Investor and Analyst Q1 FY14 Conference Call

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Percy Panthaki

Good afternoon. I would like to welcome you to the Q1FY14 Results Conference Call hosted by IIFL. With us, we have the senior management team of GCPL comprising Mr. Adi Godrej – Chairman; Vivek Gambhir, Managing Director, Nisaba Godrej, Executive Director, Innovation, Omar Momin, Executive Vice President – Strategy and Business Development, P. Ganesh, Executive Vice President - Finance, Commercial and Company Secretary and Sameer Shah, Associate Vice President, Finance and Investor relations. Also dialed in from South Africa, we have Shashank Sinha, President, International Operations. I would now like to hand over the call to Mr. Adi Godrej who will take you through the highlights of GCPL's performance. Over to you Mr. Godrej.

Adi Godrej - Chairman

Thank you and good afternoon. I welcome you to the Godrej Consumer Products Limited conference call to discuss the performance for the first quarter of financial year 2013-14.

In a challenging environment, we have delivered robust operating performance, particularly on the top line. With 27% constant currency consolidated sales growth; we have continued to sustain strong sales momentum in both our India business and our international operations. Our focus on sustaining and extending leadership in our core categories has enabled us to grow significantly ahead of the market.

Our branded business in India grew by 21% in the quarter. In the corresponding quarter last year, we had some contract manufacturing business that we no longer do. While it is difficult to give a precise estimate of volume growth given the nature of our categories, we believe that about two-thirds of our growth in the quarter was volume growth. At 38% constant currency growth, our international portfolio also grew well in the quarter.

Along with driving strong sales growth, we are continuing to invest in building a sustainable platform for the future. Over the last few months, we launched several exciting innovations along with significant renovations in our portfolio. We are continuing to back these innovations with strong marketing investments. The response to our innovations has been very encouraging and the performance is significantly ahead of our plans.

Given these aggressive investments, our EBITDA growth has been lower than sales growth. In emerging markets, we believe that an important metric to track is EBITDA plus Advertising & Publicity expenses. This measure ensures a balance between delivering near term operating profits along with adequately investing in brand building and tapping into new opportunities for driving consumption and penetration for the longer term. On an EBITDA plus Advertising & Publicity expenses basis, we had 30% growth at a consolidated level and 37% growth in our India business. As the new launches gain scale, we are confident that our marketing expenses will moderate and we will be able to get profit growth in better line with our sales growth.

We have also seen significant improvement in our gross margins during this quarter. Gross margins in our India business in particular improved by 430 basis points. The improvement in the gross margins is the result of continued operational efficiencies, lower increase in input costs and a calibrated premiumization strategy for some of our brands.

I will now recap our six 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 sustain leading positions in the three core categories that we participate in - home care, personal wash and hair care in India. Across these categories, our focus is on growing ahead of the market, driving consumption & penetration and strengthening our portfolio. If we look at our India business, across categories, this has been yet another quarter of strong sales growth and market share gains.

Our household insecticides category delivered another quarter of robust performance with 24% sales growth. This is well ahead of the category growth. Distribution synergies, innovation and continuous brand investments have contributed to this growth. We continue to gain market share and enjoy leadership positions across all formats of electrics, coils and aerosols. Given the good monsoon this year, we remain optimistic of sustaining our performance ahead.

Our soaps business continues to grow reasonably well, at 13% growth for the quarter. Promotions driven competitive activity in the quarter was very intense and our team has done well in ensuring good volume growth of 7%, much ahead of the reported category growth. We have been consistently growing ahead of the category in value as well as in volume.

We continue to be the second largest toilet soaps player in the country. Cinthol continues to perform very well post the re-launch last year. We have strongly backed the Cinthol refreshed launch with the compelling “Alive is Awesome” marketing campaign. Godrej No. 1 also continues to do well, led by our varianting strategy. We launched a new variant “Aloe Vera and White Lilly” last quarter that has been well received by consumers. Godrej No. 1 is now the third largest soap brand by both value and volume in the country.

Gross margins have expanded both on a year-over-year basis and sequentially, as a result of an improvement in our mix and lower palm oil prices. We are closely tracking the recent rupee depreciation versus the US dollar and the resultant increase in palm oil prices. We will evaluate any changes required on the pricing front based on how the situation evolves.

In the hair colorant category too, we continue to be market leaders. We grew by 32% during the quarter, far ahead of the category. We expect this momentum to continue over next few quarters. Last year, we launched Godrej Expert Rich Crème Hair Colour, the first hair cream in a sachet format in India. We strongly backed this launch with the well-received “Ohh My God” marketing campaign. The product has been received very well by consumers. We expect to see the benefits of the strong investments made over the last 2-3 quarters, over the months ahead. Godrej Expert

Advanced Powder Hair Colour has also recorded a marked increase in growth rates, aided by a new communication campaign.

We continue to support our marketing campaign on Aer air fresheners. The response on Aer too has been very encouraging. We launched a new variant "Aer musk after smoke" during the quarter.

The second pillar of our strategy is to drive growth in our international business, guided by our 3x3 strategy, of focusing on three core categories and in emerging geographies in Asia, Africa and Latin America.

Our biggest international business, Megasari in Indonesia continues to grow at a strong pace of 17%, aided by the success of new launches and distribution expansion. Local currency growth was around 21%. Megasari continues to strengthen its position as the market leader for urban household insecticides, air care and baby wipes in the Indonesian market. Reported EBITDA margin at 14% (before payment of technical and business support fee) was impacted due to two major reasons. Firstly, in line with the sale agreement with the buyer, we continue distribution for the divested foods business (Simba) at breakeven margins for a one- year period. This had a negative impact of 150bps+ on our EBITDA margin. Secondly, a 58% increase in minimum wages and 33% hike in fuel prices have also affected margins. Price hikes have been taken to absorb these cost increases, but these will come to full effect in the coming quarters.

