Investor and Analyst Q3 & 9M FY18 Conference Call

January 30, 2018

Moderator:

Ladies and gentlemen, good day and welcome to the Godrej Consumer Products Limited Q3 FY2018 Earnings Conference Call, hosted by IDFC Securities. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Harit Kapoor from IDFC Securities. Thank you and over to you Sir!

Harit Kapoor:

Thank you Stanford. On behalf of IDFC Securities, we would like to welcome everyone to the Q3 FY2018 Earnings Call of Godrej Consumer Products. We have with us the senior management of Godrej Consumer Products. I would now transfer the call to call to Tapan Joshi for his opening remarks.

Tapan Joshi:

Good evening everyone. Thank you for joining us today on the conference call to discuss the performance of Q3 FY18. We have with us, Nisa Godrej, Executive Chairperson; Vivek Gambhir, Managing Director and CEO; V. Srinivasan, CFO and Company Secretary; and Sameer Shah, Head Finance, India and SAARC & Investor Relations.

Like our previous quarters, we will start the presentation with Vivek sharing his thoughts on our performance and then we can open up for Q&A. Over to you, Vivek!

Vivek Gambhir:

Thank you very much Tapan. Thank you Harit. It was a reasonably good quarter where we delivered competitive and profitable growth, while continuing to make healthy investments in our brands. The performance was led by India, which delivered an 18% volume growth. The number though needs to be viewed in the context of the low base in the corresponding quarter of last year; however, even on a two-year CAGR basis, the volume growth was quite healthy at 8%.

Along with a strong volume growth in India, EBITDA grew at a very healthy 32%, driven by a better portfolio mix, some benefit of lower commodity costs and the benefits from our cost reduction programme. This profit growth was delivered while investing in our brands. Our marketing investments increased by 24% y-y. We believe that these investments are strengthening our brands and are also setting us up well to accelerate growth in the quarters ahead.

Our team has been very agile in navigating the continuing transition to GST. We took price cuts of about 6% to 10% across relevant categories to pass on the benefit of the rate cuts that were announced in November to consumers. Overall, the environment is getting more stable now. The trade channels are largely back to normal. Consumer demand is improving and we expect stronger demand in 2018-19. We are intensifying our pace of new launches to build on the momentum that we are seeing.

The recovery in rural has been stronger than urban, while urban did well rural pickup was much better. Given the likely focus of the government on rural developments, rural infrastructure, and rural growth, we believe that the rural demand will be one of the key themes in 2018-19.

Turning to our international business, our performance was below our expectations largely due to some one-off and some transient hiccups. In Indonesia, our business continues to show a gradual sales recovery in the midst of a continuing tough environment. We have, however, managed to deliver good profit growth in spite of the challenges. The outlook for Indonesia is more positive this year and so we are hopeful of the recovery gaining more speed.

In our Africa business, our hair extensions business continues to grow in double-digits. The scale up of our wet portfolio is seeing good traction; however, we saw growth in Kenya slowdown in the quarter due to the political and social turmoil in the country because of two back-to-back Presidential Elections. The outlook for Kenya is better this year.

Our US business also got impacted due to an implementation of a new ERP system. The system has now largely stabilised. We are very confident of Africa and the US delivering stronger growth in the quarters ahead and we are continuing to make a lot of investments in people, brand building and factory infrastructure to strengthen the foundations of the business.

Overall, we are very excited about the medium term potential of our international portfolio. While there will inevitably be occasional hiccups, we remain very committed to making the right investments and ensuring that the portfolio delivers strong returns. I am also very pleased to inform you that our Board of Directors today approved the nomination of Pippa Tubman Armerding as Director, effective immediately.

Pippa is based in Johannesburg and she is a lawyer and a business professional with 20 years of experience operating across Africa, Asia, Europe and the Americas. The Africa continent is extremely important to us from a growth perspective and Pippa's deep knowledge and expertise of the continent will be a strategic advantage.

We are also proud that GCPL will now have five women directors, the most in any Indian listed company along with Godrej Agrovet.

I will just quickly walk you through the presentation and cover with you some of the highlights and then we can open up to questions.

On Slide 3, we summarize our financial performance. On a consolidated basis, net sales grew at 11% on a constant currency comparable basis. EBITDA growth was 18% on a constant currency basis and net profit was at 21% growth without exceptional and one-off items. Slide 4, lays out the exceptional items in the quarter. Slide 5 shows the bridge between reported to operating EBITDA, like we do every quarter.

Next slide, we talk about the balance sheet data and again if you look at the balance sheet metrics, they are all trending in the right direction, so we continue to make a very good progress in making our balance sheet much more robust. If you take a quick look at our India performance in slide 8, as we have mentioned earlier, we saw a 17% comparable growth. It is driven by a very healthy volume growth of 18%. The EBITDA growth was at 32% along with very healthy brand investments.

