

Investor and Analyst Q4 FY14 Conference Call

April 29, 2014

								
								

Moderator:

Ladies and gentlemen, good day and welcome to the GCPL Q4FY14 earnings conference call, hosted by HSBC Securities and Capital Markets. As a reminder, all participants' 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 an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Amit Sachdeva of HSBC Securities. Thank you and over to you Sir!

Amit Sachdeva:

Good afternoon everyone. This is Amit Sachdeva, Consumer Analyst at HSBC Securities hosting the Godrej Consumer Q4FY14 results conference call. It is our privilege to host the Godrej management today to interact with you on the results, which we think are a strong set of results against a challenging macro backdrop. We have on the call Mr. Adi Godrej, Chairman along with GCPL top management team. Over to you Sir for the call!

Adi Godrej:

Thank you Amit and good afternoon. I welcome you to the Godrej Consumer Products Limited conference call to discuss the performance for the fourth quarter of financial year 2013-14. Joining me are 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, Vice President, Financial Planning and Investor relations. We continue to deliver robust performance in a challenging environment. During the last quarter, at a consolidated level, we delivered a constant currency sales growth of 14% that is far ahead of the growth in the house- hold & personal care sector and the overall FMCG industry. Our growth during this quarter was largely organic as we did not have any material inorganic contribution to our business. Our overall operating performance, too has been very strong, with EBITDA growing much faster than sales. Our India branded sales grew by 12%. This is more than 3 times the growth of the India household and personal care sector during the quarter. 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 driven. At 17% constant currency growth, our international portfolio also continued to do well in the quarter driven by strong performances of our Africa and Latin America businesses. This growth has been adjusted for impact of foods distribution business in Indonesia where we do contract manufacturing. Our consolidated adjusted EBITDA growth of 24% was very strong amidst tougher operating conditions across the key emerging market we play in. The India business delivered EBITDA growth of 19%, which was much ahead of sales growth. The adjusted EBITDA growth in our international business was very healthy at 36%.

EBITDA growth in our Latin America and Africa businesses was ahead of our sales growth. The Indonesia business continues to narrow down the impact of the significant cost inflation we have seen over last few quarters. Our Africa business benefited from healthy sales performance and a relatively smaller base, delivering a very strong quarter. UK had a very strong quarter in Q4 last year being the first quarter for Soft and Gentle brand for GCPL. Quarter witnessed very high

								
								

demand behind very low inventory in distribution system before brand acquisition. This higher sales base had also boosted our margins for UK business in Q4 last year. Latin America margins improved significantly on a year over year basis due to strong sales, cost effectiveness programs, and a better product mix.

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, we have significantly outperformed the reported category growth rates.

Our household insecticides business returned back to good growth, growing by 17 percent, well ahead of category growth. We continue to strengthen our market share across all formats of electrics, coils and aerosols. We believe our focus on product innovation and continuous brand investments will further help drive growth. Our recent innovation in the category, Good knight Xpress liquid vaporizer will bring further gains. This product works faster than any other LV in the world. Our other innovations, Fast Card and Anti Roach Gel too continue to do well.

The soaps category had a challenging quarter with the category witnessing high single digit de-growth in both value and volume terms. In comparison, our value growth was 1% and our volume growth saw a decline of -4%. Our growth rates were also impacted by extended winters in North and Central India which contributes little less than half of our soaps business. We continue to be the second largest toilet soaps player in the country. Continuing with our variant strategy for Godrej No. 1, we launched a new variant, Lavender and Milk Cream earlier this month. We also launched a new 360-degree media campaign for the Cinthol Cool soap for the summers.

In the hair colourant category, we continue to be market leaders. We grew by 16% during the quarter, far ahead of the category. We are driving several initiatives to drive penetration as well as consumption in the category. We launched a new packaging for Godrej Expert Advanced Gel colour. We have also launched a new media campaign 'The Best Ever Hair Colour' for Expert Rich Crème.

We continue to make good progress on aer, our air freshener brand. We have extended the gel format technology to both click and twist formats. This new product has further enhanced the user experience and has received very good feedback from consumers.

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 grew at 12% in constant currency terms (ex the foods distribution business) on a high base, aided by the success of new

								
								

launches and distribution expansion. Megasari continues to strengthen its position as the market leader for urban household insecticides and air care in the Indonesian market. We exited March with historically high market shares in both the household insecticides and air freshener categories. EBITDA margin of 18%, which is before payment of technical, & business support fee and the distribution arrangement of the divested foods business was lower by 110bps on a year over year basis impacted by significant escalation in wage, LPG, fuel costs and currency depreciation. We expect that margins will sequentially continue to improve.

Our African operations, which comprise Rapidol, Kinky, Tura and Darling, had a strong quarter and grew by 33% in constant currency terms. Revenues stood at Rs 246 crores. EBITDA margin was at 15%, and moved up 850 basis points on a year over year basis. Darling Nigeria became the first Darling business to come under 100% GCPL control.