In the longer term, we expect volume growth gains from both increasing penetration and consumption in the Indonesian market. We recently launched new products in Mitu (baby care) and Stella (air fresheners), which are faring well. We also introduced a new marketing campaign on HIT last quarter, which has been driving market share gains for the brand.

Our African operations, which comprise Rapidol, Kinky, Tura and Darling, made steady progress during the quarter and grew by 58% in constant currency terms. Revenues stood at Rs 214 Crore and EBITDA margin at 13%. The integration of the Darling businesses is proceeding smoothly. Darling business' like to like constant currency growth was at 15% and volume growth was a few hundred basis points higher. The value growth was lower than volume growth driven by a cyclical fashion trend towards braids and away from weaves. We also launched a strong campaign with wet hair care products such as braiding cream, hair creams and hair nourishers in Kenya. The new product calendar has been strengthened in South Africa for launch in the next few quarters. Nigeria has seen an intensified distribution initiative reaching more than a thousand salons and appointment of new distributors. We have recently brought on board several talented senior professionals in leadership roles in South Africa and Nigeria to deepen our talent bench strength in the organization.

Africa margins were impacted due to the South African ZAR depreciating by ~15% against the US dollar in Q1, impacting purchases and hence gross margins. On a QoQ basis, our EBITDA margins are up by 600 basis points and trending towards normative levels. We have also rationalized the store footprint in our Kinky business. 11 under performing stores were shut down since the corresponding quarter last year. We are hopeful that the Kinky business will be turned around by the end of this year. Going ahead, we expect margins to peak in the festive season in quarter 3.

Our Latin American operations, which comprise Argentina and Chile, showed improvements during the quarter. Revenues stood at Rs 130 Crore with a growth of 31% in constant currency terms. EBITDA margin moved up to 3%, during what typically is the weakest season for hair colors. We had several launches during the course of the quarter, which were supported with upfront higher brand investments. We also continue to invest in growing our business in the neighboring countries of Argentina and Chile. In Argentina, we have also launched a profitability improvement project, supported by an external partner.

Our Europe business recorded a revenue growth of 59%, led by strong organic growth and the integration of Soft & Gentle. We recently acquired Soft & Gentle, the UK's fourth largest brand in the female deodorant space, which performed well during the quarter. EBITDA margins for the business were around 9%. Brands like Bio Oil, Cuticura and Touch of Silver continue to grow well.

Our third strategic pillar is to accelerate the pace of innovation and to strengthen our brand portfolio. The last few quarters have seen many innovations and new launches across categories and across geographies. We launched Aer Air Fresheners, Godrej Expert Rich Crème Hair Colours, HIT Anti Roach Gel, and refreshed Cinthol, in India. We also launched home insecticides in Nigeria, Hit one push Aerosol in Indonesia and Villeneuve sun care range in Argentina. We also refreshed Illicit in Chile and the Aapri skin care range in UK. The initial response to these launches has been encouraging and we are beginning to see strong traction in sales from these launches. In India, over one third of the sales growth in the quarter was driven by new launches of last few quarters.

We have been making upfront marketing investments to ensure that we adequately support our new launches. Three fourths of the increase in Advertising & Publicity spend in the quarter was targeted towards our new launches. We believe that we will reap the benefits of this upfront spend as the new launches continue to gain scale. Consequently, our Advertising & Publicity expenses as a percentage of sales will moderate in the quarters ahead.

One of our other key imperatives is to create a future ready sales organization for the India business. We have launched Project Daksh to improve the productivity of our sales force and to enhance go to market efficiencies in our urban markets. Our urban growth during the quarter was 18%. Through Project Vistaar, we continue to improve coverage in our rural markets. Our rural growth in the quarter was 28%. We also continue to deepen relationships with our modern trade partners through joint business planning and setting up electronic data interchange (EDI) interfaces to automate the exchange of data. Our modern trade channel grew at 31% during the quarter.

Our fifth pillar is to create a global best-in-class supply chain. We have taken strong steps in this area by establishing centers of excellence in TPM, lean, six sigma and low cost automation. We have also set up a strategic sourcing team to leverage scale and reduce our procurement costs. Our gross margin performance, especially in our Indian sub-continent business, is well supported by ongoing cost saving initiatives. We have also launched Project ICON (ICON standing for Improving Contribution) to put additional focus on efficiency improvement and margin enhancement.

Finally, we continue to execute several initiates to foster an agile and high performance culture in the organization. Recently, GCPL was ranked as the number 1 FMCG company to work for in India by the Great Place to Work institute. This is the largest study on workplace culture in the world. Over 550 companies participated in the study in India this year. Our overall ranking across all sectors too has improved from number 25 to number 11.

GCPL has featured in the list of best companies to work for 10 years in a row. This is a great achievement – not matched by any other company – Indian or MNC in the FMCG industry, or in any other industry. Our ranking reinforces our commitment to creating an outstanding workplace that attracts and retains talented employees and delivers superior value to our consumers.

I will now cover the highlights of our financial performance this quarter. For the quarter ended June 30, 2013, our consolidated net sales stood at Rs. 1,720 crore, with a growth of 24%. Our consolidated business organic, constant currency sales growth was also robust at around 19%.

