CONSUMER STAPLES

15 March 2023

Visible signs of rural revival

- **Green shoots visible in rural markets (~40% of FMCG industry volumes) after a prolonged slowdown; policy measures to lend a further boost**
- **Improved rural penetration driving volume growth and market share gains for FMCG majors even in a tough macro environment**
- **BRIT and NEST remain our preferred picks on the back of their improving distribution networks beyond tier-1 markets**

Vikrant Kashyap
research@bobcaps.in

Recovery in rural markets holds the key: Rural consumption, which forms close to 40% of the FMCG industry's volumes, has been sluggish over the past six quarters, but green shoots have emerged towards the end of 2022. Policy measures such as wage hikes under the MGNREGA scheme, free foodgrains, hikes in minimum support crop prices, direct benefit transfer, and higher budget allocation for infrastructure development in the hinterland bode well for a rural recovery. Further, respite from inflation and strong winter crop sowing should boost consumption in these markets.

Raw material inflation has hit margins…: FMCG players have faced unprecedented raw material inflation over the last 5-6 quarters, depleting margins and prompting a rash of price hikes and grammage cuts. The relentless price increases across categories drove demand contraction, especially in rural markets, even as the economic slowdown prevented companies from passing on the full cost burden to consumers, eroding margins.

…but channel checks suggest respite ahead: Inflation headwinds have started to moderate from Q2FY23. Key inputs such as crude oil and palm derivatives have corrected 35-50% from peaks, the benefit of which will percolate through in coming quarters. Though prices of several agricultural commodities remain firm, most consumer staples players expect to see moderation in raw material cost. Our channel checks with key players in the FMCG supply chain, including distributors, wholesalers and stockists, indicate that the revival in rural markets has continued in the current quarter and volume offtake has been better than previous quarters.

Valuation and Top picks: We continue to prefer BRIT (BUY, TP Rs 5,623) and NEST (BUY, TP Rs 22,860) for their strong network buildup in rural India which offers scope for market share gains and lends a measure of resilience even amid a difficult macroeconomic climate. BRIT is trading at 44x/39x FY24E/FY25E EPS and we continue to value the stock at 51x FY25E EPS. NEST is trading at 62x/54x CY23E/CY24E EPS and we value it at 67x CY24E EPS.