Our Latin American operations, which comprise Argentina and Chile, continued to show improvements during the quarter. Revenues stood at Rs 151 crores with a growth of 28% in constant currency terms. EBITDA margin moved up further to 20%, up by 1000 basis points on a year over year basis due to healthy sales base, cost effectiveness programs, and better product mix. We continue to strengthen our market share in both Argentina and Chile.

Our Europe business recorded an INR growth of 16%, in part helped by positive forex movements. Our constant currency growth was negative at 4% due to a very wet January and the high base of the Soft & Gentle business that had been acquired in the same quarter a year ago. UK had a very strong quarter in Q4 last year being the first quarter for Soft and Gentle brand for GCPL. The quarter witnessed very high demand behind very low inventory in distribution system before brand acquisition. This higher sales base had also boosted our margins for UK business in Q4 last year. EBITDA margins for the business were around 9%, down by 380bps year on year due to high base as highlighted earlier.

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 new formats in aer Air Fresheners, new shades and packs in Godrej Expert Rich Crème Hair Colours, Good knight Fast card, a new Godrej No. 1 variant, and Good knight Xpress in India. We also launched new products for Stella air fresheners in Indonesia, and refreshed the Soft & Gentle range in the 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, nearly one third of the incremental sales growth for FY14 was driven by the new launches of the last few quarters.

We have been making upfront marketing investments to ensure that we adequately support our new launches. Nearly 3/4th of the increase in Advertising & Publicity spend in FY14 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.

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. We recently completed the rollout of hand

								
								

held terminals to all of our direct sales representatives in India. We continue to grow strongly in rural. Our rural growth in the quarter was in the high teens.

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. We have launched a new cost transformation program 'Project Pi' which will take at implementing a future ready cost structure.

Finally, we continue to execute different initiatives to foster an agile and high performance culture in the organization. GCPL was recognized among the 17 Best Employers in India in 2013 by Aon Hewitt. GCPL is one of the only two FMCG companies on the list this year. Earlier, GCPL was also ranked as the number 1 FMCG company to work for in India by the Great Place to Work institute. GCPL has featured in the list of best companies to work for 10 years in a row. Our rankings in these HR surveys reinforce 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 Mar 31, 2014, our consolidated constant currency net sales growth was 14%, excluding the impact of the distribution arrangement for the divested foods business in Indonesia.

We did see some squeeze in our gross margins during the quarter. Around of third of it was behind arrangement of foods business distribution in Indonesia. The rest of it was behind input cost pressures driven by currency depreciation in Indonesia and geography sales mix.

EBITDA margins were around 18%, excluding the impact of the distribution arrangement for the divested foods business in Indonesia.

Earnings per share non-annualized stood at Rs. 6.94 for the quarter. The Board of Directors has declared final dividend of 225%, which translates to Re 2.25 per share.

Our net branded sales in India grew by 12% with significant outperformance across all our core categories. Our EBITDA growth was very strong at 19%. EBITDA margins stood at 21.3%, up by 130 basis points on year over year basis.

Our international operations, which accounted for little less than half of our consolidated turnover during the quarter recorded an organic, constant currency growth of 17% excluding the distribution arrangement for the divested foods business in Indonesia. EBITDA margins stood at around 14%, excluding the impact of the distribution arrangement for the divested foods business in Indonesia. In these uncertain times, our team has been very dynamic in its approach. We remain watchful,

								
								

agile and prudent. We will continue investing judiciously for the longer term to improve our position, create competitive advantage and emerge stronger than ever before. I am confident that with our clear strategic focus, our superior execution and our top-notch team, we will continue to deliver industry leading results in the future. I now conclude my opening remarks on the quarter performance and open the floor for questions.

Continue: - Q&A...

								
								

Questions and Answers:

Moderator:

Thank you very much. We will now begin with the question and answer session. The first question is from the line of Avi Mehta from IIFL.

Avi Mehta:

We have seen a cut in A&P spends this quarter. Just wanted to understand the trend, is there a blip or will the A&P be lower in FY15 on a Y-o-Y basis assuming that the current competitive landscape remains as it is?

Adi Godrej:

Our A&P spend for the year is much higher than the previous year.

Avi Mehta:

I was trying to read it from the quarter's perspective.

Adi Godrej:

Advertising campaigns are not related to each month or each quarter, they are usually planned across the year and we look at advertising budgets on an annual basis. But I do not think the advertising percentage spends will be lower in the future. In fact we expect the Indian FMCG market to recover post elections. Sentiment in the country will improve post elections and growth should also be better, but of course there is a question of how the election results turnout.