EBITDA margins stood at 13.1%. EBITDA margins are relatively lower driven by strong marketing investments on the new launches, reflected in advertising and publicity expenses as of percentage of sales increase of around 270 bps on year over year basis. EBITDA margins were also impacted due to wage increase in some of our international operations and the adverse impact of currency depreciation in several currencies.

Earnings per share non-annualized stood at Rs. 3.9 for the quarter. The Board of Directors has declared first interim dividend of 100%, which translates to Re 1.0 per share.

Our net sales in India increased by 19% to Rs. 923 crore, with significant growth across the core categories. Our branded sales in India grew by 21% while growth in EBITDA for branded business was ~17%. EBITDA margins stood at 15.7%, mainly behind higher marketing investments on the new launches, reflected in Advertising and Publicity expenses as of percentage of sales increase of around 470 bps on year over year basis.

Our international operations, which accounted for little less than half of our consolidated turnover during the quarter, reported revenues of Rs. 803 crore, an organic, constant currency growth of 19%. EBITDA margins stood at around 10%.

The macroeconomic and socio-political environment continues to be challenging both in India and in other parts of the world. Competitor intensity also remains high. But we are optimistic of sustaining the growth momentum in the quarters ahead. At the same time, we will remain cautious and watchful. We will remain focused, agile and prudent to navigate the uncertainties and will hopefully emerge in a much stronger position.

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

Continue: - Q&A…

Questions and Answers:

Moderator

The first question is from the line of Mr. Abneesh Roy from Edelweiss.

Abneesh Roy:

My first question is on 32% sales growth in India hair color business, could you explain how much share are you gaining from MNCs and are you also seeing some cannibalization or upgrading from our own powder segment?

Adi Godrej:

There is some upgrading in the powder segment, but our new hair color crème in sachets has done exceedingly well. We have grown in other segments also. However, it is difficult to tell how much share we are gaining from the multinationals because AC Nielsen data does not to our mind project entirely the total position in the industry, but clearly others are not growing as fast as we are. So we expect we have gained considerably in shares.

Vivek Gambhir:

At a rough directional level, about a third of the growth has come from upgrading, about a quarter of the growth has come from share gains and the remainder has come from new users coming into the segment. So the largest driver has been penetration gains with new users coming in, the rest is a combination of both share gains and upgrading.

Abneesh Roy:

On the Africa business, we are seeing diversion in consumer trends. We are seeing some level of down trading in South Africa and up trading in Nigeria. At that moment we have the Kinky issue also. When we are seeing such diversion in trends and Kinky is also facing consolidation and pressure on profits why are we so aggressive on launching new products and why you expect Kinky to turnaround in Q4 and why are these problems there?

Adi Godrej:

Africa is a rapidly growing market. We see tremendous opportunities in Africa. Despite the problems you mentioned and the general global economy, our Africa business is very accretive and we think there is tremendous possibility of further growth in Africa.

Vivek Gambhir:

The ethnic hair color market in Sub-Saharan Africa is $2.5 billion. That market is about 55% dry hair which is largely where Darling has played in the past and 45% wet hair and wet hair has a mixture of relaxers, head nourishment and styling products. So our foray in launching these products in Kenya has been to participate more in the wet hair part of the market which we believe is equally attractive. On Kinky, clearly the performance of the business has not been satisfactory over the last few quarters. There are a number of initiatives that we have taken such as to close underperforming stores, and bringing a new leader for that business on board. Over the next few quarters you will see the business getting turned around.

Omar Momin:

Firstly this industry is influenced a lot by fashion trends. It is currently seeing the trend towards the product class which is braids and that is the reason why you are seeing a down trading in South Africa, but on an overall level, the way we drive innovation is through the introduction of new styles and these new styles are across all product categories and these new styles lead to premiumization, independent of which product category is currently in style. On the launch of new products in the wet space, it involves almost no incremental investment because these will all be branded Darling. So the way we invest in the platform brand, we are trying to maximize the infrastructure we have in Kenya to carry a lot more product categories through the same infrastructure and we will therefore see immediate financial results from these launches as they do not require any additional investment.

Abneesh Roy:

On the Indonesia business, will the margins be back to normal levels in Q2 and how will Mitu brands growth stand for the full year?

Adi Godrej:

Margins in Indonesia will not come back to the old levels because for one year we have to distribute food products without any contribution. We do not lose any money, but we do not make any money. So it comes in the topline and does not come in the bottom-line, so therefore the margins will remain low, but that does not affect the overall profits of the business.

Vivek Gambhir:

If you take the distribution part out, for the remainder of the business we will see margin improvement next quarter, but the entire price hikes impact will take a couple of quarters. So while you see some benefits in Q2, realistically you will see more benefits in Q3 as well.

Adi Godrej:

In Indonesia margins are affected because of the very strong minimum wage hike in the country which will also lead to better demand. So sales growth will display itself in the next couple of quarters.

Vivek Gambhir:

On Mitu, the team has done a lot of work to look at a re-launch of Mitu, that will happen later on this year, having said that the competitive intensity in Mitu still remains quite high in the country.

Moderator:

Next question is from the line of Mr. Abhijeet Kundu from Antique.

Abhijeet Kundu:

On the Darling business where we were impacted by currency depreciation, what amount of raw material is imported?

Omar Momin:

For the entire category, the raw material is largely sourced from Dubai and it is denominated in U.S. dollars. So you are seeing this cost increase in terms of local currency terms right across the category. For the industry itself, about 50% to 60% of raw materials would be sourced from the third parties in dollar.

