“Godrej Consumer Products Limited

Q2 FY '24 Investor Conference Call”

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Moderator: Ladies and gentlemen, good day, and welcome to Godrej Consumer Products Limited Q2 FY '24 Investor Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal to operator by pressing star then zero on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to the Senior Management of Godrej Consumer Products Limited. Thank you, and over to you.

Tapan Joshi: Thank you, Neerav. Good evening, everyone, and thank you for joining us to discuss the performance of quarter 2 FY '24. We have with us Nisaba Godrej, Executive Chairperson; Sudhir Sitapati, Managing Director and CEO; and Aasif Malbari, CFO from the GCPL Management Team. Without much taking much time, I will quickly hand it over to Sudhir for his opening remarks. And post that, we'll be happy to take your questions. Over to you, Sudhir.

Sudhir Sitapati: Thanks, Tapan. Thank you for joining us today. I will first start with an organization change. Tapan Joshi, who has been heading Investor Relations, has decided to move on. Vishal Kedia, who has been leading strategy in GCPL, would now head Investor Relations in addition to his current role. I wish both Tapan and Vishal all the best.

I will now start with an update of our quarterly performance. In Q2 FY '24, GCPL's reported volume grew by 10%, revenue by 6%, constant currency 16%; EBITDA including forex by 30%, PBT by 35% and PAT without exceptional by 17%. Organic volume grew 6% and revenue 2%, constant currency 12%. Volumes were a bit behind expectations, mainly in India, while profits were ahead of our expectations on the back of structural savings, a faster-than-anticipated RCCL integration and a benign cost environment for palm oil.

Revenue growth lagged volume growth mainly due to lower prices in personal wash, translation impact in Nigeria and hyperinflation accounting in Argentina, translation and hyperinflation accounting, both being non-cash items. PAT lagged PBT due to our availing of MAT credit in this financial year. Our cash tax rate remains significantly lower.

India volumes grew by 11%, revenue by 9% and EBITDA by 30%. Organic UVG was 4% and sales growth was 2%. India volume growth was below our expectations and surprising. Household Insecticide performed poorly on the back of poor monsoons, but what was surprising was the poor performance of Hair Colour. The category usually dips in July during the month of Shravan when consumers in North and West do not cut the hair or groom it. 2023 was a unique year after 19 years, where a second or Adhik month of Shravan was an added demand dampener. We should have anticipated this better.

The integration of Raymond Consumer is now complete. After a few months of inventory reduction and transition, we had a record September month. We are now operating at approximately 30% of the erstwhile overheads and remain confident of achieving the business case.

Indonesia had a very strong quarter with 11% volume growth, 16% revenue growth and 21% EBITDA growth. Apart from macro tailwinds, the Household Insecticide business seems to have responded very well to a significant improvement in the efficacy of our products a few quarters ago. GAUM grew volumes by 3%, revenue by minus 5% and EBITDA including forex by 49%. Non-cash translation impact has affected both revenue and EBITDA numbers and this makes the EBITDA performance all the more creditable. LatAm had an excellent quarter and grew UVG at 28%.

We continue to make good progress on key strategic pillars of category development and simplification. On category development, we again increased our media spend by 33% in the quarter. We now spend approximately 10% of turnover on A&P, which is approximately 200 bps more than the same quarter last year and 400 bps versus the same quarter two years ago. This has led to value market share gains in five of our top six global cells and volume market share in six of six. We also believe that as a company, our organic volume growth has moved from a five-year CAGR of around 4% to somewhere between mid and high single digits.

Our simplification journey is a holistic one to release fuel for growth. Our EBITDA margin is now 20%, and we anticipate steady improvement to various structural cost reduction actions. In our journey to simplify our GAUM business further, we are planning to reorganize our Hair Fashion business in smaller countries of East Africa, which includes Kenya. We will target to move our operations in these countries to an asset-light royalty model where our focus will primarily be in the areas of marketing and R&D. Collectively, these businesses contribute approximately ₹500 crores of revenue but ₹0 of profit. After the reorganization, we expect to report ₹0 sales with around ₹50 crores of profit in FY'25. We are working to determine if there are any onetime costs or non-cash accounting charges due to these changes in operations in Africa. We look forward to sharing this in the coming quarters as we get greater clarity on the transaction and other factors.