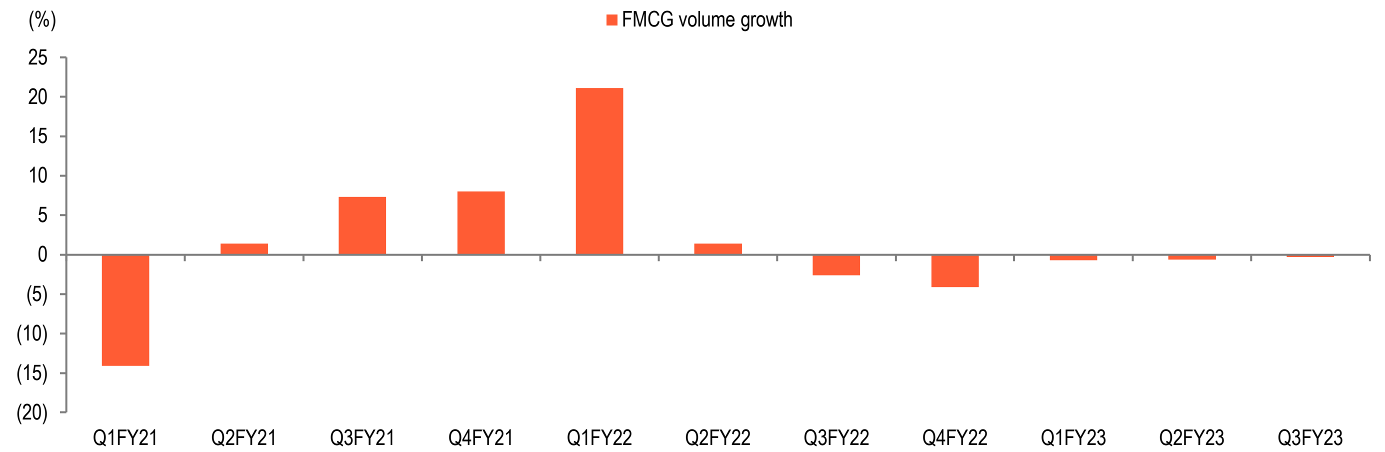
Recommendation snapshot

Ticker	Price	Target	Rating
BRIT IN	4,293	5,623	BUY
GCPL IN	915	1,112	BUY
HUVR IN	2,442	3,069	BUY
ITC IN	380	459	BUY
NEST IN	18,265	22,860	BUY
TATACONS IN	693	924	BUY