Abhijeet Kundu:

Your current EBITDA margins are at about 3% for LatAm operations, which seen an expansion of 540 bps, you have not included one time exceptional cost which was there last year, right?

Sameer Shah:

Yes. If you look at base quarter, LatAm margins were 3% after adding back 6 Crore of severance cost. If you strip out the severance cost, the margins were minus 3%. Even in Q1FY14, we had a severance cost. We decided to give a comparison versus reported margins basis which the improvement in margins is around 550 basis points and lastly it happens to be traditionally the weakest margin quarter in Argentina for us.

Abhijeet Kundu:

On a sustainable basis, what kind of EBITDA margin would you be looking at, 6%-7%?

Sameer Shah:

We would not like to give guidance on this front, but if you look at the trend of last two years, the quarterly margins have moved upwards on a full year basis quarter-over-quarter.

Abhijeet Kundu:

Have your margins been impacted due to the marketing expenses in your UK operations?

Sameer Shah:

Yes.

Abhijeet Kundu:

Volumes have to pick up for the margins to reach normal levels, right?

Sameer Shah:

The sales growth momentum is pretty strong. Even if you strip out Soft & Gentle, the organic sales growth has been very strong. What we are also doing simultaneously is investing in building brands which will further drive sales growth.

Moderator:

Next question is from the line of Mr. Manoj Menon from Deutsche Equities.

Manoj Menon:

If you look at the last few years, the EBITDA margin is down about 400 basis points and I recall the comment in the analyst meet couple of months back that the profits will now grow in line with sales. So when I look at the medium term, next three to five years, would the margins be closer to the 18-20% or would it be close to 15%?

Adi Godrej:

Margins growing in line with sales are true for organic business, but when there is inorganic business there is always the cost of financing it because we finance by borrowing. So the inorganic growth will not provide margins in line with sales growth, but it will provide accretive profits.

Manoj Menon:

The EBITDA margins which used to be around 18-20%, now it is more close to 15. For the full year, there is an expectation that sequentially EBITDA margin should improve, could I use the same metric for the medium term as well?

Vivek Gambhir:

In the medium term, our EBITDA growth should be more in line with sales growth.

Manoj Menon:

On the ad spend, in fiscal 2013, there was about four to five concentrated new launches particularly in second and third quarter. We see a lot of ad spends in the first three to four months of a new launch and we have seen them continuing six months down the line as well. If you exclude the IPL impact, why the ad spends, essentially the media spends still remains very high?

Vivek Gambhir:

It is largely a function that a lot of these launches are still at a fairly early infancy stage. For instance, HIT Anti Roach GEL was actually launched in April of this year, crème's really aggressive launch was far more towards November of last year and we have now gone into the south over the last month or so. While it was initially a pan-India launch, really it was much more towards the north and the west, so the south launch has really happened over the last couple of months. As we are facing some of these launches and going more national, it has really been a lot of activity over the last three to six months across all of these categories.

Adi Godrej:

Another reason why ad spends are quite high is that our new launches and re-launches have done exceedingly well. Therefore it means that investing money at this stage gives tremendous medium to long-term returns and it makes a lot of sense doing so.

Manoj Menon:

Your view on the media inflation considering the potential changes expected in television from 1st of October.

Adi Godrej:

It is too early to say whether it will lead to higher cost, but it could because the government is trying to control the amount of advertising times for unit hour of broadcast. So we will have to wait and watch.

Manoj Menon:

Could the industry spends shrink, so that presently the share of voice could be maintained.

Adi Godrej:

It is possible. It always happens when there are high costs then supply demand does get affected, but it is a little more complicated in media as compared to commodities.

Manoj Menon:

I asked this because of the potential slowdown that is witnessed in most of the category. So does the industry have the wherewithal to actually cut back on spends considering the headwinds?

Adi Godrej:

Naturally it tends to happen, when an economy does not do well, sales are affected, people tend to spend less, but whether competitors will follow exactly or not is entirely dependent on the competitive situation.

Vivek Gambhir:

For some of these things also some of the media mix might actually change. For instance, this year we are getting very innovative as far as investment in digital media is concerned. So almost 7% to 8% of our spends this year will be on digital. So as we continue experimenting with different forms of media, it will drive more innovation in the industry in terms of optimally using its marketing mix given the changing scenario.

Moderator:

Next question is from the line of Shariq Merchant from Ambit Capital.

Shariq Merchant:

On the domestic soap business, we have seen 7% volume growth and this has been on the back of a very strong quarter as well, where has this growth come from? Has it been because of the Cinthol re-launch or due to market share gains? Could you break up the volume growth between Cinthol and Godrej No. 1?

Vivek Gambhir:

We typically do not break up our growth across brands, but growth in both Cinthol and No. 1 has been very strong, but because No. 1 is a much larger brand than Cinthol, Cinthol has contributed much more to the value led growth, whereas I think No. 1 has had a higher contribution as far as the volume growth is concerned.

Shariq Merchant:

The growth in Godrej No. 1, is from market share gain or is the market itself growing at that pace?

Vivek Gambhir:

No, the market growth is much lower, so it is a combination again of gains that No. 1 has seen because of some of our distribution led initiatives along with market share gains.

Shariq Merchant:

Can you give out numbers on only the advertising and publicity part, not the promotions. So if I were to add the promotion bit as well, how would the numbers stack up? Has the ad spend shifted from promotion to advertising led or have both of them grown in the same proportion broadly?

Adi Godrej:

Promotion spends have also grown, but may not be in the same level as advertising spends.

P. Ganesh:

The salience is more on the A&P spends because bulk of the spends on media is also on account of the new launches. So the incremental spends are on the back of new launches and therefore between the two, the salience is more on the A&P spends.