We are now net cash positive. I am happy to announce that the Board of Directors have approved a dividend of ₹5 per share, which will result in a payout of ₹511 crores. We will strive to maintain a steady stream of dividend going forward. You can expect the dividend payout ratio to average about 50% of the annual profit after tax of the company.

We broadly feel that we will achieve our guidance for the year, both in the organic business and the acquired business, though the overall phasing may be more favorable to Q4 than Q3 given market conditions.

Finally, I would wish you and your families a very happy Diwali. Thank you very much.

Moderator: Sir, shall I open the floor for questions?

Aasif Malbari: Yes, please.

Moderator: Thank you very much. The first question is from the line of Abneesh Roy from Nuvama Institutional Equities.

Abneesh Roy: Congrats on good numbers and good to see dividend announcement also. So, my first question is on Raymond business. So, you mentioned faster scale up. And you also mentioned that the full year ambition is on track. So, I wanted to understand from the time when you had announced the acquisition in terms of all the key metrics, say, in terms of dealer margins, in terms of fixed cost, in terms of cutting down on the MRP versus the actual price selling, etc., all those elements, and increasing advertising spend substantially, where are we? Because you have mentioned most of the integration is completed, but you also mentioned that the media investments will go up. So, the sharp scale-up, is it coming because last few years it was underspent in terms of advertising, but now because spends are increasing, that's helping in terms of the sales offtake?

Sudhir Sitapati: I think what are the changes that we have made in the erstwhile RCCL business and what we have not yet made. Firstly, we have integrated entirely the RCCL distribution network with the GCPL distribution network. On average, this gives us about 400 to 500 bps of saving on distributor margin because GCPL distributor margins were lower than RCCL distributor margins. Number two, we have significantly scaled up advertising in RCCL to levels, which are a higher share of voice than share of market. We have some numbers mentally of share of voice by share of market, and these have been quite unprecedented for RCCL. Number three, that we have integrated the business. Approximately 30% of the erstwhile RCCL we have absorbed into RCCL related job in GCPL. Another bunch has been absorbed into other GCPL roles. Therefore, roughly 70% of overheads have been cut. These are the three things that have happened in the last two to three months. The first three-four months, we didn't sell very much mainly because we were trying to reduce stock, reduce SKUs.

We had a very good September. Things are looking quite good in Q3 as well. We are putting the right inputs in. We're broadly happy with the output both in terms of profitability and revenue. Probably a little later, a few months later, we will know how much advertising has helped, how much has distribution helped, etc.

Abneesh Roy: Two very quick follow-ups. One is because you are a very strong and relevant player in the deo category and GCPL, obviously, is adding much more muscle to the brand. Do you see the overall category spends by other players also increasing given there is an unlisted player for whom this is the main business. That is one part.

Second is now that you have run this business for a few months and GCPL is multiple times the distribution of this company, where do you see the distribution scale-up within two-three years because now you'll have a better understanding. I'm not asking about the H2 of this year, from a two-three years perspective, what can be the conservative scale-up in terms of distribution?

Sudhir Sitapati: On the first question, I don't know the answer on whether overall category heat would go up or not. What we do know is that consumption of deodorants in India is lower and the more the category grows faster, the more all the players will benefit. So, I feel it's a category that should be invested in. It is not a category that is non-growing or a zero-sum game. It's a category that can grow in high teens or even 20% at the right levels of investment. So, one way or the other, it doesn't bother us. I think we are investing what we think is appropriate, but either which way is less of a concern to us.

In terms of distribution, we do have some early reads in distribution. One of the early reads is certainly in rural, pretty much this was a whitespace. So, we are definitely seeing pure incremental sales in rural. General Trade, GCPL was far stronger than RCCL. Modern Trade, RCCL was doing a pretty good job and so were they in e-commerce. These channels are growing very well. And I think GCPL will be the same or better. But definitely in the General Trade system, we will see a lot of improvement.

I think the area that we are working very closely to get to better than where we were is to devise and create a chemist system, which takes the best of GCPL and RCCL. So, we're setting up a new chemist system. Most of it is already done, which is a consolidated solid chemist operation for both GCPL and erstwhile RCCL products.