Vivek Gambhir:

For example, if you look at our A&P as a percentage of sales, it was about 10% for fiscal year 2013 and 10.6% for fiscal year 2014. So our A&P as a percentage of sales is roughly trending to somewhere between 10% and 10.5%. We intend to maintain that kind of a range going forward. A lot will again depend on our innovation plans and the nature of competition but clearly our strategy is to ensure that we back all products and launches with competitive investments but as Mr. Godrej said there will always be some quarterly fluctuations and it will always depend a lot on the kind of launch that is planned in each quarter.

Avi Mehta:

Which line items are being targeted in the cost saving plan of Rs. 250 crore? How much of it would be reinvested? How much would flow through the bottom-line? Could you share more details on that?

Adi Godrej:

Like every year, we continue to have aggressive cost reduction programs to make our operations a lot more operationally effective and even this year for instance we had a program to deliver over

								
								

Rs. 100 crore in cost savings. The idea of this cost reduction program is to look at our entire cost base, our supply chain, manufacturing footprint, sales and marketing effectiveness to drive further cost improvements. Some of these costs savings will flow into FY15, a large chunk could also flow into FY16, and our overall intend would be, to make sure that EBITDA growth is actually ahead of the sales growth. For example, in FY14 the domestic business sales growth was at about 15%, EBITDA growth was 19% and that is going to be the guiding principal that we will try and work towards and then figure out how much of the saving to plough back into more marketing investments versus the bottom-line.

Moderator:

The next question is from the line of Aditya Soman from Goldman Sachs.

Aditya Soman:

The soaps business has seen a volume decline of 4% whereas one of your competitors mentioned that they have had relatively better volumes. Is there any specific reason why you have seen a volume decline or is it that you are growing faster than the rest of the industry but a specific competitor has grown faster?

Vivek Gambhir:

Clearly the entire industry has been impacted by slowdown in the soap category and the category growth rates point to volume and value de-growth far greater than the kind of growth challenges we faced. Our portfolio tends to be more disproportionately impacted or more reliant on the north. The north had a much harsher and extended winter this year, so we saw a temporary blip driven by the season in Q4 which hopefully will not happen next year. We do not necessarily have a strong winter portfolio of soaps. Companies which have winter soaps such as moisturizing and glycerin soaps tend to do better. It is a longer term opportunity for us. But, both portfolio and geographic mix were against our favor in Q4 but given the low base, this year should be much better than last year.

Aditya Soman:

Would two thirds of volume growth as a proportion of value growth hold true for the hair colours and home insecticides?

Sameer Shah:

In case of both household insecticides and hair colours, our volume growth would be higher than two thirds.

Vivek Gambhir:

Almost all the growth in Hair Colours would be volume growth because we did not have any price increases in the quarter. Insecticides have seen marginal price increase. If you strip out soaps then almost 80- 85% of our growth in those two categories would be volume growth which makes us feel quite good that the underlying strength of the portfolio from a volume perspective has been very strong in spite of a very difficult economic environment.

								
								

Aditya Soman:

In our Latam business, we had 20% EBITDA margins. Are these margins sustainable or are they very high this quarter?

Vivek Gambhir:

It is driven by season. If you look at Latin America for the entire year, margins were about 10% which is on the lower side; our intent is to get the margins to about 15% over the next 18 months. Directionally, margins will move towards the mid-teens but 20% margin was mainly driven by season.

Moderator:

The next question is from the line of Abneesh Roy from Edelweiss.

Abneesh Roy:

In the hair colour crème segment, we have seen MNCs launching similar products and they have also cut their pricing and then we have seen some home grown players also enter hair colour crème with a similar technology, packaging, etc. Although their price might be a bit higher, we have seen the value growths come down because of the base effect. Are you seeing lower growth in the coming quarters because of competitive intensity?

Vivek Gambhir:

It is always a wonderful testimony when we become innovation leaders and global giants start copying us, it is a good endorsement that our products are extremely high quality and doing very well in the market. This is an area where a lot of conversion is happening from powders. We are in the beginning stages as far as consumption and penetration opportunities are concerned. We see a huge amount of growth potential. We believe that our product is the best in the market, therefore we launched a new exciting campaign called 'the best ever hair colour'. We are expanding distribution quite rapidly. Last year, a lot of our focus was on urban growth because initially we had supply shortages. Those have been taken care of, so we will see a lot of growth from rural areas as well. There is more competition & we are well geared for it. We are very confident about the quality of our product, marketing and distribution strength that we should be able to sustain similar growth rates this year as well.

Abneesh Roy:

In the salon channel, MNCs have been traditionally more aggressive. How has our new product panned out in the last two years? How much is our penetration in this specific channel?

Vivek Gambhir:

This is the big opportunity area for us. This is an area where we can do a lot more. We are in the beginning stages of work in this area. You will see a lot more happening in the next few years but this is one area where we could have done more. Going forward this area will be a big opportunity for us.

								
								

Adi Godrej:

One thing we have to bear in mind, in the areas where products in the form of sachets for powders or crèmes are consumed strongly, our distribution is much stronger than any competitor whether multinational or Indian and our distribution will help us maintain strong share of the market.

