Investor and Analyst Q3 FY16 Conference Call

January 27, 2016

Moderator:

Ladies and Gentlemen, Good Day and Welcome to Godrej Consumer Products Earnings Conference Call. As a reminder, all participants' line 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 the conference call, please signal an operator by pressing '*' then '0' on your touch tone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Amit Sachdeva from HSBC Securities. Thank you and over to you.

Amit Sachdeva:

Good Evening, everyone. Welcome to the Godrej Consumer Products Limited Q3 FY16 Conference Call hosted by HSBC Securities. We have with us Mr. Adi Godrej -- Group Chairman along with the management team to discuss the Q3 FY16 Results and answer any questions you may have. Over to you, sir.

Adi Godrej:

Thank you Amit and good evening. I welcome you to the Godrej Consumer Products Limited conference call to discuss the performance for the third quarter of fiscal year 2016.

Joining me are Vivek Gambhir (Managing Director), Omar Momin (Head, Africa and M&A), V. Srinivasan (CFO and Company Secretary) and Sameer Shah (Head Finance (India, SAARC) and Investor Relations).

In a challenging operating environment, we have delivered a resilient and competitive performance in 3QFY16. Our consolidated organic constant currency sales growth of 9% and EBITDA growth of 19% are well ahead of the market growth.

After a couple of quarters of an uptick in volume growth, 3Q for the Indian FMCG industry witnessed a slowdown in growth sequentially versus the previous two quarters. In this difficult environment our India business sustained its volume growth leadership with a growth of 9%.

Other emerging markets in 3Q also witnessed softness in consumer demand. In particular, our key international market, Indonesia, continues to have flat FMCG industry growth. In this volatile scenario, our international business too performed reasonably well with an organic constant currency sales growth of 9%. Operating earnings growth was ahead of sales growth across most of our geographies aided by lower commodity costs, calibrated price hikes, stringent cost management and the effective leveraging of brand platforms.

I will now recap our key business imperatives and assess how we have performed on these priorities during the quarter. After this, I will discuss the highlights of our financial performance during the quarter. We will then be happy to answer your questions.

One of our most important imperatives is to extend leadership in our core categories - home care, personal wash and hair care. We remain focused on delivering superior ahead of the market growth, driving consumption and penetration in our core categories, as well as extending into attractive adjacencies. In our India business, we have delivered a competitive and profitable performance with a branded net sales growth of 8% and a volume growth of 9%.

Our Household Insecticides business sustained its double-digit volume growth momentum and delivered sales growth of 15%. The success of our new launches, effective communication and superior on ground execution have aided this strong and ahead of the category growth. We have consistently gained market share across formats and ended the quarter with our highest ever market share. We are taking various initiatives to drive category penetration and develop the market. Our gross margins continue to benefit from lower crude oil prices and have improved significantly.

Our Soaps business maintained its mid-single digit volume growth in a highly competitive environment. However, this was offset by deflationary pressures, resulting in a value growth of 2%. As part of our focus to premiumise our portfolio, we have launched Godrej No. 1 Nature Soft - Glycerin & Honey variant in the winter soap space. Cinthol, our premium soap brand, maintains its strong performance and leads volume and value growth. We remain competitive on sales promotion investments, in a low commodity cost environment. Our gross margins during the quarter benefited from lower palm oil prices and have improved significantly.

The sales of Hair Colours declined by 1% this quarter. While Godrej Expert Rich Crème recorded a growth in the high teens, powder hair colour growth declined due to channel destocking. This was caused by up-stocking towards the end of the previous quarter, ahead of price hikes and a decline in value growth due to price-off trade offers. This is a temporary dip and we expect growth rates to stabilise from next quarter onwards. Our Expert Rich Crème brand continues to gain market share and lead distribution reach and household penetration in the crème category. During the quarter, we introduced Godrej Expert Rich Crème in a multi-application pack priced at INR 120 and also launched a new advertisement campaign.

In addition to sustaining our leadership positions in our core categories, we are also strengthening our presence in our emerging categories.