Price & Target in Rupees | Price as of 14 Mar 2023

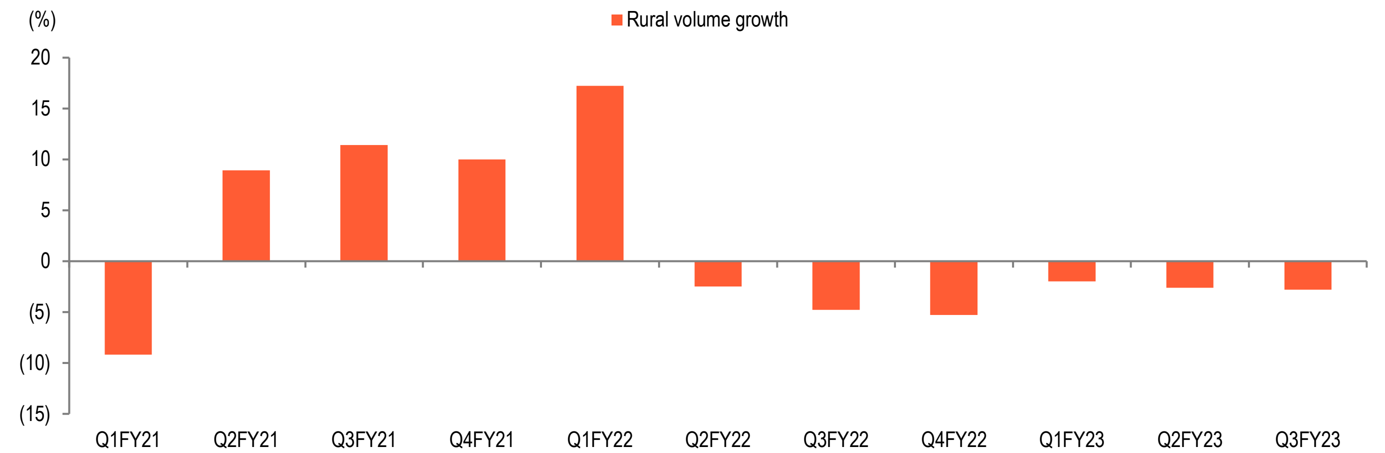
Focus charts

Fig 1 – FMCG sector: Quarterly volume growth trend



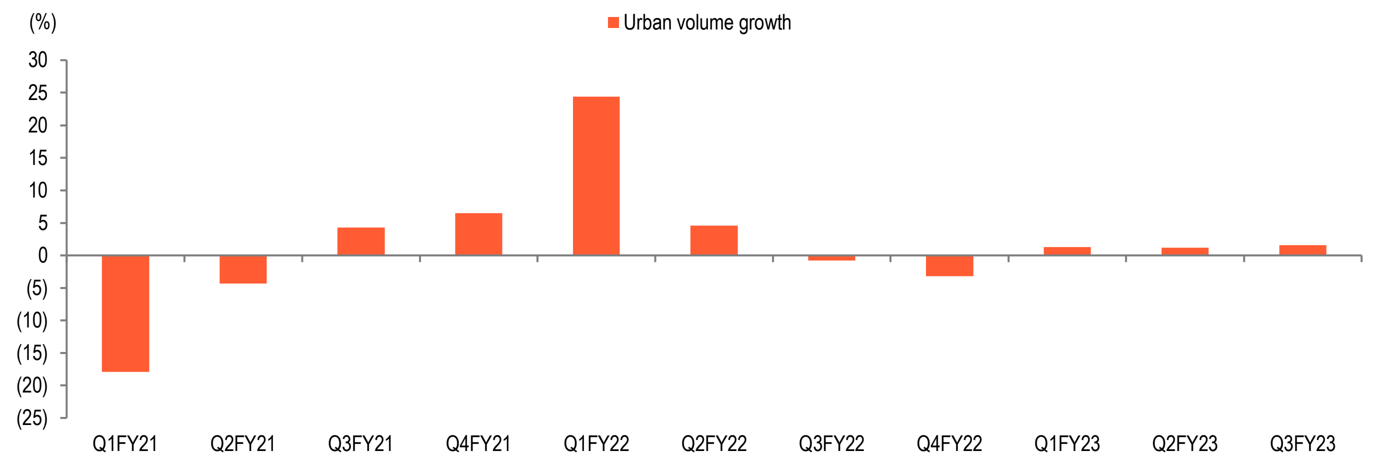
Source: Nielsen, BOBCAPS Research

Fig 2 – FMCG sector: Quarterly rural volume growth trend



Source: Nielsen, BOBCAPS Research

Fig 3 – FMCG sector: Quarterly urban volume growth trend



Source: Nielsen, BOBCAPS Research

Strong rural footprint key to growth

FMCG players are banking on Rural India for growth and making concerted efforts to deepen their direct reach in these markets. Increased government spending in rural areas, a good monsoon, better crop realisations and improved non-farm incomes are expected to boost consumer sentiment. We note that companies with strong product portfolios, a large rural presence and localised marketing strategies are gaining market share in respective categories despite the challenging demand environment.

- ITC, BRIT, NEST, Dabur (Not Rated), Adani Wilmar (AWL: Not Rated) and Tata Consumer (TCPL) have all amplified their focus on rural markets and are fortifying their distribution networks. ITC, for instance, has been adding stockists in these areas over the last two years besides bolstering digital technologies to better target growth in smaller markets.
- TCPL has added over 8,000 distributors in rural and semiurban regions across India during FY22 and automated its network to improve the quality of servicing.
- Dabur has added touchpoints in 30,000 villages during FY22 to reach a total of ~90,000. Expansion in these markets remains a strategic priority for the company.
- Rural towns (less than 100,000 population) contribute ~30% of AWL's volumes in both the edible oil and food & FMCG categories. The company's distribution reach is growing in high double-digits with its retail rural reach rising to 1.6mn, rural-focused distributors numbering over 7,300, and presence in rural towns climbing to ~5,300 touchpoints as of Dec'22.

BRIT and NEST best placed

We retain our preference for FMCG players with a strong presence and product acceptance in rural markets. In our view, BRIT (BUY, TP Rs 5,623) and NEST (BUY, TP Rs 22,860) are best placed in this regard, having already deepened their rural footprint by the addition of dealers and direct distribution channels. Revenue contribution from rural markets is relatively lower for NEST, but we expect ready acceptance of its products and a targeted distribution strategy to percolate into the revenue mix and margins going forward.

