



Input cost environment turning favorable

Provides support to margins in the near-term; aids promotions and volume growth

Crude showing respite

- The ongoing crude price correction, if sustained, should bring relief to a few consumer companies from point of view of margins. We believe the same would reflect in gross margins of consumer companies with a lag of a quarter or two, depending on the inventory and forward covers.
- Also, correction in crude and crude derivatives should be positive for FMCG companies across the board given the implications it has on packaging and logistic costs, but the extent would be difficult to determine.
- Ad spends' intensity based on savings from crude related costs over this period does not seem to vary significantly. This is true for APNT, PIDI and for the rest of the consumer pack. However, consumer companies, particularly APNT and PIDI appear to pass on the benefits, either through realization reduction or through promotions during certain short periods of the deflationary phase. This is particularly true of APNT over a more sustained period, extending from 1QFY16-2QFY17. Paints are an oligopoly, unlike adhesives and thus APNT, unlike PIDI feels the need to pass on the benefits more.
- For 3QFY19, the average input prices for consumer companies has remained mostly inflationary YoY led by crude-linked inputs, but pressures have reduced as the average prices are currently down 10% QoQ and off 38% from its peak at the end of the December quarter. Most key crude-linked inputs such as Titanium Dioxide (TiO₂ - up 14.4% YoY), Vinyl Acetate Monomer (VAM - up 6.3% YoY), Linear Alkyl Benzene (LAB - up 16.1% YoY) and High-density Polyethylene (HDPE - up 27% YoY) have corrected from their peaks, except Light Liquid Paraffin (LLP – up 21.5% YoY), which is still showing an upward trend.



Agri-commodities – A mixed bag in 3QFY19

- For 3QFY19, average Wheat prices continued to show a sharp uptrend (up 21.2% YoY) and Barley prices also remained firm, rising 26.3%. Mentha prices remained inflationary (up 13.1% YoY) but are showing signs of cooling off (up just 3.7% QoQ).
- Key agri-commodities are down YoY: Malaysian Palm Oil (down 26.4%), Copra Calicut (down 23.2%), Sugar index (down 13.1%), Cashew (down 5.7%), Molasses WPI (down 77.2%) and even milk and SMP prices remain soft for the quarter.



Our top picks: Marico (MRCO), Britannia (BRIT) and Hindustan Unilever (HUVR) in the consumer space

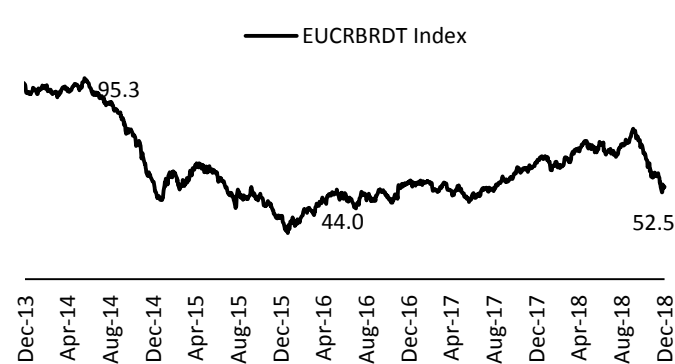
- In our coverage universe, Pidilite is one of the biggest beneficiaries of the correction in crude prices with Vinyl Acetate Monomer (VAM) being a key raw material linked to crude prices. Asian Paints is another key beneficiary as a key raw material - Titanium Di-Oxide (TiO₂) is linked directly to crude. Solvents and resins are also directly impacted by crude pricing. Even monomers are crude-based, but monomer pricing is more dependent on global demand/supply. The gradual increase in water-based paints (now over 50% of total), however, means that crude correlation has reduced to some extent compared to the previous decade.
- Copra's deflationary cycle is a factor underpinning our confidence on Marico's earning prospects, with strong Parachute volume growth, VAHO sales growth and healthy momentum in new products.
- Inflation in wheat should affect Britannia but we believe it will be offset by continuing premiumisation, ongoing cost efficiencies, likely price action (grammage reduction) in the next quarter and low sugar, milk and cashew costs.
- HUVR should benefit from low raw material and crude costs across items if crude remains at these levels.
- While we are cognizant of valuation concerns surrounding the sector, we believe that valuations will continue sustaining at premium levels for companies offering the highest visibility in volumes and earnings growth in their near-term, medium-term and longer-term earnings. MRCO, HUVR and BRIT remain our top picks in the consumer space.

