to consolidate their position

The COVID-19 outbreak’s short, sharp shock to economic activity caught some over-leveraged retailers flat-footed. EMIS DealWatch data shows that the size of M&A deals has jumped more than fivefold even as the number of deals declined in Q3 and Q4 2020 compared with a year before, indicating an increase in deal activity by the largest players in the Indian consumer goods and retail sector

Total value of M&A deals (USD mn) and number of deals from 2019 to Q1 2021 (until the end of February 2021)



Source: EMIS DealWatch

The **Tata Group** has also taken advantage of the pandemic to strengthen its position. The conglomerate reached an agreement to purchase 60% of the equity in the online grocery retailer, **BigBasket**, in February 2021, valuing BigBasket at between USD 1.8-2.0bn. The BigBasket purchase announcement followed hot on the heels of news of the Tata Group’s proposed purchase of a 55% stake in the online pharmacist, 1mg

Other major deals:

Target name	Acquirer Name	Merger/Acquisition	Year
Kottaram Agro Foods (KAF)	Tata Consumer Products Limited (TCPL)	Acquisition	2021
Eveready Industries	Dabur's Burman family	Acquisition (19%)	2020
GlaxoSmithKline Consumer Healthcare Limited	Hindustan Unilever Ltd. (HUL)	Merger	2020
Glenmark Pharmaceuticals Ltd.'s Vwash Brand	Hindustan Unilever Ltd. (HUL)	Acquisition	2020
Eastern Condiment	Orkla	Acquisition (68%)	2020
Beardo	Marico	Acquisition (100%)	2020
Sunrise Food Private Limited	ITC Ltd.	Acquisition	2020
PepsiCo's stake in NourishCo Beverages Limited	Tata Consumer Products Limited (TCPL)	Acquisition	2020
Sunrise Food Private Limited	ITC Ltd	Acquisition	2020

5. Strategies adopted by top players

Strengthen rural network:

- In February 2021, Nestle India announced plans to reach ~1.2 lakh villages (with each having population of over 5,000) over the next 2-3 years.
- In April 2021, rural distribution company StoreKing announced that it will launch modern retail stores in rural India.
- Other players such as Marico is introducing bottom-of-the-pyramid products to its portfolio of value-added hair oil, helping the business reach rural markets. Rural penetration will continue to be important for Godrej Consumer Goods Ltd. Over the next three years, the organisation plans to extend its presence to 80,000 villages in key states

Direct-to-consumer channels

- Businesses such as Dabur India and Marico Ltd. have introduced retail telephone services and rolled out a dedicated app that enables orders to be placed by kiranas.
- In January 2021, Tata Consumer Products announced that it is looking for ways to add more of its beverages' portfolio onto a direct-to-consumer platform to capture the urban online market.

New market entry

- In January 2021, FMCG businesses in India are planning to expand their oral care portfolio by entering new and niche categories such as mouth sprays, ayurvedic mouth cleansers and mouthwashes to meet the rising consumer demand for **hygiene products**.
- For example, Pulling oil, an **ayurvedic concoction** used as a morning oral cleansing ritual based on centuries-old Ayurvedic regimen, was launched by companies such as Colgate Palmolive (India) Ltd. and Dabur India.
- In December 2020, Godrej Consumer Products Limited (GCPL), under its Godrej ProClean brand, has ventured into home **cleaning products** to meet the rising demand for cleaning and hygiene products among Indian consumers. The home cleaning products segment, which includes branded floor, toilet and bathroom cleaners, is estimated to be ~ Rs. 2,600 crore (US\$ 354.05 million)

E-commerce

- FMCG companies are focusing on strengthening their e-commerce engagement. An Ayurveda baby care range has been introduced by Dabur, which will be sold only on e-commerce platforms. With its contribution expanding from 1.5% to 5.6%, the e-commerce division of the group has more than doubled over the previous year. Similarly, in the first quarter of FY21, Marico's e-commerce sector has grown 37% YoY, while Emami's e-commerce business doubled to >100%.

Why?