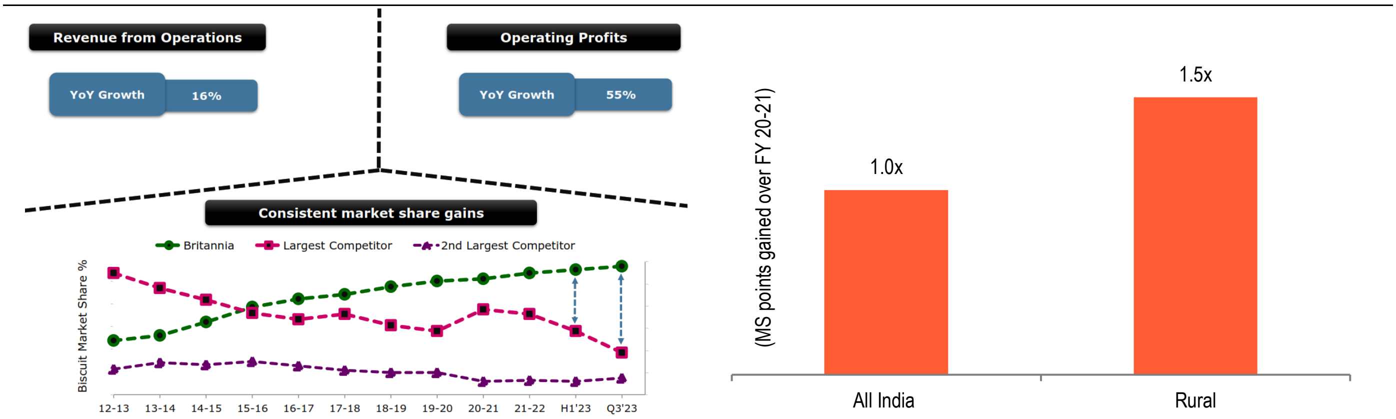
Britannia Industries (BRIT): Accelerated network growth

BRIT continues to increase its rural presence by adding preferred rural dealers every year. At the end of Q3FY23, the company had 28,000 preferred rural dealers as against 22,000 in FY22 and ~8,000 in FY16. Over the years, BRIT has increased its direct distribution reach to 2.64mn outlets in Q3FY23 from 1.3mn in FY16. Growing market penetration, especially in the Hindi belt, has been one of the biggest contributors to BRIT's growth over the years.

The company's strategy has been to enter rural markets through value products and then push premium products through the same channels once distribution is established. Another strategy has been to offer smaller, low-priced product packs that appeal to the price-sensitive customer base.

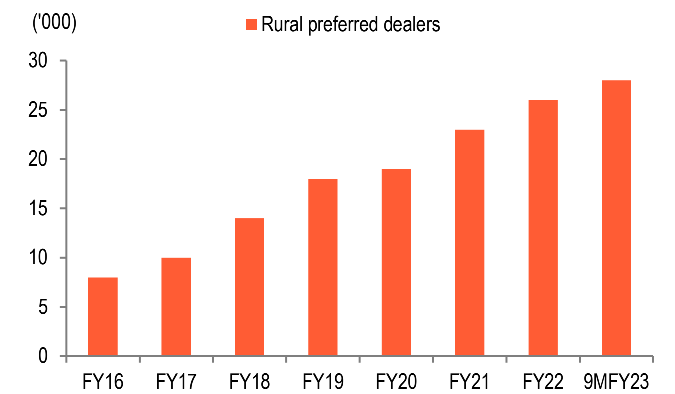
Q3FY23 marked the 39th consecutive quarter of market share gains for BRIT widening the gap with #2 player. The company's market share gains in rural areas were ~1.5x those in urban markets, helping stave off headwinds from the broader demand slowdown and enabling sustained growth in the portfolio.

Fig 4 – BRIT's market share gain



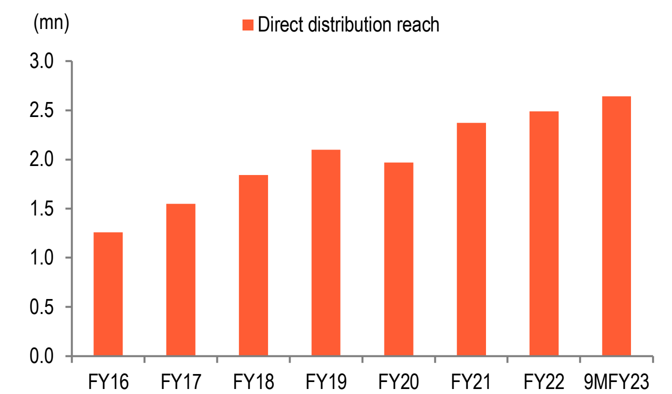
Source: Company, BOBCAPS Research

Fig 5 – Rural preferred dealers



Source: Company, BOBCAPS Research

Fig 6 – Direct distribution reach



Source: Company, BOBCAPS Research

BRIT has continued to report double-digit growth with margin expansion in Q3FY23 despite sticky commodity inflation. We expect the company's focus on innovation, brand investment, direct reach expansion with a rural thrust, adjacencies, and product launches to spur profitable growth.