Our Air Freshener brand, Godrej aer, continues to perform well, aided by innovative product offerings and various consumer engagement initiatives. Godrej aer continues to gain market share and is now the number one player in the home sprays air care market on an exit market share basis. We believe there is huge potential to drive penetration in the air care segment. So, we recently launched Godrej aer pocket, which targets the bathroom space. We believe that this launch will further extend our leadership in the air fresheners category.

Our Health and Wellness portfolio of Godrej Protekt hand washes and hand sanitiser has been successfully introduced in the general trade and the initial response has been encouraging. We believe that the hand wash and sanitiser categories have a lot more room to grow, given changing consumer needs and increased awareness of hygiene levels.

Our BBLUNT range of premium hair care and styling products have been launched in modern trade and premium general trade outlets. We remain optimistic about the growth opportunities in the premium hair care market.

The second pillar of our strategy is to drive growth in our international business, guided by our three by three strategy, of focusing on three core categories of home care, personal wash and hair care in the emerging geographies in Asia, Africa and Latin America. We believe that these emerging market geographies hold tremendous long-term potential. Our strategy in these markets will be to drive innovation led growth in the categories where we are leaders and have a competitive advantage.

Our biggest international business, Megasari in Indonesia, delivered a competitive performance with a constant currency sales growth of 3%. This was despite the high base of 27% growth in 3QFY15. FMCG industry growth in Indonesia continues to remain flat, impacted by the overall macroeconomic challenges in the country. Our operating margins (EBITDA) increased by 490 bps year-on-year, driven by calibrated price hikes, lower commodity costs and the optimisation of marketing investments.

Our Africa business, where we have business presence in countries in East, West and Southern Africa, delivered strong growth led mainly by 20% constant currency growth in our Darling business. Overall, Africa business EBITDA margin declined by 100 bps year-on-year led by upfront investments in marketing and sales infrastructure.

Our Latin America business delivered healthy sales and profitability growth. We sustained our robust sales growth momentum with a growth of 28%, in constant currency terms. This was driven by a strong performance in Argentina. Our EBITDA margin increased by 670 bps led by better gross margins and the effective leveraging of brand platforms.

Our European business, also delivered a competitive performance with a constant currency sales growth of 10% led by strong growth in our owned brands portfolio. Our operating margins (EBITDA), declined by 40 bps year-on-year due to higher brand and infrastructure investments.

Our third strategic pillar is to accelerate the pace of innovation and strengthen our brand portfolio. Innovation is a key driver of our growth strategy and it is our endeavor to delight our consumers with superior quality, world class products at affordable prices. We have consistently introduced several new disruptive products and renovations. In India, we launched Godrej aer pocket, a multi-application pack of Godrej Expert Rich Crème hair colour, Godrej Nupur Coconut Henna Crème, Good knight Fast Card, Xpress and Neem low smoke coil, a Godrej No.1 Nature Soft - Glycerin & Honey variant and new variants in Cinthol. We also launched our Protekt range in general trade and made a foray into premium hair care with BBLUNT.

In our international businesses too, we had several new launches, such as new styles in Darling hair extensions, an ammonia free hair colour for Illicit, a Pamela Grant make up range extensions in Chile, new variants for Stella air fresheners and Hit household insecticides in Indonesia and a new range of Soft & Gentle deodorants. We also have a robust pipeline of innovative products to be launched over the next few quarters that will aid stronger growth and market share gains.

Our fourth strategic pillar is to create a future ready sales organisation for our India business. We are driving multiple initiatives to enhance our go-to-market approach. We are piloting Project Rural One and Project E-cube to accelerate growth rates and leverage lower penetration in a few of our categories. Our focus will be on generating demand and extracting more from rural while simultaneously expanding our coverage and improving our distribution effectiveness. For the quarter, rural growth continued to be ahead of urban growth and remains an important focus for us.