Abneesh Roy:

The HI business came out with new products like Fast Card and Anti-Roach Gel in the last one year, how are these contributing to the growth of 17% and where do you see these two segments in terms of size in the next three years? Can they also become game changers like crème?

Vivek Gambhir:

Apart from Fast Card and Anti Roach Gel we have also launched GoodKnight Xpress which is the fastest liquid vaporizer in the market. Over the last 12 months, we launched three major innovations. In fact our launches are more than the entire industry over the last five years. We are still at the early stages. There is a huge opportunity to drive rural penetration through Fast Card. There is a significant opportunity to drive urban consumptions through Xpress. There is a big opportunity to increase usage of pest protection products beyond mosquitoes and we would also see a lot more dual usage occasion emerge in the category. We will see overall growth increase significantly over the next three years. We feel good about our growth prospects in HI on the back of these innovations.

Abneesh Roy:

We have seen an increase in the promotions of HI? Is El Niño an area of concern and are you worried of because lesser rainfalls? Could it have a negative impact on HI demand?

Vivek Gambhir:

Competitive intensity has always been quite high. Not only in promotions but also seen over the last couple of years various competitors significantly increased A&P expenses. This is par for the course and typically whenever you see growth slowing down; it is not unusual to see greater competitive intensity. This is something we remain very watchful for but this is again inline with earlier trends.

Adi Godrej:

El Niño phenomenon does not affect all monsoons. It is difficult to tell how it will affect the forthcoming monsoon. Whether the monsoon is strong or not does not affect the mosquitoes from breeding. Monsoon is a strong period for mosquito infestation and our products tend to sell well at that time. We will have to watch and see. Other phenomenon of weather can have a greater effect on mosquito infestation than the intensity of the monsoon.

Abneesh Roy:

On aer business segment, could you talk about the size, market share, is it meeting your internal benchmark and do you see this becoming a sizable part of the business in the next three years?

								
								

Vivek Gambhir:

The current run rate of this business is far ahead of our internal plans. The product experience and the products are viewed extremely favorably by consumers and we definitely expect this business to be a sizable portion over the next five years.

Moderator:

The next question is from the line of Vishal Gutka from India Infoline Limited.

Vishal Gutka:

Why has depreciation gone down by 20%?

Sameer Shah:

There was a one-time write back in our Indonesian business to the tune of Rs. 5-6 crore on account of the global depreciation policy, so there is a one-time drop in depreciation charge.

P. Ganesh:

The depreciation rate is now uniform across the country.

Vishal Gutka:

Why have consolidated margins gone down by 200 basis points whereas your standalone margins have gone down by 60 basis points is it partly due to palm oil prices?

Sameer Shah:

In standalone, 60 basis points drop is because of increase in palm oil prices, also depreciating currency and little bit impact of the packaging materials. In international the drop is around 350 basis points, a third of the drop is on account of foods business, distribution, arrangement which we have in the Indonesian business wherein we record sales but EBITDA margins are zero, the rest of the 350 basis points drop is on account of increase in input cost in Indonesia mainly behind sharp current depreciation which we had seen in last quarter and balance is on account of adverse geography mix because Africa has a relatively lower gross margin as compared to our international blended gross margins especially in the Darling portfolio, these are the reasons for the drop in the international business margins.

Vivek Gambhir:

Africa was a larger proportion of our sales mix this quarter, it has lower gross margin but lower A&P spend as well, it actually translates into improved EBITDA, just because of the way Africa business works. On the overall gross margin and in international, a bulk of the gross margin decline was driven in Indonesia. As the business absorbs significant cost increases and there have been price increases that the business has taken sequentially, you will see improvement in that happening as well.

Moderator:

								
								

The next question is from the line of Hardik Shah from Birla Sun Life Insurance.

Hardik Shah:

In the balance sheet statement, the non-current investments have gone up to Rs. 2,064 crore from Rs. 1,450 crore, would that be for the Darling acquisition?

P. Ganesh:

Yes that is purely on account of the acquisition.

Hardik Shah:

How has the funding of the same taken place because the reserves have gone up by Rs. 200 crore, in fact borrowings have been repaid?

P. Ganesh:

The latest round of Darling acquisition which has happened has been funded entirely by overseas debt. What you see by way of increase in investments in these standalone numbers is actually the repayment of existing acquisition loans which have been funded by infusing equity from it and that is the reason why you are seeing an increase in inflow.

Hardik Shah:

The reserves have gone up by Rs. 250-260 crore and there is also a repayment of long term borrowing, the net outflow is around Rs. 800 crore whereas the inflow is around Rs. 250 crore, it appears as if the short term sources have been used for funding these?

P. Ganesh:

You will actually see a movement from non-current to current liabilities because loan maturities which fall within one year move from non-current to current.

Hardik Shah:

So will they be appearing in the other current liabilities?