Shariq Merchant:

Given what is likely to happen in the media industry, would you say that there would be a shift from more advertising to more promotion-led spends?

Sameer Shah:

It is too early to comment on this front. Also just to come back to your earlier question, if we look at the advertisement and publicity that is what has gone up for us directionally, the sales promotion as a percentage of sales has not moved baring the impact of category mix.

Moderator:

Next question is from the line of Mr. Ashish Upganlawar from Elara Capital.

Ashish Upganlawar:

Is the sharp increase in A&P entirely to do with new launches part and if you could clarify on a like-to-like basis compared to sales, would the existing product basket have grown in line with sales, basically the A&P spends?

Sameer Shah:

In our India business, the increase is around 74% in A&P, nearly three-fourth of the increase has been behind supporting new product launches. Our new product launch is at what we internally call as an investment phase, which are the new product launches of last three or four quarters. So the investments on base portfolio have not moved up much.

Ashish Upganlawar:

To understand the rupee impact on the gross margins and how would you do the promotional activities because our raw material cost will also be impacted because of this uptick in palm oil prices. How these two move the gross margins and the promotional activity?

Sameer Shah:

It is too early, we are watching the situation very closely. The rupee-dollar 60 equation has been more starting late June, so we are watching the situation more closely as of now.

Vivek Gambhir:

Particularly in the soap segment, given the rupee depreciation and the impact on palm oil prices, it could lead to a reduced level of promotional activity in the soap sector.

Ashish Upganlawar:

Does that also mean that the ~7% volume growth in soap that we have seen as a major contribution would have been from the extra volumes that have been thrown into the market and because of these factors moving in the reverse direction, the raw material cost benefits, would we see a lower volume growth there?

Vivek Gambhir:

What happened was because of the changes in the legal metrology, some of our SKUs which were 110 grams a year ago got reduced to 100 grams. It actually impacted our volume growth. So on a pure unit basis, our unit growth was about over 10%. For some of the other competitors, it actually benefitted them in terms of the grammage actually increasing in size. So for them they may see an impact in the quarters ahead, but for us we will not see much of an impact as far as hopefully volume growth is concerned.

Adi Godrej:

But none of our growth came from extra stocks in the market. We have kept the market stocks extremely lean.

Ashish Upganlawar:

Across geographies the growth has been pretty good, but how are you sensing the continuity of the topline growth numbers for two quarters down the line? What do you expect from Africa, Indonesia and India as far as a slowdown in topline growth you are registering as of now?

Vivek Gambhir:

The environment is still overall uncertain and we are definitely seeing some signs of discretionary spending at an overall levels slowing down, the impact of currency devaluation, but for the particular categories that we are in, the growth seems to be still robust and so we remain cautiously optimistic that the current growth that we have seen in the first quarter will be sustained particularly given the focused manner in which we approach our categories.

Ashish Upganlawar:

Has it been true for Indonesia and Africa business as well?

Vivek Gambhir:

The sentiment still seems to be uncertain, but our teams are feeling quite cautiously optimistic of sustaining this growth momentum going forward.

Moderator:

Next question is from the line of Arnab Mitra from Credit Suisse.

Arnab Mitra:

On Africa question which was asked earlier on the margins, where I think the currency depreciation and some of the other things like down trading could continue even going forward. Do you feel confident that you can get back to that 16% to 18% EBITDA margin trajectory or will FY14 be at a lower level because of all these issues?

Omar Momin:

Looking at different countries in the mix, Nigeria and Kenya in terms of currency have headed up very well even better than the Indian rupee. It is the Rand that has taken the largest hit. We should be pretty close to ending up with 16% to 18% kind of number for the full year, if not getting there.

Arnab Mitra:

The constant currency organic growth in Darling was 15%. What was this number last quarter and have you seen a significant improvement over Q4?

Sameer Shah:

This is like-to-like constant currency growth and not constant currency organic growth which we estimated to be around 14-15% level. Similar number in Q4 would be around high single digit. The reason being because in Q4 there was three to four weeks of closure in Kenya in and around the election period.

Arnab Mitra:

Where do things like consumer promotions, products which are given free or sampling of products, where do those costs get captured? Is it in sales promotion or is it under the ad and publicity or is it just knocked off from the topline?

Sameer Shah:

The consumer promos which reach to the consumers finally are part of advertisement and publicity and again directionally nearly 90% plus of our expense in advertisement and publicity are towards media investments.

Arnab Mitra:

On the Darling side, what is the acquisition tranches now in terms of FY14? Do you expect to do the next tranche of acquisition and how would that pan out?

Omar Momin:

We have a few countries in the pipeline, but I think till we are at a stage where we can't be sure of the timing, we wouldn't like to comment on that.

Moderator:

Next question is from the line of Chanchal Khandelwal from Birla Sun Life AMC.

Chanchal Khandelwal:

We have elections coming in Indonesia and we are seeing some rate hike and there are some problems in the Indonesian economy. How will this impact us going forward?

Shashank Sinha:

Elections are a part of the business environment wherever we operate. Particularly for Indonesia, most of the election related increases in wages or reduction in subsidy of petrol prices has already been built in, so that has already happened in the earlier part of this year and the petrol price hike took place a couple of months ago. We do not see any significant derailment in Indonesian economy going forward. In fact elections have been smooth. Increase in minimum wages is actually fueling consumption. We are seeing a big increase in penetration and consumption of whole lot of consumer products. I do not expect any negative impact on the election in as much as anywhere else.