Abneesh Roy: Sir, my second and last question is on your other two businesses in India. So, you mentioned on *Adhik Maas* impact and *Shradh* impact. And you also mentioned that hopefully or possibly you could have been a bit more proactive here. So, what do we mean that given this is an impact when consumers are not really using the Hair Colour, what did you mean when you said that you could have been a bit more proactive? Second is down-trading and down-grading in Soaps and Hair Colour, I know it is much lesser of a problem than detergent bars. But given the situation which is there currently and so much of gross margin expansion in Soaps, and Hair Colour clearly, a lot of regional players, are you seeing down-trading and down-grading because numbers are a bit weak? So, I wanted to understand, is it only one-offs which are there? Or there is more to it?

Sudhir Sitapati: So, in Hair Colour you see, we know every year that July is the *Shravan* month and Hair Colour dips. What we missed this time was to forecast for the second additional *Shravan* month since it happened after 19 years. The calendars have also moved, as everyone else has said, for the festive season. I think the miss here is to study the impact of the Indian calendar on demand a little bit more carefully. I guess that's the learning for us. So that's what I meant saying that we look at demand in terms of Q1, Q2 and seasonality. We are now realizing that there's a clear relationship between the lunar calendar and demand drivers as well. That's something we need to predict better. But I think, again, what we have seen post *Shravan* on Hair Colour has enthused us quite a lot.

On your answer on down-gradation, it's a bit complex. This Q2 *Shravan Maas* and postponing Diwali season. When we look at our market shares, they are very, very good right now. So last three months or MAT, across India, Indonesia, everything in volume is positive and in value, the only one that is slightly negative is Household Insecticide where we are still losing a bit of share to incense sticks. But the share gain, for example, in Hair Colour is very, very strong. So, I would prefer to say that it was a bit of an odd quarter in terms of calendar rather than down-grading.

Abneesh Roy: One small follow-up. I understand Nielsen market share has got sampling and lead-lag issue. My question was from a media intensity and from a promotions and general aggression in Soaps and Hair Colour. Are you seeing local players coming back? Because I think that's far more important than Nielsen market share because always, there is some other issue there.

Sudhir Sitapati: I think on Hair Colour, unequivocally no. On Soaps, there was a time 15-20 years ago, when Soaps had a lot of local competition in its base. As has time progressed, that has shrunk. Even for other categories, it has shrunk while they still remain large. So, it is possible that the margin in Soaps with these kinds of low prices are affecting volumes. It is certainly not in the large major states, maybe in some parts of Eastern MP, Bihar, Orissa, there is a local player. It's hard for us to read it except for Nielsen and the Kantar panel where it's not, but I buy your point, there might be something. But also, our sales guys come and talk to us when the local players are becoming very aggressive or when we're losing volumes. So, I would say, possibly in Soap, but doesn't look to be a major thing. And Soap also had a good quarter in terms of volumes in Q1. So Q2 kind of slightly balances that out.

Moderator: Thank you. Next question is from the line of Percy from IIFL. Please go ahead.

Percy Panthaki: Sudhir, my first question is on Africa, the royalty arrangement that you have made. So basically, those are geographies which are making ₹0 profit, but you will get about ₹50 crores of royalty is what your expectation is, which means that the person buying the business is expecting to make at least a ₹50 crores profit before royalty. So, if they are able to do it, then why we are not able to make it profitable?

Sudhir Sitapati: I think there are a couple of reasons for it. These markets are relatively low-gross-margin markets and high overhead cost structures that GCPL operates with. So, we feel it is more appropriate in the Hair Fashion business, where the gross margins are low, and we do need to have overheads, which are high because we have governance requirements and so many requirements we have. So, we just think that some of these markets are more appropriately run by a distributor. We continue to own the brand, one must look at this more in terms of a Coke bottling or a distributor kind of model. The Angola and Uganda was already in this model in some form or the other, and it has been quite profitable for the last decade. Kenya and Tanzania are now moving to this model. Angola and Uganda are changing the way we are looking at this entire thing in a slightly different way in terms of accounting.