P. Ganesh:

Yes, they will be appearing under the other current liabilities.

Hardik Shah:

Can you give some light on performance of Kinky and Rapidol?

Vivek Gambhir:

On the Rapidol side of things, it has been a good quarter, there was a challenge that we were facing with an increasing spread of counterfeits in Rapidol and the team has done a relatively good job in trying to control it, so Rapidol growth has been in the mid-20s as far as sales is concerned and

								
								

about 28% growth in EBITDA, so Rapidol's performance has been good. Kinky is still not out of the woods yet, we shut down about 11 stores and we are trying to get the business back on track and hopeful that we can get the business to breakeven margins later on this year.

Hardik Shah:

Given that you have launched GoodKnight Xpress, do you see any cannibalization of existing products?

Adi Godrej:

Whenever you launch a superior product, there will be some cannibalization of existing products but overall there is considerable growth and if you want zero cannibalization then you cannot launch any new product. Overall, there will be very considerable growth and penetration in this category, so better & more convenient products will always add to increased penetration.

Nisa Godrej:

If you look at the theory behind Xpress, there are dual users between coils and LVs. Some consumers use coils over LVs as they don't act fast enough. Ours is the fastest acting & the action is as fast as coils, so we see it as another active coil conversion and this is a much higher price realization business for us, if cannibalization happens would be positive for our overall HI business.

Moderator:

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

Latika Chopra:

What has been the volume growth during the quarter in Indonesia, Latin America and the Darling business and any comments on growth rates which have been moderating in Indonesia and on market share trends in the country for the past year?

Sameer Shah:

Starting with Indonesia, close to around two-thirds of our growth was volume driven and rest would be price led. In Africa, because of different businesses ranging from soaps, hair extensions to hair colors, it is difficult to give volume growth number but we can share specifically on hair extensions. Bulk of the growth in hair extension in Africa is driven by volume growth. In Latin America, the volume growth would be high single digit in the overall value growth which we have reported in this quarter.

Latika Chopra:

How is the insecticide foray progressing in Africa?

Omar Momin:

								
								

We continue to build on our launch in Nigeria; so far we have seen very good growth as we progress. This will continue to be a priority for us in the coming years and we are also looking to open a few more markets in the continent in this financial year, we are happy with the progress of HI in Africa.

Vivek Gambhir:

The intent will be to improve the margins we had this year in Africa.

Moderator:

The next question is from the line of Prasad Deshmukh from Bank of America.

Prasad Deshmukh:

Last year we were talking about increasing distribution in the African markets, at what stage is this now and when do we see benefits coming from that?

Omar Momin:

We made effort for improving direct distribution in Nigeria in the hair extension business wherein we had set up a tricycle program to reach out to salons both from a selling and a influencing perspective and as of now we have touched about 3000-4000 salons, so that we expect to again ramp up significantly this year and this is a gradual process as we build direct distribution as well as the engagement program, overtime we will see the benefit reflected in our number.

Prasad Deshmukh:

Wasn't the Company considering appointing distributors to shift from the wholesale model to a direct distribution model?

Omar Momin:

Yes that is again part of the outreach program in terms of moving from what is largely a wholesale market to again established direct distribution, so the two go hand in hand.

Prasad Deshmukh:

How much of our business right now is coming from distribution versus wholesale?

Omar Momin:

The direct distribution percentage will still be very small because the entire market operates on a wholesale basis but over the time the salience will increase.

Prasad Deshmukh:

Earlier when Darling was acquired it was said that Kinky would be the front end and Darling would be the back end for the product, what has gone wrong here, why are we consistently closing stores, is there no profitability?

								
								

Omar Momin:

In South Africa where Darling and Kinky both operate, Kinky operates largely in Durban or the KZN province and it had some stores in Johannesburg. Darling has a pan South Africa presence, so the idea was continue supporting the Kinky store presence by sourcing from the Darling business. What we have done as part of restructuring is concentrated the store presence for Kinky in KZN because that is where the brand has the maximum equity and some of the diversification. We had planned on expanding our store presence but we have cut back on that, it is a gradual process wherein we will need to correct the business model according to the changing South African landscape and will continue to build on sourcing synergies from Darling.

Vivek Gambhir:

Things have probably taken longer than planned given the economic turmoil in South Africa, the economy has gone through an extremely tough period over the last 12 months, let us see how the economic environment shapes up, there are some early indications that the environment might improve this year particularly post elections. The plans are now in place, we are hopeful that you will see improvements this year but some of it depends on the economic environment as well.

Moderator:

The next question is from the line of Ashish Urganlawar from Elara Capital.

Ashish Urganlawar:

On the movement of gross margins, there has been a correction this quarter and the gross margins year on year, how do you see them moving next year?