Exhibit 1: 3QFY19 RM scenario — Crude linked commodities showing respite; agri-commodities a mixed bag

Commodities	Segment impacted	YoY	QoQ
Crude & Crude linked commodities			
Crude	❖ Paints, Adhesives, Packaging and Logistics	10.3	(10.1)
TiO2 (INR/kg)	❖ Paints	14.4	3.7
Titanium Dioxide (CNY/MT)	❖ Paints	(2.8)	(1.7)
VAM prices (USD/MT)	❖ Polymers and resins for adhesives, coatings, paints and other end-products	6.3	(5.8)
LAB (INR/Kg)	❖ Detergents	16.1	4.7
HDPE (INR/Kg)	❖ Packaging (Plastic bottles)	27.0	(0.5)
Liquid Paraffin (INR/Lt)	❖ Hair oils	21.5	12.8
Agri-commodities			
Malaysian Palm Oil (MYR/MT)	❖ Foods (palm oil from the flesh of the fruit) and others (mainly palm kernel oil)	(26.4)	(12.2)
Copra Calicut INR/100Kg (Company)	❖ Hair oil	(23.2)	(12.4)
Wheat Prices (INR/Quintal)	❖ Food products	21.2	3.0
Sugar index	❖ Food products	(13.1)	(2.9)
Cashew WPI index	❖ Food products	(5.7)	(1.4)
SMP Prices (INR/Kg)	❖ Food products	(1.5)	(0.9)
India CPI coffee powder gm	❖ Food products	2.9	2.2
NCDEX Barley Spot (INR/quintal)	❖ Beer	26.3	16.3
India WPI Molasses	❖ Spirits	(77.2)	(4.7)
Cotton (INR/Quintal)	❖ Clothing	16.6	(5.8)
Mentha Oil (INR/kg)	❖ Flavors & Fragrances	13.1	3.7
Other key commodities			
PFAD (INR/MT)	❖ Soaps	(32.3)	(19.3)
M CXGOLD Comdty	❖ Jewellery	6.8	3.9