But we do have evidence to suggest that in certain kinds of markets, where A&P, R&D innovations play less of a role, one has to be faster to market, with very, very low overheads, it is probably better for us to not do this ourselves. In any case, the ₹0 profit that we are running is a positive ₹50 crores in some profit-making markets and negative ₹50 crores in the loss-making markets and the sum of which is ₹0. So even if the negative ₹50 crores goes to ₹0 in East Africa, this will still remain at ₹50 crores.

Percy Panthaki: Understood. Secondly, I wanted to understand on Household Insecticides. What is the reason for the slowdown? Is it just the erratic monsoon, or is it something over and above that as well? I mean, you did mention some market share issues with the illegal incense sticks. But is that a material sort of driver of the overall performance or just something on the fringe?

Sudhir Sitapati: One is the shorter term it has definitely been weather. Weather does play a role in Household Insecticides category. Last quarter, we had a very good quarter. This quarter, August month, as all of you know, was an exceptionally dry month. September rained again. So, it definitely varies. When you look at our results across quarters, there's definitely an impact of weather, and this has been a particularly bad quarter. This will happen, Percy. There will be a good quarter in terms of weather, a bad quarter in terms of weather.

There is a longer-term story that we have been losing share for a longer period, not just us, but the entire category to illegal incense sticks. Broadly speaking, this trend has, in some ways, reduced over the last 12 months. Our overall underlying volume growth, we see has gone from being between 0 and 2% to being, let us say, between 3% and 5%. And this has been mainly on the back of the new SKUs that we launched, which democratized the category. But the 3% and 5% or let's say, 4% volume is still significantly below the potential of the category.

As we spoke in the May annual analyst review, I said that give us 12 months, we will come with a structural solution. We will come with a structural solution quite soon that we hope we will move the category to high single-digit kind of volumes.

Percy Panthaki: Right. And last quick question is on margins. So, this quarter, you have delivered close to a 30% EBITDA growth. Do you think your margin levers are more or less fully exercised and seasonally adjusted margins from here on should be sort of flat?

Sudhir Sitapati: No. I think we should continuously improve margins for three reasons. One is our GAUM margins are low and they will fundamentally improve. Two is our Indonesia margins are also below normative margins, and we think that, that business should improve margins. We also think that there are structural cost savings that are possible in India, which without affecting investments in pricing or A&P can continue to deliver some incremental margin every year. So, I don't think that the margin expansion is over, but the margin expansion will come from Indonesia and GAUM though.

Percy Panthaki: Right. And just one request for GAUM, when you report going ahead because part of the business is sort of franchised out, the EBITDA margin will look sort of optically higher because the top line flows directly to the bottom line for some part of the business. So just a request is to give some kind of adjusted margin on a like-for-like basis, which sort of gives a better picture of the business.

Aasif Malbari: So, Percy, we will kind of try to give you something, which will kind of give you a flavour of how the underlying margins are moving.

Moderator: Thank you. Next question is from the line of Vivek from Jefferies India. Please go ahead.

Vivek: Sudhir, last quarter, you had mentioned on RCCL that there was some destocking, which was expected even in the second quarter. But ₹142 crores number, is that due to primary secondary is kind of coinciding in some of this? Or is this the number or it could have been higher for destocking?

Sudhir Sitapati: I think it could have been higher without destocking because you see we had a very poor July and August and an exceptionally good September. As I was telling Abneesh, it is still hard for me to read how much of this is because of pipeline was dry, how much of this was because of demand increase due to advertising, how much of this was due to better distribution. It's difficult for me to read. What we do know is the following, which is that RCCL distributors were on average sitting at 75 days of stock. GCPL distributors were sitting at 20 days of stock. That is a fact.

Probably the stock at the trade also has come down because we have reduced the SKUs. It's hard for me to give a number. But we are definitely, in a 4-month period, lost 60 days of stock and delivered ₹140 crores, which is very close to the average of RCCL. We bought this business roughly at about ₹600-₹620 crores and we have reduced about 10% to 15% of revenue through SKU cuts. So certainly, the September number is a creditable number, which was really the one that pulled up the quarter, whichever way you look at it.

Vivek: Got it. And on the EBITDA, given the slide you estimate EBITDA to be positive despite scale-up in media investments. So, one is good to see the investment side. But what do you exactly mean by estimate EBITDA to be positive? Is it at a full year level? Is it second half?