Sameer Shah:

It is difficult to forecast the gross margin movement as it is very dynamic on a year-on-year basis, because there is a commodity element and currency element not only in India but across our businesses. The good thing is that we are market leaders in most of the categories in which we operate across geographies, we have pricing power and price increases in a calibrated way can be taken to offset some of the input cost pressure, but it is something on which you will have to be more agile and also ensure strong volume led growth.

Ashish Urganlawar:

Is my understanding next year the profit growth may not be gross margin driven growth or overall there may be pressure on the gross margins and the cost cutting program or cost savings would drive some kind of improvement of EBITDA ahead of sales growth.

Adi Godrej:

It is very difficult to tell what the gross margin will be, for example in India post elections if the rupee appreciates then gross margin could improve.

Vivek Gambhir:

								
								

The pricing situation is quite dynamic, over the last 12 months our growth has been largely volume driven depending on what happens to inflation and depending on the economic environment it is difficult to make a call right now on how much price led growth would be there this year.

Ashish Upanlawar:

Are we saying that pricing power is curtailed to a larger extent and that is why maintaining gross margins to our liking may not be the case?

Vivek Gambhir:

If you look at last year where the economic growth was very low and inflation was quite high, we had relatively less pricing power but in spite of that we saw gross margin improvements last year at an overall annual level, this year it is very difficult to give an exact call. There are too many variables here to be able to tell you exactly which lever will work but a lot of this will depend on the economic environment post-elections in India.

Ashish Upanlawar:

Was the advertising lower this quarter because of lower launches or lesser spends on launches?

Vivek Gambhir:

We had no launches last quarter, when a lot of our previous launches had been gaining scale to that extent we got more leverage from advertising as this scaled up, so A&P will fluctuate depending on what launches happen in what quarter.

Ashish Upanlawar:

We have seen lot of innovation in most of the categories, does the pipeline look similar in terms of newer launches next year and hence the A&P will be high?

Vivek Gambhir:

We will keep A&P investments competitive, the intent is to get EBITDA growth in line and ideally little bit ahead of sales growth, based on that we will try and figure out and calibrate the right level of launches throughout the year, we have a lot of products in the pipeline but we will calibrate these launches again depending on the economic environment and what the P&L can support.

Moderator:

The next question is from the line of Pritesh Chheda from Emkay Global.

Pritesh Chheda:

Are there any plans for better cash generation on the working capital side in the international operations?

P. Ganesh:

								
								

Working capital is an area which we continue to focus on in terms of optimizing the working capital, looking at opportunities to reduce and we have consistently been able to reduce working capital across businesses. While India business for most of the year continues to operate on a negative working capital, we do have positive working capital in our international businesses. But, the focus on optimizing those and achieving reduction is an ongoing exercise.

Pritesh Chheda:

Any ballpark targets that you want to put out on a 3-year basis?

P. Ganesh:

It is difficult to put out targets. We have been able to achieve levels between two and three weeks of working capital on a consolidated level.

Pritesh Chheda:

In the international operations on the currency other than translational risk, which GCPL takes from consolidation, is there transactional risk in any of the three operations with respect to materials?

P. Ganesh:

We do have transaction related risk, because we do import in India, we import in Indonesia, we imports in parts of Africa as well. To that extent, we do have transaction risks over there.

Pritesh Chheda:

What is the quantum of import in Africa and Indonesia?

Sameer Shah:

It differs from geography to geography. For instance in Indonesia we would have a little less than half of our purchases being imported.

P. Ganesh:

But having said that, the current policy in a volatile currency situation which we are following is that we have cut down our exposure significantly and we operate with limited exposures.

Moderator:

The next question is from the line of Manoj Menon from Deutsche Bank.

Manoj Menon:

What is happening in the HI part of the business, it appears that there is some tactical competition emerging?

Vivek Gambhir:

								
								

On the insecticides front given where the rural penetration is, we see opportunities through Fast Card driving rural penetration significantly. On the urban side with Xpress, we will continue to see consumption opportunities and new forms of dual usage and new occasions will also be emerging based on what we are seeing in the market. The tactical competition has already been there. It has been going on for the last two or three years and this is par for the course and we will continue to deal with both marketing and innovation.

Manoj Menon:

Could you break down A&P without quantifying directionally, how the media spends have moved and the other promotional spends have actually moved?

Sameer Shah:

Bulk of A&P does not have anything on sales promotion.

Manoj Menon:

For the first half, you had close to 50% increase in A&P and it is 10% down now. So the percentage A&P to Sales over the next two years would be at current levels.

Sameer Shah:

Right.

Moderator:

The next question is from the line of Harsh Mehta from HDFC Securities.

Harsh Mehta:

Looking at last 7-10 years of the EBITDA at a consolidated level, it was usually in the range from 18-20%. In the past two years, because of overseas acquisition, it has fallen below 16%. Going ahead with further Darling group acquisition coming up in other countries, where do you see the sustainable EBITDA margin two to three years down the line?