Investments toward the scale-up of adjacent categories are expected to fuel the next phase of growth for the company. Profitability has improved on cake, rusk, and bread, even as the wafers business continues to gain market share. Premium products are outperforming value products despite a challenging demand environment.

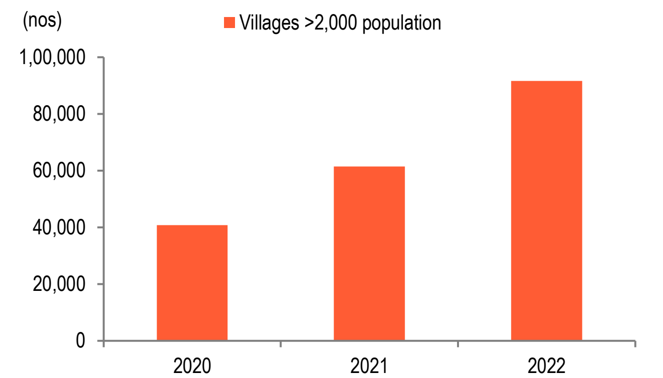
The stock is trading at 44x/39x FY24E/FY25E EPS. We maintain BUY and continue to value the stock at 51x FY25E EPS, in line with the long-term mean, translating to an unchanged TP of Rs 5,623.

Nestle India (NEST): RURBAN strategy starting to pay off

NEST continues to post robust growth across smaller towns and rural markets driven by acceptance of its products and increased rural penetration. Rural centres contribute 20% of the company's sales and are growing at 25-26%. NEST has ramped up its distribution footprint to 91,683 villages (population of more than 2,000) in 2022 versus a mere 1,000 villages in 2016. The target is to cover 120,000 such villages by 2024.

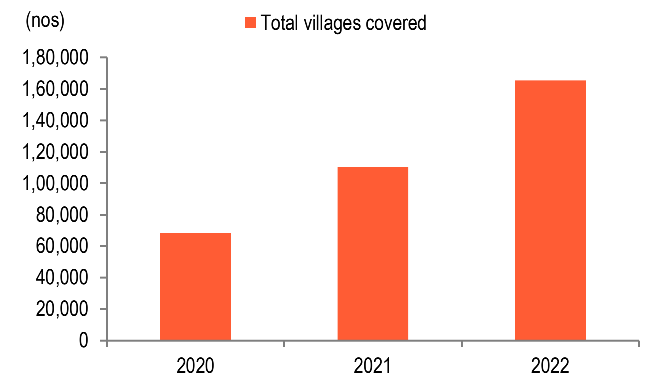
The company has also broadened its direct reach by 1.5mn outlets in 2022, taking the total to 5.1mn in 2022. After the 'Maggie Noodles' crisis in 2015, NEST's distribution network shrank considerably. The company managed to rebuild its network through its RURBAN (rural and semiurban) strategy that emphasised an increase in direct reach, customisation of the product portfolio, regionalisation, and participation in village markets (*haats*), among others. The RURBAN strategy also has strong technological moorings, powered by data analytics and digitals.