Sudhir Sitapati: No. We meant at a quarter level, Vivek. As you know, now it's very hard for us to estimate what is the overheads of the RCCL business. So, we can only roughly estimate it based on what it was and so on. It's difficult to give an exact EBITDA number for RCCL now. But because we know what the gross margins are, what the net contribution after advertising and BTL, that can be allocated to a business. We know approximately what the overheads are likely to have been because of the reductions that we have done. We will own the onetime costs that we had to bear. So that is why our estimate is that despite significant increases in media, we feel that this business was probably EBITDA positive in the quarter.

Vivek: Got it. And on Household Insecticide, Sudhir, what is the estimated incense stick share right now at a category level?

Sudhir Sitapati: I think these are Nielsen available numbers. It's in the late teens.

Vivek: Late teens. Okay. And again, we have discussed about Household Insecticides on this call as well as in the past, but just one thing, even if the interventions that you make, basically, there is this piece of the market, which is very difficult for you to capture. Is that a fair thought process?

Sudhir Sitapati: Vivek, why don't we get back to you on this? I think I said last in May to give us 12 months. Why don't you wait rather than me telling you what we want to do on Household Insecticide, which is right now confidential, and we shouldn't speak about it until we do it. I think the bigger question in Household Insecticide is that this is a market that should grow, or we should be growing at high single-digit volumes, and we think it's possible. We think we know what the answer is, and we will bring it into play pretty soon. And let's leave it there for now. If we go don't give it at the next analyst conference in May, you can say you guys haven't but give us till the time that we asked.

Vivek: Right, Sudhir. And lastly, one quick question on staff cost. I know the base is a bit off, but can you just talk about if there is anything to read into it sequentially, or it has moved up a bit.

Aasif Malbari: There has been a little bit of a true-up, which has happened in this quarter. And hence, you see a bit of a spike in this quarter compared to last year's base. It should kind of even out as the kind of go through in the year.

Moderator: Next question is from the line of Arnab Mitra from Goldman Sachs. Please go ahead.

Arnab Mitra: My question was on Africa. What happens to the assets in the business which you are franchising out in terms of manufacturing and working capital. How much of capital employed does it release if at all? And secondly, is this only for dry hair? And is this a model, which is replicable in other parts of Africa or other geographies like LatAm? Or this is very particular to this block in East Africa where profitability was very low?

Aasif Malbari: Yes. So, Arnab, firstly, just kind of to clarify it's not that we are executing a transaction today. We got kind of in principal direction to kind of move ahead with simplifying the operations in a few countries. The simplification is only for dry hair or hair fashion, and over the next few months, we will kind of work out the exact nature of the deals and how we are going to kind of simplify this operation. It will include clearing out certain assets, which we have on the ground. And all those exact nuances will be kind of done over the next few months.

As we indicated, the deal should be kind of done and settled more towards early part of Q4. The second part of the question in terms of the rest of the business. The rest of the business model remains exactly as it stands today. And that business is significantly high gross margin. It's been growing at very significant rates, and we remain kind of committed to growing that further.

Arnab Mitra: Okay. Understood. Understood. The second question was on Indonesia, where your growth rates have been pretty good. But what we understand is that the macro has been quite weak in Indonesia for FMCG consumption. So, is it largely a base effect for you? Or do you feel your categories and your initiatives are such that you are being able to do well despite the macro environment. Why I'm asking this is the low base can obviously run out in a couple of quarters' time. And do you worry that the growth rates could come off that stage?

Sudhir Sitapati: Arnab, I think it is true that we've had a low base. But I think the real truth is that the relaunch that we did of Household Insecticide a few quarters ago, where we increased the efficacy of our product by 5x seems to be resulting in a pretty significant sequential growth. So that has been the driver of the Indonesia performance apart from a poor base. And therefore, I do anticipate a reasonably good performance in Indonesia because we're also seeing market shares, we are seeing sequential volume offtakes of Household Insecticide and there is a common effect here. So that has been the bigger driver for us rather than this because we have achieved what we had forecast also. We had forecast something based on knowing what last year's base, etc., was, but we have done better than that.