Sameer Shah:

It is not only driven by relatively lower EBITDA margins for couple of our international businesses like UK and Latam. But, they are also driven by upfront marketing investments which we have seen over last couple of years both in domestic as well as international business.

Harsh Mehta:

Do you think that the sustainable EBITDA margin has moved down from around 18-20% to around 16% going ahead in the longer term?

Vivek Gambhir:

								
								

If you look at the 12 month EBITDA margin and if you exclude the impact of the foods distribution business which is temporary, EBITDA margin for FY14 was 18.5%, so in that sense we have maintained margins between 18-20%. I see further improvement opportunities here because as we were pointing out, some of our acquired geographies were lower margin and as the margin profile of these businesses improves, we will continue investing behind brand building and innovations, but it is actually a fairly healthy margin story, if you look at fiscal year 2014.

Harsh Mehta:

PFAD prices have gone up recently, you have taken 3-4% price hike in soaps in Q3, can you comment on palm oil prices going ahead and also likely price hike in the soap business?

Adi Godrej:

It is very difficult to predict commodity prices, a lot depends on how the rupee behaves because all vegetable oil prices in India depend on imported costs, if the rupee appreciates then the cost of vegetable oil comes down and vice versa and also a lot will depend on what develops in terms of Chinese growth, because a lot of commodity prices depend on Chinese demand. It is very difficult to predict and as you know crude oil, packaging, etc., depend on petroleum prices which again depends on geopolitical issues, Chinese demand etc. Hence, it is very difficult to predict.

Harsh Mehta:

In addition to the 3-4% price hike which you had undertaken in Q3, are further price hikes expected or were taken in Q4 in soaps?

Sameer Shah:

We took 3-4% price increase in early Q4 and going ahead we will be evaluating what are the possibilities on price refreshes.

Moderator:

The next question is from the line of Rajasa K from Jefferies.

Rajasa K:

What is the gross debt on the consolidated as well as standalone balance sheet?

P. Ganesh:

Most of our debt is on consolidated and the gross debt is about Rs. 2,200 crore.

Rajasa K:

There is a drastic reduction in domestic working capital. How much of that is sustainable and whether it is related to this slowdown or some of the measures that you have taken to combat the slowdown?

P. Ganesh:

								
								

Most of it is sustainable and bulk of the reduction has come by more efficient management of our inventories, bringing down inventory days as well as the increase in creditor days. This is an ongoing process in terms of optimizing working capital and that will continue.

Rajasa K:

Is this the kind of level that one should assume going forward as well?

P. Ganesh:

That is right.

Rajasa K:

Could you help assess the impact of the divested food business, what would be the revenue contribution and what would be the absolute EBITDA amount in Indonesia?

Sameer Shah:

Very roughly, we used to have foods business contributing of 10-12% of our overall Indonesia business revenues and this 10-12% business was giving us about zero EBITDA whereas in the base, the same 10-12% of the business was giving us more or less Indonesia business blended EBITDA which used to be 18-19%.

Rajasa K:

What are the adjusted margins for the Indonesian foods business for FY14?

Sameer Shah:

The adjusted margins are around 18% and reported margins would be lower, because they would record the topline and will not have the EBITDA for the business, but they would be lower by percentage and a half, close to 16.5%.

Moderator:

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

Arnab Mitra:

We spoke about the competition coming into the lower price segment of crème. Does this in anyway constraint pricing power because you were at Rs. 30 and now there are people at Rs. 39, in terms of the price hikes you can take? What impact will this have on the powder segment where you have a large presence and it is very profitable? Is it a risk and are you seeing growth slowing significantly in powder hair colors?

Nisa Godrej:

We launched the crème as we did want to convert a number of our users into a more premium format and on a sort of per usage basis, we obviously earn more with premium products. In terms of pricing power, we launched the new variants of Expert Creme at Rs.35. What the competition is

								
								

doing will not affect our strategy and this has been a successful launch. We will continue to focus on this product and will keep on innovating behind us.

Adi Godrej:

We must also realize that converting non-users to users will be a major objective and powders will help do that. With crème available at a lower price, some people are directly entering the hair colour segment through crème, it has broadened our offering and our strong objective as leaders in the market is to convert more and more non-users to users.

Arnab Mitra:

Has there been any price increase on the powder's portfolio?

Adi Godrej:

No.

Arnab Mitra:

Has the overall working capital as a percentage of sales come down, what kind of operating cash flow have you seen in FY14?

P. Ganesh:

The operating cash flow continues to be strong and the cash flows, after tax profit plus depreciation would in line with your cash flows.

Arnab Mitra:

Could you tell us anything about the tax rate, will there be any changes next year and is the Rs. 2,200 total debt in USD?

P. Ganesh:

Rs. 2,200 crore is mainly USD debt and this is gross debt. Net debt is in the range of Rs. 1,500 crore. The position on the tax rate will unlikely see any major difference, on a consolidated basis, tax rate will continue to be in the range of 22-23%.