- The rapid increase in the number of internet users
- Companies are creating an omni-channel presence, blending online shopping and offline retail to overcome trust issues of customers
- Availability of numerous choices in terms of brands, discount offers, reduced delivery time, personalization, cash on delivery, digital payment infrastructure and easy returns have been major factors for development of the B2C e-commerce
- These companies are forming innovative product bundles aligned with the needs of customers and thus ensuring greater customer engagement

Green initiatives

- FMCG companies are looking to invest in energy efficient plants to benefit the society and lower costs in the long term.
- Procter & Gamble (P&G) India has set up a Rs. 200 crore (US\$ 28 million) environmental sustainability fund in the country to offer sustainable solutions, such as plastic-free packaging and environment-friendly logistics services, in partnership with Indian businesses.
- In November 2020, NIVEA, by launching the first ever e-commerce ready-to-ship kit, 'NIVEA CARE BOX', in collaboration with Amazon India, has taken a step towards being more sustainable through its packaging.

Analytics

- HUL implemented a transformational programme called Connected 4 Growth (C4G) to help drive business growth by increased speed to market, faster decision making, localised and swifter innovation.
- Patanjali uses Oracle and SAP for Enterprise Resource Planning (ERP). It will further standardise the application on SAP. It plans to use machine learning for quality control and product enhancement and are also in talks with Net App for big data solution

6. Recent News

- **Tata Consumer Products rolls out new branding for Tata Soulfull range**
Tata Consumer Products on Friday announced the rollout of new branding for the Tata Soulfull range of health and wellness food. The company said it has integrated the Tata logo into the Soulfull portfolio, subsequent to Tata Consumer Soulfull Pvt Ltd becoming a 100 per cent subsidiary of Tata Consumer Products in February 2021
Link: <https://bit.ly/3l2xGfP>
- **Amul, Parle, others stop direct supply to B2B startup Udaan**
Alleging that business-to-business (B2B) ecommerce platform Udaan was monopolising distribution to retailers, some of India's largest fast-moving consumer goods (FMCG) makers such as Amul and Parle Products are not supplying stocks directly to the Bengaluru-based startup
Link: <https://bit.ly/3l07Jh2>
- **Covid impact: As nature unleashed its wrath, natural products topped the charts**
Sales of naturals products across personal care categories have grown at nearly twice the rate of regular consumables during the year ended June, as the spread of Covid-19 led to an increased consumer interest, awareness and demand for ayurvedic brands
Link: <https://bit.ly/3DSx316>
- **Indian FMCG industry clocks 37% value-based growth in Apr-Jun quarter: Report**
Indian FMCG industry recorded a 36.9 per cent value-based growth in April-June 2021, the quarter hit by the second wave of the pandemic, over the corresponding period a year ago, data analytics firm Nielsen has said. However, when compared with this year's January-March quarter, the industry saw a 2 per cent drop, it added
Link: <https://bit.ly/3ha5bvl>
- **Ecommerce sales for FMCG companies to hit double-digits soon**
Ecommerce contribution at FMCG companies will hit the double-digit mark within a year in the fastest adoption of online sales across categories despite the easing of curbs, pointing to altered purchase patterns for daily-use items hitherto sold largely by either large-format supermarkets or tiny mom-and-pop neighbourhood stores
Link: <https://bit.ly/3tp3lXs>

7. Policy measures undertaken by the government



New goods and service tax (GST) would simplify tax structure:

▪ **Supply chain structure**

Introduction of GST as a unified tax regime will lead to re-evaluation of procurement and distribution arrangements.

Removal of excise duty on products would result in cash flow improvements.

The rate of GST lies between 0-18% on services and 0-28% on goods.

▪ **Pricing and Profitability**

Elimination of tax cascading is expected to lower input costs and improve profitability.

Application of tax at all points of supply chain is likely to require adjustments to profit margins, especially for distributors and retailers.

▪ **System change and transaction management**

Changes need to be made to accounting and IT systems in order to record transactions in line with GST requirements and appropriate measures need to be taken to ensure smooth transition to the GST.

It is estimated that India will gain US\$ 15 billion a year by implementing GST.

▪ **Cashflow**

Tax refunds on goods purchased for resale implies a significant reduction in the inventory cost of distribution. Distributors are also expected to experience cash flow from collection of GST in their sales before remitting it to the Government at the end of the tax-filing period.