Our fifth pillar is to build a global best-in-class supply chain. Leveraging a global, best-in-class supply chain to become more agile, is imperative for us. We are strengthening and enhancing supply chain processes across our businesses. We are also leveraging our global scale to optimize our procurement costs. On 'Project PI', our cost transformation project, we have made good progress and expect to see continued impact over the coming quarters. I am pleased to share that GCPL has been ranked on CDP India's Climate Disclosure Leadership Index 2015.

The sixth pillar of our strategy is to foster an agile and high performance culture. We take much pride in fostering an outstanding workplace and are fully committed to providing our team members with great careers, great rewards and a great work environment. We are also benchmarking ourselves against best-in-class global perspectives and becoming world-class in our approach to attracting, developing and retaining talent.

GCPL was ranked the number 1 FMCG company to work for in India in the Great Place to Work Survey 2015. We ranked number 14 on the Great Place to Work – Best Workplaces in Asia 2015 list and were featured among Aon Hewitt's Best Employers in India 2015.

I will now cover the highlights of our financial performance.

For the quarter ended December 31, 2015, in organic constant currency terms, our consolidated net sales increased by 9% along with a stronger operating earnings growth of 19%.

Our India business reported sales increased by 8% on a year-on-year basis led by double-digit volume growth in Household Insecticides and robust mid-single digit volume growth in Soaps.

Our international operations, which accounted for little less than half of our consolidated turnover during the quarter, recorded an organic constant currency sales growth of 9%.

Our consolidated gross margins expanded by 450 basis points, aided by lower input costs, calibrated price hikes and cost saving initiatives. Our consolidated EBITDA margins of 19.5%, expanded by 160 basis points led by better margins in our India, Indonesia and Latin America businesses.

In India, EBITDA increased by 18% and margins expanded by 180 basis points year-on-year. This strong expansion in profitability was delivered along with a branded business volume growth of 9%. In our international operations, our organic EBITDA margin of 17%, expanded by 130 basis points year-on-year. Earnings per share (non-annualised) stood at INR 9.48 for the quarter. The Board of Directors has declared an interim dividend of 100%, which translates into INR 1.00 per share.

While the pace of economic recovery is slower than anticipated, we are hopeful of continuing our relative outperformance in the quarters ahead. Over the next few quarters, we will be introducing several exciting new launches to stimulate demand and extend leadership in our core categories. We are also enhancing our go-to-market infrastructure and investing strategically for the future. Overall, we expect our focus on innovation, distribution initiatives and superior on-ground execution to aid growth ahead of the market. The medium and long-term growth prospects in India and our other emerging markets remain robust. We believe that there is still a lot of headroom for growth across these markets, given the low penetration and consumption rates in our core categories. I am confident that with our clear strategic focus, differentiated product portfolio, superior execution and top-notch team, we will continue to deliver industry-leading results in the future.

I now conclude my opening remarks on the quarter's performance and open the floor for questions.

Continue: - Q&A…

Questions and Answers:

Moderator:

The first question is from the line of Sanjay Singh from Axis Capital. Please go ahead.

Sanjay Singh:

Can you give a sense of how the domestic volume growth of 9% is calculated?

Sameer Shah:

In terms of better understanding the category volume growth rate - Household Insecticides had volume growth in teens, soaps had a little higher than mid-single digit volume growth and Hair was mirroring the decline, which we had. Another category which becomes little meaningful for us in this quarter is Liquid Detergent, which is close to around 7-8% in terms of overall contribution to India business revenue. That category also grew more or less closer at the overall value growth. So if you stack up all of it, it does come to around 9% underlying volume growth.

Sanjay Singh:

How would you calculate volume growth for the overall business? Is it SKU to SKU or any other methodology?

Sameer Shah:

At a higher level, it is the underlying volume growth, which most companies also use as a metric for calculating volume growth. The overall calculation for us happens at a level called 'Design Type', which basically is an aggregation of few SKUs

Adi Godrej:

In Soap, the volume growth is very easy to calculate. In other categories, the volume growth would be value growth adjusted for price changes.

Sanjay Singh:

Can you give a sense on the volume growth on each of the geographies or in the key geographies, especially given the inflationary environment in some of the currencies?