Chanchal Khandelwal:

Have you taken some price increases to take the impact on margins into account?

Shashank Sinha:

Particularly for Indonesia, there are two factors for the reduction in EBITDA margin; one-time factors which will be restored back in the business. We are still doing contract manufacturing where we capture the sales, but not the profits. That is going to go on for a year and that accounts for approximately 150 or 200 bps. So that will come back. The second factor is the delay in passing on the impact of wage increase. So the prices have been increased, but in this quarter we have not captured the full impact. As we go into the next three quarters, we will see the full impact of those price increases coming in. I do think that the normative margin level will gradually come back into the business.

Chanchal Khandelwal:

Darling is more of a fashion brand and you have seen some down-trading, but is this structural or is this just a temporary phase and will it get back to where it was?

Vivek Gambhir:

Just one other thing on Indonesia to remember is that in the last Nielsen Global Consumer Confidence Survey, Indonesia moved over to the number one spot. The Indonesian consumer continues to still feel very bullish about the progress in the country.

Chanchal Khandelwal:

I am just weighed on the medium term business, on long-term we know, but the problem is that in the election year I do not know how consumers will behave or how the Indonesian economy will behave?

Omar Momin:

In terms of the trends, it is more about moving between different product categories and these trends typically last a few quarters. There is nothing structural about the movement towards braids presently, these change with fashion season so to say and affect a certain percentage of the portfolio. I do not foresee any structural changes to the business.

Chanchal Khandelwal:

In Africa, can we go back to 16% to 18% margin in one or two years or will it take time?

Omar Momin:

I think you should see that happening within the next few quarters.

Chanchal Khandelwal:

On the acquisition which is left on the Darling business, do we have option to postpone the acquisition or we do not have an option and also do we have the option not to acquire these acquisitions which are still left?

Omar Momin:

As we had mentioned in our last analyst interaction, we are now covering almost about 70% of revenues of the Group and almost 80% of profits within the joint venture already having covered three big countries of Kenya, Nigeria as well as Southern Africa. We have the option of doing the remaining countries subject to mutual agreement between both parties. There is no obligation or compulsion. We will do it when we think the time as well as the country situation is right for us.

Chanchal Khandelwal:

So nothing in the six to nine months?

Omar Momin:

We would not like to comment till we are sure.

Chanchal Khandelwal:

How is household insecticides segment in Africa doing, one that we have launched and what is the plan for household insecticide in Africa?

Shashank Sinha:

The first country we have launched insecticides is Nigeria. We are going to start our advertising campaign in the first week of September. Before advertising and before a big consumer oriented campaign, so far it has been on track. This is related to distribution that we are getting and also some initial off-take numbers that we are seeing from the stores where we are present. Our plan for the rest of Africa, a lot depends on the lessons we learn in Nigeria, the best practices from there.

Moderator:

Next question is from the line of Vivek Maheshwari from CLSA.

Vivek Maheshwari:

Did I hear it correctly when Mr. Godrej mentioned that rural India growth in this quarter was 28%?

Adi Godrej:

Yes, that is right.

Vivek Maheshwari:

Your standalone growth which is domestic business is 19%, rural is 28% which means urban would have slowed down, but modern trade still grew 31% and there have not been very aggressive expansions by retailers or developers in general. How do you explain this divergence between overall urban and modern trade within that if urban indeed is slowing down?

Sameer Shah:

While we have reported 19% growth, our branded business sales growth is around 21%, rural is roughly around one-fourth of our India branded business which has grown by 28% and urban has grown by 17%-18% which is close to around three-fourths of our business. I hope you are clear as to both of them add up to a 21% branded sales growth and not 19% reported growth.

Vivek Maheshwari:

But within that, if urban is tapering off, and we are hearing about it, why should modern trade be 31%, why is that divergence there?

Adi Godrej:

First of all urban is not tapering off and modern trade growth has always been higher than overall urban growth because modern trade off-take has been growing faster than overall urban off-take.

Vivek Maheshwari:

The rest of the industry has been talking about urban markets slowing down and now you think that there is no such slowdown in case of urban India then?

Adi Godrej:

The proportion of our sales in fast growing categories is much higher than most of our competitors. If you look at both household insecticides and hair color, they are underpenetrated categories. They are growing faster than the general FMCG categories. In our soap business, the sales growth was lower than our overall growth, but because both hair color and household insecticides are underpenetrated, the opportunities to grow is much more than in the case of other categories which have much higher penetration levels.

Vivek Maheshwari:

Your A&P in the domestic business on a quarterly basis was highest ever, but typically while it is a good strategy, you are spending two-thirds on new products, but typically for most consumer companies and in fact in your case also in the past, you have staggered your new launches whereas these are kind of bunched up in this quarter. How do you see the A&P evolution and has there been a change in the strategy instead of spreading out new launches, bunching them together if the opportunity is right?

Nisa Godrej:

We look at new product innovation, the investments in a strategic way. We have not really bunched it up in any particular quarter, but we are market leaders in hair color and HI and we consider it very important that we are first-to-market with sort of new offerings to consumers. That being said, it is very important with what we consider a very strategic NPD where we feel we are very differentiated like HIT Roach, Expert crème hair colours, where we feel that the ROI is very high, we should invest very aggressively in the first year to 18 months, for a couple of reasons. One is in India to get that distribution push is very important. Two, we want to be far ahead of competitors if they try to copy us in these product categories, but we actually feel in the long-term once these products are paying for themselves, they are very strategic investments.