8. Sector outlook and category outperformers and underperformers (LTM basis)

The surge in Covid-19 cases during February-March 2021 and consequent imposition of state wise restrictions from April 2021 onwards within the country has impacted the demand-supply dynamics in FMCG industry in Q1-FY22.

The rural demand that had grown the urban demand during the first wave of the pandemic in FY21 seems to be hit more severely in the second wave. Although restrictions are being eased gradually across states from June-July 2021 onwards, discretionary products are estimated to witness soft demand in FY22. The second wave caused significant **financial distress to households** who are expected to become prudent in terms of spending on discretionary products and focus on savings instead. The demand for hygiene products is likely to see continued traction due to increased awareness with regards to Covid-19 and apprehensions surrounding the third wave of the pandemic.

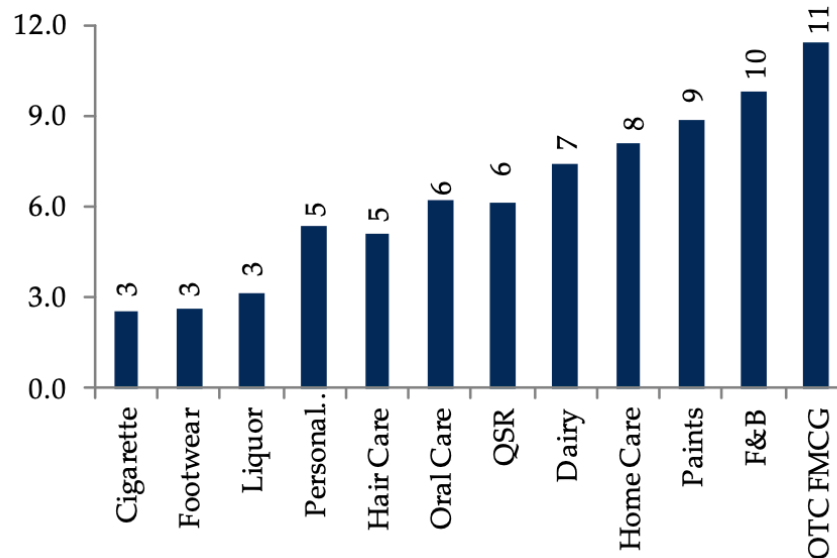
A favourable monsoon is forecasted to aid the rural demand. However, the rural economy comprises farm and non-farm sectors and therefore prospects of good monsoon will not necessarily imply higher demand from the whole of rural economy. Besides, the second wave coincided with the sowing season and unlike urban areas, testing and health infrastructure is poor in rural regions. Hence, it is difficult to assess the impact of the pandemic on rural India and the propensity to spend during the festive season.

Globally, the Indian market is one of the fastest growing markets for FMCG industry although the per capita consumption of FMCG products is amongst the lowest. Hence, immense growth opportunities exist in the market. The long term outlook for the sector remains positive on the back of growth in e-commerce industry, favourable demographics, increase in disposable income among other enablers. Rise in the share of women workforce is expected to lead to double income households and thereby increasing the household's propensity to spend and is also expected to lead to increase in demand for ready to eat food items.

The share of unorganised players is likely to decrease following higher demand for branded products from smaller towns and cities through online portals. Further, a change in perception of health and hygiene following the pandemic will ensure that the demand for immunity-boosting and hygiene products sustains even after the pandemic.

- OTC FMCG & F&B outperformed in LTM: F&B, oral care and OTC FMCG categories outperformed in the past four quarters, aided by the heightened demand in the last few months. Marico (Saffola), Nestle and Britannia clocked the highest growth in F&B while Dabur (Health Supplements) and Emami (pain management, digestives) led the growth in OTC FMCG.
- QSR, footwear, liquor and cigarette underperformed in LTM: QSR, footwear, liquor and cigarette categories have been the most impacted in the past four quarters by the lockdown. In footwear, Bata was the most impacted business, with a higher business mix from school shoes. Within QSR, Jubilant outperformed its peers with a strong delivery model. Within liquor, United Breweries was the worst impacted as the closure of pubs reduced beer consumption.

Category Performance- five-year average (%)



Source: Company, HSIE Research

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