Sameer Shah:

At 9% organic constant currency growth at the International business level, around 2/3rd of the growth is price-led growth and 1/3rd is volume-led growth.

Moderator:

The next question is from the line of Arnab Mitra from Credit Suisse. Please go ahead.

Arnab Mitra:

On the soap business, we have started seeing the PFAD prices move up in the recent past. So, does it impact your margins, which are at a high level right now? Are you seeing any signs of pricing growth coming back into the category?

Vivek Gambhir:

We are fairly comfortable in terms of our covers for the time being. We see no impact at least till Q4. We will have to wait and see what the outlook for PFAD will be going forward. Some of it depends on the degree of enforcement of biodiesel mandates that some countries have. But we don't see much of an impact from a profitability perspective. Beyond Q4, we will have to wait and watch to see what implications this has on our pricing strategy.

Adi Godrej:

The vegetable oil price related inputs into Soap are still considerably lower than what they were a year ago.

Arnab Mitra:

With crude at almost $30 levels, should there be a further reduction in derivative prices or has it been built into the Q3 FY16 cost?

Sameer Shah:

Crude compared to palm has a little longer lag because we do not directly purchase it. The current levels of prices, if they remain as it is, will get reflected in a couple of quarters down the line. So for the next couple of quarters, we would see crude-led y/y expansion on the margin-front.

Arnab Mitra:

On the Air Care business, how much of the sales, currently, are institutional? Is the Bathroom Air Freshener, which you have launched, a bigger market than the segment of Air Care?

Sameer Shah:

Around 1/4th of our Car Air Fresheners sales would be institutional. In terms of overall category split, it is close to around Rs.400-450 crore, of which Home Fresheners would be around more than half of it, and within that half, there would be gel block, which is where aer pocket has been launched.

Arnab Mitra:

GCPL's market share leadership in Home Air Care would be of this Rs.225 crore of market?

Sameer Shah:

We are market leader in the non-gel block part of home air fresheners' space, which would be around Rs.100-150 crore.

Arnab Mitra:

On the Indonesia business, we are seeing very high levels of margins. Do you see a risk that if growth does not pick-up, you may have to invest back into the business for it to grow? Are the margins sustainable on an ongoing basis, especially given how the growth is going there?

Vivek Gambhir:

Our market share positions are being maintained or being increased. So, we believe, we are investing competitively behind brand building. In terms of sustainability of margins, there is going to be the effort to try and drive profit growth ahead of sales growth. But difficult to give a sense on how the margins will end up evolving in the next year.

Arnab Mitra:

On the Africa business, how much of the Darling business growth of 20% constant currency, would be organic growth? Especially in Nigeria and South Africa, are you seeing an impact on consumer sentiment or is it that the currencies, especially in South Africa, have come up, but you have been able to take pricing to compensate for it?

Omar Momin:

Darling's constant currency growth of 20% is completely organic. We are seeing a very challenging environment in terms of the overall demand sentiment in Nigeria and South Africa. In Nigeria, because of the crude oil situation and in South Africa, given overall economic sentiment. We have used this as an opportunity to consolidate our own position in these markets. So the market is growing for us in line with the total average and we will continue to do that given our local manufacturing strength as well as presence on the ground.

Arnab Mitra:

On your past few quarters' strategy, you took a bit of lag in taking pricing to gain market share, so is that still playing out and is that helping the growth remain high?

Omar Momin:

We are constantly catching up on pricing as well, which is why we are seeing the margin profiles change. But even in the last quarter, the rand saw a further devaluation. So there will be some play between how we play in the market and the currencies. We had seen growth in excess of 20% over the last few quarters, which will normalize a bit but we will continue to try and consolidate our position.

Moderator:

The next question is from the line of Latika Chopra from JP Morgan. Please go ahead.

Latika Chopra:

Overall, in the quarter, it appears the organic constant currency growth for the Africa region has been close to 12%, which means the non-Darling business is not performing up to the mark. So, would this be a sustainable growth number or we can see some improvement? Also, could you comment on how are the new forays like Wet Hair Care and Household Insecticides shaping up and any sense on contribution from these?