Arnab Mitra:

Thanks so much and best of luck.

Moderator:

The next question is from the line of Vivek Maheshwari from CLSA.

Vivek Maheshwari:

Rs. 60 crore A&P in domestic business or 6% as a percentage of revenues is lowest in past several quarters at least as a percentage of revenues. You started with a 15% and you are ending with 6%.

								
								

There is a sharp volatility depending on new launches, are there some cut backs on A&P or did you maintain your share of voice during the quarter or has the overall pie shrunk, due to the new regulations there was a big media inflation that the Company would have seen? Am I reading it incorrectly?

Vivek Gambhir:

The industry and the various players across the board, in Q4 there has been a general cutback in A&P spends primarily because overall growth has been slower in both FMCG and in home and personal care. Consequently, growth has been slower, people have cut back a little bit on A&P spends for the particular quarter. Some of this is timed with 75% of our incremental A&P spend, if you look at the last two years, it has been driven by new launches and we have been disproportionately focusing our A&P spend on funding them and supporting these new launches. Last quarter we did not have a new launch, so we cutback our spend.

Vivek Maheshwari:

In the beginning of year, domestic business the growth was around 18-19%. You are ending the year with 11.5-12%. Do you think that the revenue growth has bottomed out and should it stay at this level or should it move up in the next four quarters?

Vivek Gambhir:

It completely depends on what happens to home and personal care growth rate and the economic environment because we began with a much higher growth in teens but if you look at the Q3 and Q4 our growth rates have been over three times the category growth rates. So you know in that sense our competitiveness and our brands are much stronger than ever before, but ultimately we have to bear in mind the overall industry context. As the economic environment improves you will see growth return back but the big wild card honestly is what happens to overall home and personal care, and overall FMCG growth rates.

Vivek Maheshwari:

Your other expenses on a consolidated basis are flat, on a standalone basis are down slightly by a percent. What is the reason for this?

Sameer Shah:

This would all be driven in standalone by category mix and in international by geography mix because categories in standalone business have a different percentage of other expenses as percentage to sales and in consolidated it will again depends on each geography's other expenditure as a percentage of sales.

Moderator:

The next question is from the line of Abhijeet Kundu from Antique Stock Broking.

Abhijeet Kundu:

								
								

During the quarter you saw about 39% growth and 33% constant currency growth. How much of that would have come from the consolidation of Darling and other operations?

Sameer Shah:

This quarter was completely organic. The entire 33% percentage constant currency or 39% growth in Africa is completely organic in nature.

Abhijeet Kundu:

What would be the category growth in hair colour and household insecticides, because hair colour as a category, growth had come down to single digit? What is the trend right now?

Sameer Shah:

We have been hearing on the call that it is little sluggish across HPC, fortunately both hair and household insecticides are doing well for us but our growth is much better than the overall category growth.

Moderator:

The next question is from the line of Prakash Kapadia from iAlpha Enterprises.

Prakash Kapadia:

We have seen a huge jump in contribution from our non-core categories, is it fair to say that liquid detergents and aer are the next big drivers and has liquid detergents crossed Rs. 100 crore in terms of size?

Sameer Shah:

It is a category which is very seasonal in nature, so Q3 and early Q4 normally is a big season for liquid detergents but the best way of looking at it is on a full year basis, if you had to look at what was the contribution of liquid detergents last year to this year, it has marginally moved up and this was the first full year of air freshener & is not comparable like-to-like with the contribution in FY13.

Prakash Kapadia:

In the deodorant market, what is happening in the market because of rupee depreciation, are we seeing smaller players getting marginalized, are we seeing consolidation, what is our sense?

Sameer Shah:

It continues to be a highly fragmented market where we see huge amount of competitive intensity and honestly nothing much has changed over the last six to eight months in this field.

Moderator:

The next question is from the line of Hardik Shah from Birla Sun Life Insurance.

								
								

Hardik Shah:

What is the expected capex for the next one or two years?

P. Ganesh:

The capex by and large tends to remain in terms of our depreciation level, so incremental capex will not be very significant, also while we add to capacities the categories that we operate both in India as well as internationally are not very highly capital intensive, so capex does not add significantly in terms of cash flows.

Hardik Shah:

What about loan repayments and how much would it be within one year?

P. Ganesh:

We have long term loans to fund the various acquisitions with end maturities between 4 to 6 years from that we are right now. We have periodic repayments which are in the range of USD 60 to 70 million.

Moderator:

Ladies and gentlemen, that was the last question. I would now like to hand the floor over to Mr. Adi Godrej for closing comments.

Adi Godrej:

With that we would like to bring the call to a close. Thank you all of you for being on the conference call. If you need any further information our people are at your disposal. Thanks.

Moderator:

Thank you on behalf of HSBC Securities and Capital Markets that concludes this conference, thank you for joining us and you may now disconnect your lines.

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

								
								