Fig 7 – Rural reach



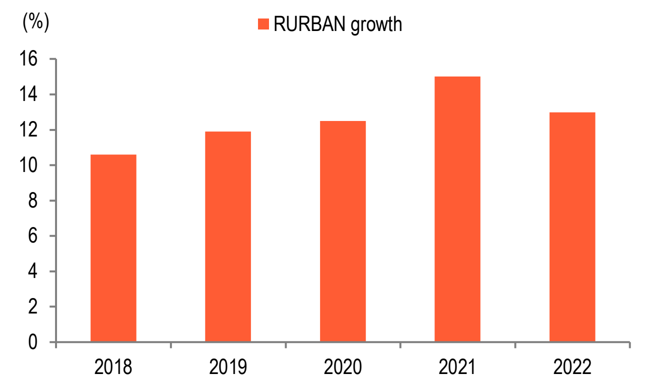
Source: Company, BOBCAPS Research

Fig 8 – Total villages covered



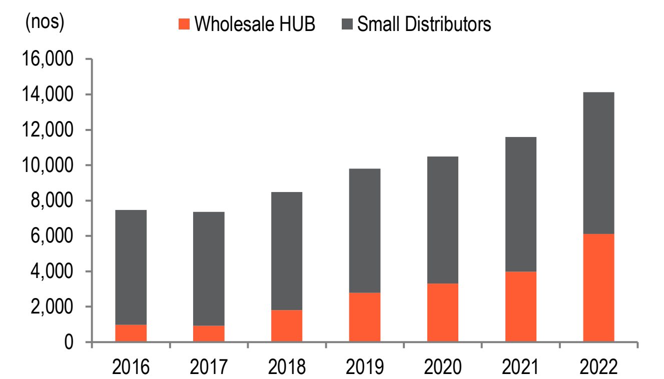
Source: Company, BOBCAPS Research

Fig 9 – Revenue growth from rural and semiurban markets



Source: Company, BOBCAPS Research

Fig 10 – Presence in RURBAN areas



Source: Company, BOBCAPS Research

The targeted rural strategy is playing out well for NEST in a tough economic environment. We expect the rural revenue share to rise as penetration grows, aiding market share gains. Further, continued investments in innovation and premiumisation as well as forays into newer categories should help the company sustain its growth momentum. The stock is trading at 62x/54x CY23E/CY24E EPS. We continue with BUY and value the stock at 67x CY24E EPS, in line with the long-term mean, translating to an unchanged TP of Rs 22,860.

Monsoon deficit could delay recovery in rural markets

Early estimates from US weather forecaster, National Oceanic and Atmospheric Administration, indicate a phasing out of the existing La Nina weather pattern with a neutral phase shaping up till June and a higher probability of El Nino from July onwards.

Over the past two decades, there have been three of thirteen instances – 2002, 2009 and 2015 – where a rainfall deficit in India coincided with an El Nino event, leading to severe droughts in the country. A deficit southwest monsoon severely impacts the *Kharif* cropping season (Jun-Sep) in India and the resulting high temperatures during the *Rabi* harvesting months (Mar-April) takes a toll on the overall agriculture output.

As per reports from the Indian Met Department, February was the warmest month since 1877 with the average maximum temperature touching 29.5C. The early onset of summer could impact Rabi sowing this year. This coupled with abnormal rainfall could push up food prices. In the event of a material rainfall deficit in 2023, India is thus likely to experience a further delay in anticipated consumption growth and an elongated recovery cycle. The rural market is already experiencing a slowdown and a monsoon failure would only exacerbate matters.

Companies with a strong rural presence would be adversely affected by a poor monsoon. Lower wheat output could erode the margins of companies such as BRIT. A decline in agricultural and allied produce can also dampen the performance of quick service restaurants (QSR). Further, as volume growth comes under pressure due to weak consumer sentiment, it would be difficult for companies to pass on additional cost increases. On the other hand, warmer weather would play to the strengths of beverage companies as demand for carbonated and non-carbonated drinks will move up.

NOT FOR DISTRIBUTION, DIRECTLY OR INDIRECTLY, IN OR INTO THE UNITED STATES OF AMERICA (“US”) OR IN OR INTO ANY OTHER JURISDICTION IF SUCH AN ACTION IS PROHIBITED BY APPLICABLE LAW.

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOB Capital Markets Limited (BOBCAPS).

General disclaimers

BOBCAPS is engaged in the business of Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS’s activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction We are not soliciting any action based on this material. It is for the general information of BOBCAPS’s clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice. BOBCAPS research reports follow rules laid down by Securities and Exchange Board of India and individuals employed as research analysts are separate from other employees who are performing sales trading, dealing, corporate finance advisory or any other activity that may affect the independence of its research reports.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities — that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have “long” or “short” positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS’s prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company or third party in the past 12 months in connection with research report/activities. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.