Omar Momin:

Let me take the second question first; we have continued to build on our product portfolio in the Wet Hair Care space. In this last quarter, we launched a range of new relaxers in Kenya and we will be extending it to East Africa. So our objective of building a platform around the new category of Wet Hair Care continues and so far we are seeing good traction on that. In terms of the other parts of the Africa portfolio, we have had some issues with exports of Hair Colors in other parts of Africa, that is something we are correcting over this fiscal and should get normalized going forward.

Latika Chopra:

Should we expect low-teens to mid-teens of a constant currency organic growth in Africa?

Adi Godrej:

We would not like to make forward predictions and we do not give guidance, but the markets are doing well, fortunately. Consumer businesses are performing much better in most of the geographies we operate.

Latika Chopra:

Latin America margins benefited due to better gross margins and effective leveraging of brand platforms. Can you give more color on the aspect of brand platforms? We had taken operational controls for Chile in October, has that helped margins? Overall, how should one look at sustainable margins on a full year basis for this geography?

Vivek Gambhir:

Lot of the improvements is being seen in Latin America, which is a result of a successful implementation of "Project Iceberg", which was operational effectiveness improvement project. So improvements in Chile are not reflected yet. Going forward, our efforts will be to maintain the performance in Argentina and drive further improvements in Chile, now that we have full control. Overall, you will continue to see improvements in performance for all of Latin America though one has to be a little bit watchful of how the economic situation in Argentina evolves. But so far things are heading in the right direction and we should see improved performance in next year as well.

Moderator:

The next question is from the line of Percy Panthaki from IIFL. Please go ahead.

Percy Panthaki:

For the entire FY16, what are the savings that you are likely to derive from 'Project PI'? Also what is your expectation of the annual savings in FY17 on this account?

Sameer Shah:

At the beginning of the year, we had set a target of FY16 exit annualized savings of around Rs.200 to 220 crore. We are very much on track on annualized savings target. Also, there are a lot of initiatives in the pipeline which becomes a very strong base for next year's PI savings. So we are very optimistic in terms of rigorously focusing on some of the initiatives, which we have in the pipeline and also looking at some fresh ideas and initiatives to have this more on an ongoing basis.

Percy Panthaki:

From April 2015 to March 2016, what would be the savings on this?

Sameer Shah:

Banked savings would be close to around Rs.80-100 crore in this fiscal year.

Percy Panthaki:

So the difference between Rs.220 crore and Rs.80 - 100 crore is because the savings have been towards the latter half of the fiscal or is there some other difference?

Sameer Shah:

Timing differences.

Percy Panthaki:

What figure would you target for FY17?

Sameer Shah:

We have a very strong platform on taking some of the initiatives of FY16 into the next year. At this stage, we are in process of forming up as to what should be our PI aspiration for next fiscal year.

Percy Panthaki:

The margins in the Household Insecticides category are becoming attractive with the fall in crude, does that attract more competition and does that show up in a higher promotional spend rather than a pass-through on the top line? In terms of retention at EBITDA level, will Household Insecticides be markedly different from Soaps?

Vivek Gambhir:

In terms of profit margins, on a net contribution basis, Household Insecticides have a higher net contribution than Soaps. It also tends to be little less volatile as far as margins are concerned. On the Soaps business front, margins do tend to be more volatile. In terms of competition, the entry barriers in Household Insecticides category are quite significant in terms of both the R&D requirement for Insecticides along with the timeframes required to get new products registered by any player. So this market is fairly consolidated with four players in the market with over 90% market share. So it is hard to have a true sense of new competition, but it is much harder for newer competitors to be able to gain a foothold.

Percy Panthaki:

Within the existing competitors and the existing products, are we seeing existing players becoming more aggressive in the marketplace? Are we witnessing increased amount of promotions?