Vivek Maheshwari:

On the soap business Vivek explained about the revenue versus volume in your case as well as in competitor's case, around 5-6% price hike, is that a carryover impact and do you plan to reverse that or shouldn't there be an anniversary impact basically by this point of time?

Sameer Shah:

You will see a 6-7% price-led growth for us in Q1, but that is because of the carry forward price-led growth in Godrej No. 1 and also because of the Cinthol refresh. When we refreshed Cinthol somewhere in mid-year last year, there was an inbuilt price increase, so to that extent in quarter two, we will still have a favorable base on Cinthol for price-led growth, but nothing much on Godrej No. 1.

Vivek Maheshwari:

Will this fade away second quarter onwards?

Sameer Shah:

Yes.

Vivek Maheshwari:

On Indonesia, have we taken all the price hikes that were required to pass on the impact of employee cost or the wage settlement?

Vivek Gambhir:

No, not yet, we are still looking at further price hikes and that will evolve as the situation develops in Indonesia.

Vivek Maheshwari:

We are yet to pass on this impact, is it the entire impact of wage hikes?

Vivek Gambhir:

A lot of impact has been passed on, but we will have to see the situation again in the next couple of quarters to evaluate whether we need a further price hike.

Vivek Maheshwari:

On FX loss in standalone, on what account has this 5.5 odd crore loss been incurred?

P. Ganesh:

Those are entirely on account of the oil imports where we have our payables in dollar terms.

Vivek Maheshwari:

Consolidated will be, the interest payments or principal repayment that you would have done along with import of oil?

P. Ganesh:

That is a mix of the intercompany loans revaluation, which we have as well as operating payables and receivables revaluation.

Moderator:

Next question is from the line of Vaishali Jajoo from Aegon Religare Life Insurance.

Vaishali Jajoo:

The household insecticides will be gradually launched all over Africa in the next five years. Is it going to be the range of products we already have or will it be a particular category that we will launch including Magic Paper and how is the regulatory environment differentiate in Africa from other markets?

Shashank Sinha:

The product range tends to be different because different markets have different living conditions, climatic conditions, etc. For example, South Africa is a more developed market compared to Nigeria and therefore the Nigerian market has more coils and more paper products as compared to South African market where the living standards are different. We have to be very specific to individual markets. We operate in a wide range of markets and therefore, our Indonesian product range is quite different from the Indian product range. We will customize our product range. We have knowhow across the wide range of products both for mosquitoes and for cockroaches in different formats

Vaishali Jajoo:

Will it take another five years from here to actually settle in those markets?

Shashank Sinha:

Yes.

Moderator:

Next question is from the line of Hemant Patel from Axis Capital.

Hemant Patel:

On pricing power and I am just worried that in the context where we have certain amount of volume moderation in category growth rate and on the other end, we do have cost inflation building up because of rupee depreciation, would it be fair to say that price hikes going ahead can come only if we were to let go off certain amount of demand, meaning that demand elasticity is actually working against us going ahead?

Adi Godrej:

In many of our categories, the demand has very little to do with price because they are essential items. Clearly it is more to do with pricing and competitive pressures than to do with consumer demand.

Hemant Patel:

In soaps where we are slowly, incrementally seeing a buildup in palm oil cost and that impact on a Y-o-Y basis probably will come into the second half. We are not really worried about taking up prices if that comes through. Is that what I should be reading into it?

Adi Godrej:

No, in palm oil prices, the current prices compared to a year ago are lower. Of course some of that is lost to the rupee depreciation, but generally there is no inflationary pressure at present compared to a year ago.

Hemant Patel:

What have the category growth rates been across for the domestic businesses, at least in the top three categories?

Sameer Shah:

Due to a lot of inconsistency in the category growth rates, we will not be sharing going ahead what are the category growth rates, but the three categories in which we play we have grown much ahead of the category reported growth rates.

Hemant Patel:

This is on similar lines as what we did last year, but it has been slipping in terms of the insecticide portfolio and the hair color on a quarter?

Sameer Shah:

There is too much of inconsistency, in the data. Honestly, there is nothing much to read, especially for a shorter period of a quarter.

Nisa Godrej:

There are categories which are not as highly penetrated as other categories in FMCG. So there is huge opportunity to offer consumers innovative, new offerings that they even would pay a premium for. Similarly few of our offerings are for value for money segment, it can create demand to penetrate in rural India. So in both these categories we see huge amounts of opportunity. As the category leader, we would like to set the pace of growth in penetration for these categories.

Hemant Patel:

Are we going to be maintaining the level of ad spends that we are doing at this particular moment for the next few quarters and therein it will come down as a percentage of sales as sales builds up?

Sameer Shah:

Yes. If you look at our last nine quarters, A&P as a percentage of sales, you will see that typically early part of the year, our A&P as a percentage of sales is high which directionally moves down during the course of the year.

Hemant Patel:

Is there any particular guidance at least in terms of the advertisement spend that you will likely to do for this year as a percentage of revenue?

Sameer Shah:

Sorry, we do not give guidance on this front.

Moderator:

Next question is from the line of Mr. Harit Kapoor from IDFC Securities.

Harit Kapoor:

You have done all these new launches and re-launches over the last three to six months. In the next 12 to 18 months, do we see further new launches from India or the last six months the innovations that we have done, we will be really spending behind them right now or at least for the next 12 to 18 months. Do we see more launches coming through or will we be spending behind these new launches?

Vivek Gambhir:

Definitely there are new launches in the pipeline, but equally or perhaps more important is the focus on our existing launches and making sure we scale them up. So there will be new launches, but I think disproportionate focus will be on the launches we have done over the last three to six months.