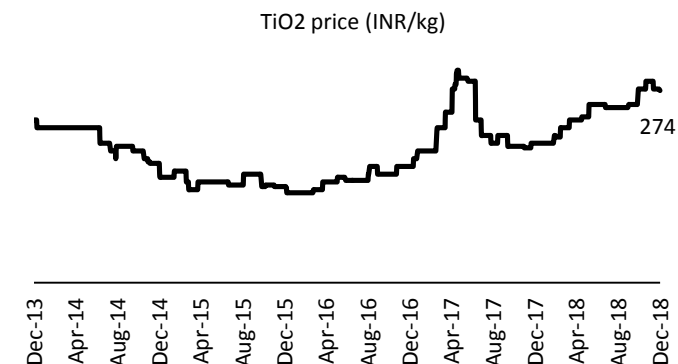
Source: Company, MOSL

Exhibit 2: Crude up 10.3% YoY in 3Q19; down 10.1% QoQ



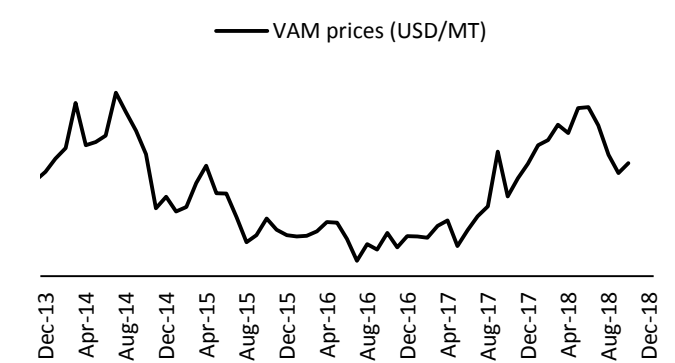
Source: Bloomberg, MOSL

Exhibit 3: TiO2 up 14.4% YoY; up 3.7% QoQ



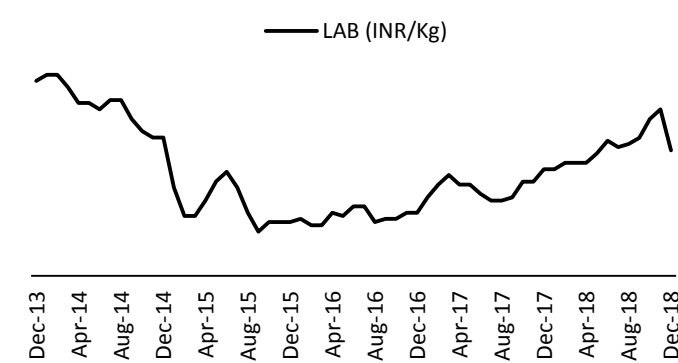
Source: Bloomberg, MOSL

Exhibit 4: VAM up 6.3% YoY; down 5.8% QoQ



Source: Bloomberg, MOSL

Exhibit 5: LAB up 16.1% YoY; up 4.7% QoQ



Source: Bloomberg, MOSL

Exhibit 6: HDPE up 27% YoY; down 0.5% QoQ

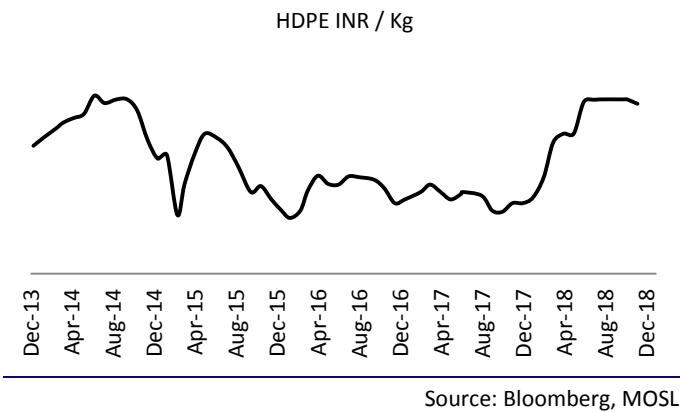


Exhibit 7: LLP up 21.5% YoY; up 12.8% QoQ

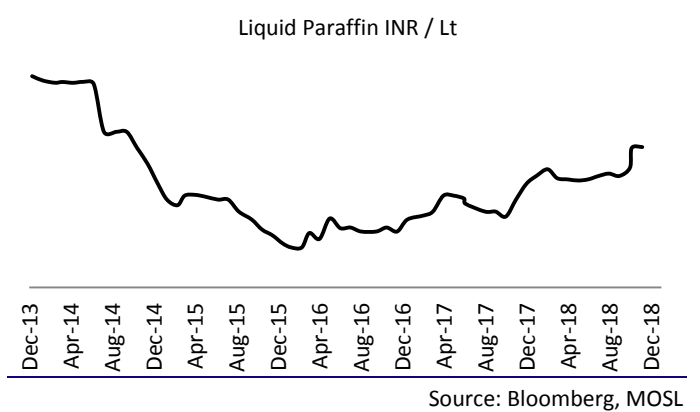