Vivek Gambhir:

It has been going for the last 2 to 3 years. There have been increased efforts by various players to increase the intensity. This is where the power of branding, competitive market investments and continued innovations along with distribution really helps us. So in terms of the strength of our brand, coupled with innovation and distribution, we continue to see consistent share gains in spite of competitive efforts. So we still feel very confident that we will be able to sustain the momentum going forward as well.

Percy Panthaki:

FMCG industry growth in many of GCPL's international geographies is not that great, but you have been able to grow much faster than the industry and have posted handsome double digit constant currency sales growth. But, if this situation continues for a couple of more years, do you see your growth rates falling from the levels that you have been reporting for the last one or two quarters?

Vivek Gambhir:

Our internal belief is that the growth will improve going forward, in terms of focus on brand building, our distribution, innovation and putting a good team in place. So the results of the last one or two quarters is a function of investments and efforts made over multiple quarters before that. As we look at the innovations and the other efforts that we are putting in place, you will see continued momentum and improvements going forward as well. So, our hope is that you will see even better performance from us, going forward in the quarters ahead.

Moderator:

The next question is from the line of Prasad Deshmukh from Bank of America Merrill Lynch. Please go ahead.

Prasad Deshmukh:

In the current challenging macro-environment in Indonesia, are you finding it easy to achieve expansion of distribution or are there any challenges that you are facing?

Vivek Gambhir:

There are certain goals that we have in terms of incrementally improving distribution every quarter; those plans are still in place. Beyond increasing distribution, there is a lot of focus on improving productivity too. Similar to what we had done in India, we are going through a fairly extensive exercise to be able to implement handhelds with our sales team. We are also putting in business intelligence applications and functionality for our sales team. Again, in our India business over the last two years, we have seen a lot of gains coming from handhelds and business intelligence. That process is underway as we speak. So over the next few quarters, we will be able to extract more growth through just better analytics and science and technology in our Indonesian business. The third element is that we have been a little bit slow as far as new launches are concerned over the last 12-months or so. There will be a renewed focus on more innovations, potentially looking at some additional category, along with more premium offerings in our existing categories. So, a combination of all of these things gives us enough confidence that we will be able to significantly outperform whatever the market growth in Indonesia might be.

Prasad Deshmukh:

What exactly do you mean by consolidating position in Africa in the current macro environment?

Vivek Gambhir:

When we start seeing significant devaluation in currency, a lot of competition, at least for Dry Hair market, tends to be the Chinese players, who run more of a trading model. While the overall secular growth in the category might be more challenged; because of local manufacturing there are two things that we can do – one is to be far more dynamic in terms of launching new styles and secondly, because the relative impact of currency is bit less than players who are exporting into the market, we can gain shares. Looking at the market environment, we have been gaining a lot of share even in markets like South Africa, which has seen a lot of economic turmoil. So our relative position across all of these markets, whether in South Africa, Nigeria or Kenya is far stronger than it has ever been before.

Prasad Deshmukh:

In the current scenario across geographies, what is your acquisition strategy? Now if the targets are available at reasonable valuations, would there be a preference to go for large ticket acquisitions or is there too much on plate in terms of cross-pollination?

Vivek Gambhir:

We are very open to acquisitions. Our acquisition strategy is not based on the next 6-months or one year or two years. Our acquisition approach is looking at the potential of the geography and the asset over the next 3 to 10 years. In that sense, our commitment to acquisitions is still there. We are very open to looking at both scale acquisitions or bolt-ons in our existing geographic footprint. At this stage, our appetite is to remain focused on our existing geographies. But within our existing geographies, if we find interesting assets that have attractive valuations and make the right strategic operations, we are open to doing those.

Adi Godrej:

We are also increasing our shareholding in many of our joint ventures.

Moderator:

Thank you. I, now hand the conference over to the management for closing comments. Thank you and over to you.

Adi Godrej:

Thank you. With that, we would like to bring this call to a close. Thank you all for being on this conference call.

Moderator:

Thank you. On behalf of HSBC Securities, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

Disclaimer - The following transcript has been edited for language, factual errors and grammar, it however may not be a verbatim representation of the call.