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FMCG cos all set to reap benefit from declining trend in commodity prices

The firms have also got an additional succor from the govt decision to reduce excise duty in two stages

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FMCG

Consumer goods companies could notch a far better performance in the fourth quarter of this fiscal based on drastic fall in global commodity prices and rise in the value of several currencies against the rupee.

Analyst reports say the benefit will be for consumer nondurables, collectively described as fast moving consumer goods or FMCG. While commodity prices had begun falling from the later half of 2008-09, FMCG companies took time to take advantage of that. They were running high inventories that took time to ease off. To move the goods, while some companies reduced prices during the quarter, the soap and detergent category increased the size of their products or offered freebies. This led to increase in sales especially of low-end products like Godrej No 1 and Ghadi detergent from Godrej Consumer Products. Companies like Emami went the other way and increased prices of some of their products. "We won't go for price reduction. We always have on-going offers and price-related promotions to boost sales," said Aditya Agarwal, director of Emami Group of companies. According to a report of Sharekhan, equity analyst house, while premium products like Hindustan Unilever Ltd's soaps and detergent and Marico's Saffola witnessed fall in volume growth, down market product like Godrej's Ghadi saw a robust growth.

The companies have also got an additional benefit from the government decision to reduce excise duty in two stages, from 14% to 8% across the board.

The sharpest advantage has come from reduction in edible oil prices. Angshu Mallick, vice-president (sales & marketing) of Adani Wilmer said, "Consumption increased while prices came down from November 2008".

The impact of reduction in prices offered by edible oil companies was not felt immediately as many of the retailers did not pass on the benefit to customers retaining higher margins for themselves. Reduction in global commodity prices, particularly crude, helped FMCG companies to garner better margins. Palm oil prices came down to Ringgit 1916.50 per tonne during the fourth quarter as against Ringgit 3447 for the corresponding period of the previous fiscal, registering almost a 45% drop.

LAB (feed stock) prices during the fourth quarter came down by 26.3% to Rs 23,131 per kilolitre from Rs 31,380. HDPE, required for packaging, came down to $ 936 .7 during the Q4 of FY 2009 from $1645 during the year-ago period, registering a 43.1% drop. These helped home care products like detergents and soaps along with personal care products like shampoos, toothpastes and skin-care to benefit from the low input cost situation. Shah said that Godrej Consumer Products Ltd (GCPL) and HUL stood to benefit the most due to high contribution of soaps and detergents to their revenues.

"Raw material cost comprises almost 70% of edible oil companies' revenues. Prices of soya also came down during the period," said Adani Wilmer's Mallick. According to Sharekhan reports, prices of sunflower oil during the quarter came down by 43.1% to Rs 440.30 per 10 kg as against Rs 774.10 in the year-ago period.

Recent fall in copra and safflower oil prices by 15-20% owing to higher supply on account of flush season was likely to aid Marico, said Shah.

"While prices of inputs came down by 25% during the period, dollar prices went up by 10%, leading companies to benefit by almost 15% during the quarter from the input cost reduction," said Mallick. As a result, Angel Broking's research analyst for the sector, Anand Shah expects companies like Nestle, Godrej Consumer and Marico to register a 15% growth in top line in the results due in April.

While appreciating dollar has reduced margins for FMCG companies, companies like Marico doing business in the Middle East stands to benefit from currency translation gains. Sharekhan finds that the UAE Dirham and the Egyptian pound appreciated by 26.4% and 23.4%, respectively, over rupee during the quarter on a y-o-y basis. "This, along with the price increases undertaken in the international product portfolio, will help Marico's international business' top line to grow in Q4," it said.

On the other hand, increase in the global tea prices has helped Indian tea companies. Tea prices at Indian auctions were Rs 81 per kg in the fourth quarter as against Rs 62.5 for the corresponding period last fiscal. Sharekhan expects Tata Tea's top line for the quarter to grow by 10.5% y-o-y owing to a strong growth in the domestic business.

Meanwhile, companies have also reduced other expenses. "In view of recessionary trends, we have embarked on an austerity drive," said Emami's Agarwal. The company has reduced spends on advertising and marketing by a significant margin. A special importance is being given on improving the work efficiency and to do away with all wasteful expenditures," he said. Adani Wilmer achieved a cost benefit of 5% by cutting down various other expenses.

Sharekhan expects that HUL's advertisement and sales promotion expenses as percentage to sales to decline by 90 basis points to 10.5% during the quarter. "Thus, overall, we expect the operating margins (of HUL) to improve by 135 basis points to 12.1% in Q4 of FY09. Consequently, we expect the operating profit to increase by 27.7% y-o-y to Rs 520.8 crore and the adjusted net profit to rise by 21.7% y-o-y to Rs 460.7 crore during the quarter," it said. In terms of relative performance in the stock markets, FMCG companies have shown better results. The BSE FMCG Index delivered a marginal outperformance of 182 basis points vis-à-vis Sensex led by mid-caps like GSK Consumer, Dabur and Colgate during the quarter.

"FMCG stocks registered a sign of moderation after several quarters of significant outperformance. Most FMCG stocks in our universe outperformed the Sensex except for GCPL, HUL and Asian Paints. Going ahead, we expect FMCG stocks to continue to command premium valuations though the overall P/E band could fall in line with Sensex valuations." said Shah of Angel Broking.