Exhibit 8: PFAD down 32.3% YoY; down 19.3% QoQ

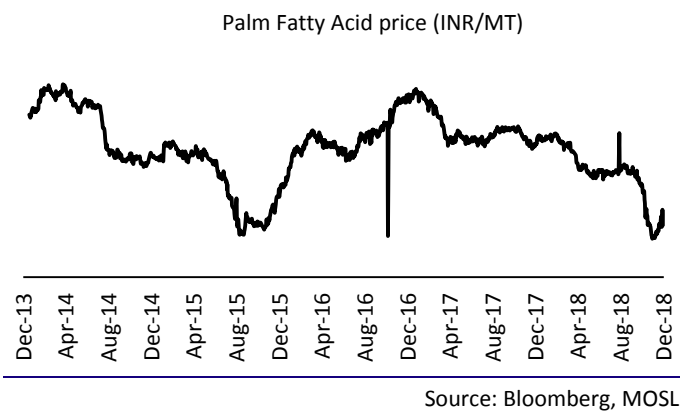


Exhibit 9: Palm Oil down 26.4% YoY; down 12.2% QoQ

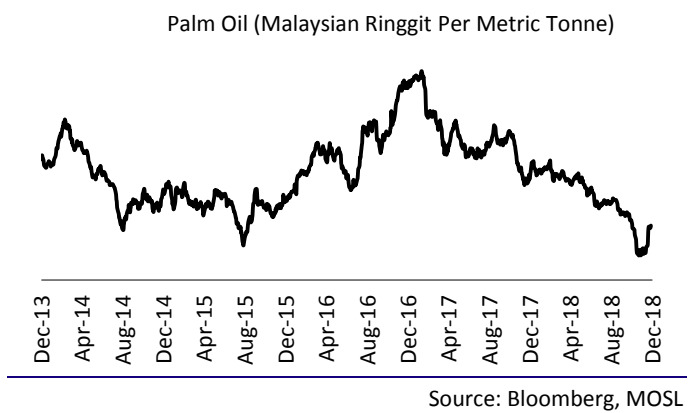


Exhibit 10: Mentha up 13.1% YoY; up 3.7% QoQ

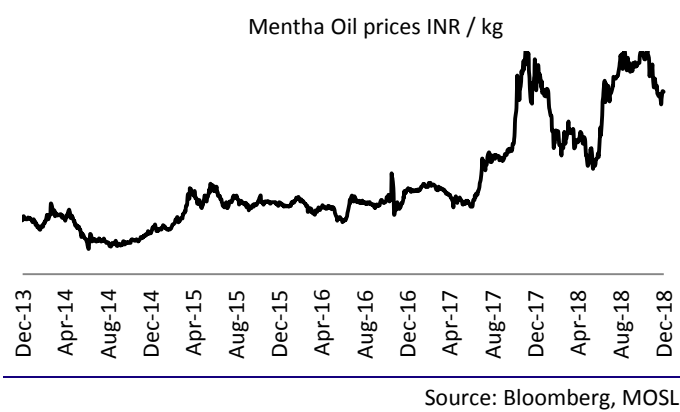


Exhibit 11: Copra Calicut down 23.2% YoY; down 12.4% QoQ

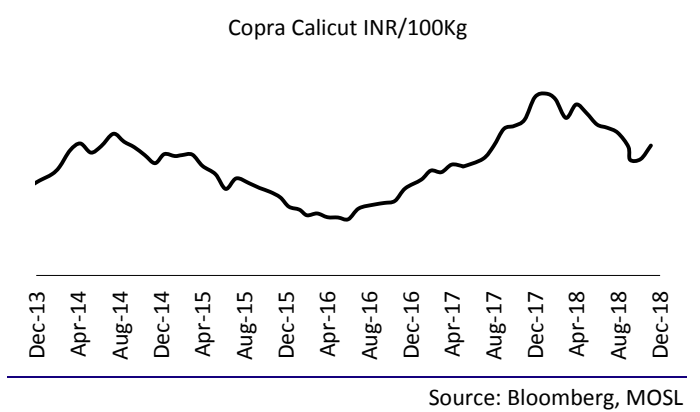


Exhibit 12: Wheat up 21.2% YoY; up 3% QoQ

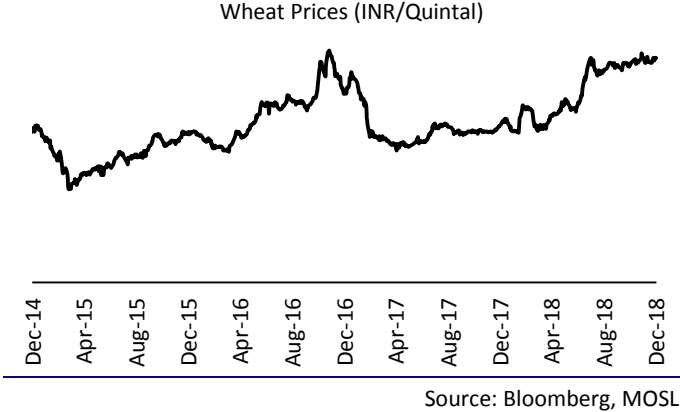
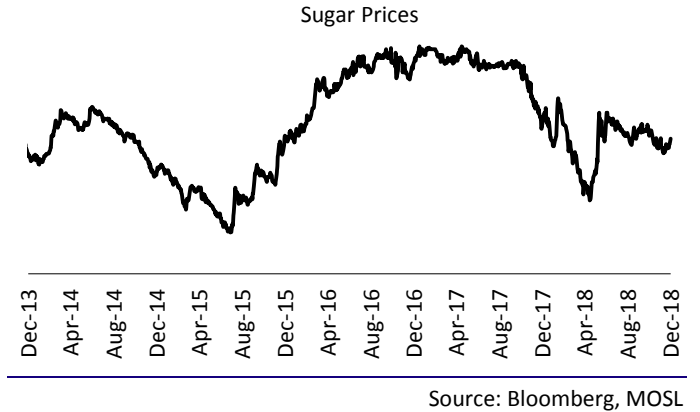


Exhibit 13: Sugar down 13.1% YoY; down 2.9% QoQ



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