Moderator:

Next question is from the line of Varun Lohchab from CIMB.

Varun Lohchab:

On the distribution footprint, there are specific projects for both urban and rural distribution. What is the current distribution footprint in urban and rural in terms of direct and where could that move over next couple of years?

Sameer Shah:

In terms of data points from Nielsen, there is a bit of inconsistency, again they have changed the panel and hence all the more inconsistency compared to what it used to be earlier, but we have been growing in terms of our reach, both direct and indirect. If we look at last year, we grew +10% and again the growth will continue for us both in direct as well as indirect within both urban as well as rural markets.

Varun Lohchab:

Will the growth remain at similar pace or will the growth rate accelerate in terms of the distribution expansion?

Vivek Gambhir:

It should remain at similar rates.

Varun Lohchab:

On the household insecticides, we have been growing ahead of category consistently for some period. Are we seeing category growth rate slipping, like, even say based on your own observations on the ground and is the gap versus the category growth expanding further?

Vivek Gambhir:

No, we are not seeing any category growth slowdown, in fact, because of the good monsoon. I think the category growth rates should continue to be healthy this quarter as well.

Nisa Godrej:

If you look at HI and you break it up between mosquitos and cockroaches and other problems consumers face, cockroaches penetration with branded product is 3% that gives you a sense of what the potential in the market is.

Varun Lohchab:

In terms of the distribution synergies of merging of GHPL and GCPL distribution, there was some sort of strong growth, is that largely over or should we still continue to see some more benefits of that?

Vivek Gambhir:

About 70% is over, but the remaining 30% of benefits still remains, which we will get over the next couple of years.

Moderator:

Next question is from the line of Prakash Kapadia from iAlpha Enterprises.

Prakash Kapadia:

In the household insecticides few years ago the coil was contributing more than half of revenue growth for the industry, now is electric and aerosol more than that at the industry level? Secondly, on the soaps category, are we seeing some consumers' down-trading from a grade one to a grade two soap and Cinthol has been a flagship brand for us, is there some internal size we are looking at for talcum powder and deodorants for Cinthol in the next few years because of the small category size and young population in India?

Vivek Gambhir:

Definitely the salience of coil has come down because LVs and aerosols have grown much faster. On soap down-trading, we have not seen any visible down-trading yet though what initial data has suggested that the premium part of the market has grown the slowest over the last quarter or so, which essentially could create an opportunity for brands like Godrej No.1 in that sense. Third, with Cinthol, these are all important opportunities. Cinthol is scaling up quite well. I think talcs, deos, there are lots of other opportunities, Cinthol actually has a unique brand positioning which is a lot more around grooming and freshness and that applies to a bunch of different categories. So the brand is well-positioned to capitalize as an opportunity not just in soap, but other adjacencies as well.

Prakash Kapadia:

All these newer initiatives should be a big focus area and we are likely to see many more products?

Vivek Gambhir:

Absolutely. As a platform brand, Cinthol will continue to do well.

Prakash Kapadia:

You said coil obviously has come down. Is it fair to say today, electric and Aerosol are more than half of the market?

Vivek Gambhir:

Yes, absolutely.

Prakash Kapadia:

Given the gross margin improvement in the soap business, is the current segment margin in soaps about 12-13%?

Sameer Shah:

We do not share for competitive reasons what are the segment margins, but yes, the gross margins on soaps have moved up on a Y-o-Y as well as sequential basis.

Moderator:

Next question is from the line of Mr. Percy Panthaki from IIFL Capital.

Percy Panthaki:

On Africa, when we evaluated and took over Darling, the margins that we had in mind for the business was a rough 20%. Now the margins have come below that and we are saying that basically they could go to the 16% to 18% range in a few quarters. Do you think that 20% now is basically out of question or do you think we can regain 20% and if yes in what timeframe?

Omar Momin:

The first thing is when we did the acquisition, we were basically in the festive period for the business, which is the third quarter of the financial year and we also had some benefits from both a strong festive season and favorable seasonality. So on a normative basis, the Darling business and Africa overall should be in the 18% EBITDA margin range and we will see those margins coming back by the end of this calendar and financial year.

Vivek Gambhir:

20% because of the investments required in the business and to scale it up, I don't think 20% is reasonable over the next three years, but we should be able to get to 18% kind of margins.

Percy Panthaki:

Two interdependent variables, which is your ad spends and your EBITDA margins, we have seen what kind of trend they have played out over the last three years 21% domestic FMCG growth is probably the highest across all FMCG companies. As Nisa was saying, the new launches have to be supported for a period of about 12 to 18 months. Should we assume that the current ad spends are probably higher than normative levels and the ad spends would come down in future and therefore the margins would expand? I am talking about timeframe of about two to three years?

Vivek Gambhir:

Absolutely. As our new launches scale up, you would find that the ad spends will see some benefit from higher sales contribution. The other important thing is in our approach what we are trying to do is create brand platform, so that we can leverage the platform across multiple category's, Cinthol is an example of that, that should also help us manage our marketing investments more prudently.

Percy Panthaki:

I would like to hand over to Mr. Adi Godrej for closing comments.

Adi Godrej:

Thank you for joining us. As mentioned, we expect to grow quite well in the future and I would like to point out that the big advantage we have in Godrej Consumer Products is that we have leadership positions in two of our major categories which are under penetrated categories and have scope for growth. So we are working on innovation in these two categories and strong growth in them. With that, I would like to bring the call to a close. Thank you all for joining in this conference call.

Moderator

Thank you very much Sir. On behalf of IIFL Capital Limited, that concludes this conference. Thank you for joining us.

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