Moderator: Next question is from the line of Aditya Soman from CLSA.

Aditya Soman: Sir, just following up on Indonesia. You mentioned that the margins there were something that you can improve. So, any specific measures that you think you can drive to improve margins, sir?

Sudhir Sitapati: I think there is definitely net revenue management that can be better in Indonesia, Pricing, BTL, Access. I think there is further savings in overheads that are possible now that we have moved to the RD system. So, a combination of overhead and better NRM are what will drive margins in Indonesia.

Aditya Soman: I understand. And any sense of guidance on what you feel are the right level of margins?

Sudhir Sitapati: I don't know whether we hit the historic margins or not, but mentally, the kind of portfolio that we have, both in India and Indonesia, mid-20s margins is not something that is over margin or we can't grow at that level. So, I mean, obviously, we'll keep kind of calibrating growth and margins, but Indonesia is significantly below that right now. It used to be that level not long ago.

Aditya Soman: I understand. And lastly, in terms of the underlying demand environment in India, anything to call out? Have you seen any pickup, let's say, in October? As you mentioned, September was quite strong. Any improvement in October or anything to call out do we expect? I heard you say earlier that you expect a recovery from 4Q and not necessarily 3Q, but any reasons behind that?

Sudhir Sitapati: See, the demand environment in India is tough. I think most of you know it and we've been seeing in a lot of other sectors that the K-shaped recovery continues. Premium is doing well. Modern Trade, e-commerce, they continue to do well. The balance is definitely under pressure. That's the bigger story. And I'm not seeing any major change in that relative story there. Within that yes, I mean, October is a festive month. There has been some calendar change with *Shravan*, etc.,. So, I mean, definitely, some of those things are bearing out and will bear out I think in Q3.

Moderator: Next question is from the line of Richard Liu from JM Financial. Please go ahead.

Richard Liu: Okay. Sudhir, just one question. Not really asking for guidance, but come to think of it, if you look at your margins now at around the 20% level. If I look at last year, which is FY '23, H1 versus H2, the margin pictures, obviously, were very, very different. And the full margin recovery has somewhat happened at least at the operating margin level by the time we came to H2 FY '23. So, FY '23 margin was already 20.5%.

Your run rate currently is at 20%. Now, if your top line growth doesn't pick up and given that there is all these headwinds that you still talked about, are we looking at a situation where your earnings growth, EBITDA growth could fall from the mid-20s to, let's say, single digits, if your top line doesn't pick up?

Sudhir Sitapati: No. See, firstly, Richard, the shape of our portfolio is such that the H2 margins are structurally higher than the H1 margins. Soaps is smaller. A lot of our dry hair businesses and more premium businesses pick up now. So, it's not entirely right to say that H1 is different when compared to H2 of last year. I mean, our growth in volume terms is about 6% this quarter. Last quarter was about 10%.

I think we are somewhere in between these two. A lot of the revenue growth, as I said, is either because of palm oil prices being low, which has no impact on margins or because of currency translation that doesn't have, again, any major cash impact. So, I don't think what you're saying, I don't know, but I don't think that will happen in the foreseeable future.

Richard Liu: I understood about the seasonality on margins, but is there a chance that the top line picture in terms of growth will look very different in H2 versus what we are seeing right now because if you look at the Africa impact, if you look at the Soaps price offs, those numbers are still going to be better in Q3 and in part of Q4 as well, right?

Sudhir Sitapati: No, I don't think, as I said, this revenue number one has to look at it with a little bit of caution, especially non-India. Our volume trajectory between the first two quarters is about 7% and that's not bad actually. I think that's an improvement in our trajectory in H1 with ups and downs happening between quarters and months.

I don't anticipate that revenue trajectory in the next six months changing. I hope that, that changes a little bit more once we sort out Household Insecticide but if this business grows at, let's say, second half similar to first half, and there is seasonality in margins which there is, then you will be able to calculate for yourself what the earnings growth would be.

Moderator: As there are no further questions, I will now hand the conference over to the management for closing comments.

Sudhir Sitapati: Thank you very much. Thank you for joining us.

Aasif Malbari: Thank you.

Moderator: Thank you very much. On behalf of Godrej Consumer Products Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.