Other disclaimers

BOBCAPS and MAYBANK (as defined below) make no representation or warranty, express or implied, as to the accuracy or completeness of any information obtained from third parties and expressly disclaim the merchantability, suitability, quality and fitness of this report. The information in this report has not been independently verified, is provided on an "as is" basis, should not be relied on by you in connection with any contract or commitment, and should not be used as a substitute for enquiries, procedures and advice which ought to be undertaken by you. This report also does not constitute an offer or solicitation to buy or sell any securities referred to herein and you should not construe this report as investment advice. All opinions and estimates contained in this report constitute BOBCAPS's judgment as of the date of this report and are subject to change without notice, and there is no obligation on BOBCAPS or MAYBANK to update this report upon issuance. This report and the information contained herein may not be reproduced, redistributed, disseminated or copied by any means without the prior consent of BOBCAPS and MAYBANK.

To the full extent permitted by law neither BOBCAPS, MAYBANK nor any of their respective affiliates, nor any other person, accepts any liability howsoever arising, whether in contract, tort, negligence, strict liability or any other basis, including without limitation, direct or indirect, special, incidental, consequential or punitive damages arising from any use of this report or the information contained herein. By accepting this report, you agree and undertake to fully indemnify and hold harmless BOBCAPS and MAYBANK from and against claims, charges, actions, proceedings, losses, liabilities, damages, expenses and demands (collectively, the "Losses") which BOBCAPS and/or MAYBANK may incur or suffer in any jurisdiction including but not limited to those Losses incurred by BOBCAPS and/or MAYBANK as a result of any proceedings or actions brought against them by any regulators and/or authorities, and which in any case are directly or indirectly occasioned by or result from or are attributable to anything done or omitted in relation to or arising from or in connection with this report.

Distribution into the United Kingdom ("UK"):

This research report will only be distributed in the United Kingdom, in accordance with the applicable laws and regulations of the UK, by Maybank Securities (London) Ltd) ("**MSL**") who is authorised and regulated by the Financial Conduct Authority ("FCA") in the United Kingdom (MSL and its affiliates are collectively referred to as **"MAYBANK**"). BOBCAPS is not authorized to directly distribute this research report in the UK.

This report has not been prepared by BOBCAPS in accordance with the UK's legal and regulatory requirements.

This research report is for distribution only to, and is solely directed at, selected persons on the basis that those persons: (a) are eligible counterparties and professional clients of MAYBANK as selected by MAYBANK solely at its discretion; (b) have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended from time to time (the "Order"), or (c) fall within Article 49(2)(a) to (d) (high net worth companies, unincorporated associations, etc. as mentioned in the stated Article) of the Order; (all such persons together being referred to as "relevant persons").

This research report is directed only at relevant persons and must not be acted on or relied on by any persons who are not relevant persons. Any investment or investment activity to which this material relates is available only to relevant persons and will be engaged in only with relevant persons.

The relevant person as recipient of this research report is not permitted to reproduce, change, remove, pass on, distribute or disseminate the data or make it available to third parties without the written permission of BOBCAPS or MAYBANK. Any decision taken by the relevant person(s) pursuant to the research report shall be solely at their costs and consequences and BOBCAPS and MAYBANK shall not have any liability of whatsoever nature in this regard.

No distribution into the US:

This report will not be distributed in the US and no US person may rely on this communication.

Other jurisdictions:

This report has been prepared in accordance with SEBI (Research Analysts) Regulations and not in accordance with local regulatory requirements of any other jurisdiction. In any other jurisdictions, this report is only for distribution (subject to applicable legal or regulatory restrictions) to professional, institutional or sophisticated investors as defined in the laws and regulations of such jurisdictions by Maybank Securities Pte Ltd. (Singapore) and / or by any broker-dealer affiliate or such other affiliate as determined by Malayan Banking Berhad.

If the recipient of this report is not as specified above, then it should not act upon this report and return the same to the sender.

By accepting this report, you agree to be bound by the foregoing limitations.