Slide 9 lays out our volume growth. On slide 10, I will spend a little bit of time on this particular slide. Generally, while our performance has been very healthy, we did see some softness in our insecticide business. This was driven by a bunch of different factors; some of the factors were more seasonal in nature. The delayed onset of winter impacted this business a little bit particularly in the north and the west.. We saw lower incidence of mosquito borne diseases this quarter as well. We did not see the kind of growth bouncing back in household insecticides as a category like we saw in some of our other categories and this is also borne out from the data from external research houses and from the performance of the other players.

The potential for growth is very significant in this category as you know. Also to a certain degree, some of the other categories, which saw a lot of growth did benefit from price cuts. This was one category where there wasn't any price cuts in the quarter, but clearly the potential for growth is very significant and so we have begun significantly dialing up our efforts in innovation. Over the next few quarters, you will see several exciting launches from us that will help us get this category back to the kind of growth trajectory that we would like to see from this category.

The other important point to mention is that we have been doing relatively well as far as the value added formats are concerned and so in our value added formats we continue to gain share, but we have experienced some pressure in the more commodity formats like coils but our innovation agenda will try and cover the entire portfolio so you will see new launches from us across all the formats over the next 6 to 12 months that will help us drive significant growth going forward.

On Hair Color, very strong growth driven by volume. Expert Crème did very well and what was also very encouraging to see was a strong pickup in powder hair colors post the GST led price cuts. Our growth momentum in soaps has been sustained. I think this is the third quarter, where we are seeing a very good growth in soaps both Godrej No. 1 and Cinthol have done very well on back of some very strong marketing initiatives and good execution.

This is a season where our liquid detergents portfolio Ezee does well. It is a seasonal category and we are seeing some strong growth in Ezee as well. Across the board, I think, our new launches are doing well, but as I mentioned to you we are intensifying our pace of new launches and so over the next 6 to 12 months, across all of our categories, you will see a very healthy mix of very differentiated new products. We have been working on these over the last couple of years and we are very excited to launch these over the quarters ahead.

Turning to our international business, as I mentioned to you, the performance was mixed. We are laying down the foundation for international to perform much better, but the performance in this quarter was below our expectations on both sales and on the profit line.

On Indonesia, the performance is recovering and I think the macro environment in Indonesia is still quite difficult. For the sector as a whole, Home and Personal Care growth is still negative. The outlook for 2018, however, is more positive and so we are hopeful of environment improving. The encouraging news is that sequentially if you look at our performance, our sales decline has narrowed down. The decline was 2% in Q3 versus 7% decline in Q2 and 11% decline in Q1. So this trend is heading in the right direction and while sales growth has been a challenge, we have ensured strong delivery of bottomline.

The strategy going forward is to focus far more innovations. Here again, we have launched a couple of interesting products. There are more launches planned over the next 6 to 12 months to change the narrative from a very discounting-led approach to a more innovation brand-led approach across the categories and we also are putting a lot of focus on transforming our go to market model to increase focus on general trade where we have a relatively low channel salience. So we are hopeful of a continued recovery going forward.

On slide 21, we talk about our Africa and US business. In this portfolio, we saw continued double-digit growth in hair extensions. The Wet Hair business has seen good traction on the ground and we are very hopeful of seeing a positive contribution from this business over the next few quarters. The quarter did see a lot of turbulence in Kenya that went through two back-to-back Presidential elections, which significantly impacted the trade environment. The macro outlook for the country is much more positive for 2018.

In the US, we migrated to a new ERP system and the implementation caused a lot of upheavals as far as servicing US customers were concerned. The system is now getting far more stable. We are making a lot of upfront investments, in new talents, in brand building, in new factory infrastructure and that has impacted near term margins; however, we believe this is a right call to strengthen the foundation of the business.

Across the board, there is great work happening on the ground in terms of new talent coming on board, brand building, new product launches, scale up of our Wet portfolio and driving operational efficiency. We believe that we are very well geared to deliver stronger growth in the quarters ahead and to capitalise on the tremendous potential that we see in the region.

The performance in Latin America was soft this quarter, but we are hopeful of seeing the growth return back in Q4. Europe continues to see a good momentum on both sales and earnings growth. Slide 24 is a summary of our Q3 performance and let me just pause here and then turn it over for Q&A. Thank you.

Continue: - Q&A…

Questions and Answers:

Moderator:

We will take the first question from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy:

In the presentation, I do not find any mention of Cinthol. How is the performance of Patanjali? Earlier you said in soaps, Patanjali has had limited impact. Is it now worse or is it better? Could you talk about the micro marketing initiatives which is doing well for Godrej No.1? What has been the benefit from upstocking because of the rate cut?

Vivek Gambhir:

Our secondary sales were higher than our primary sales, that is a good indicator in terms of how to think about any potential upstocking. For a multiple quarters now, we have been trying to look at both secondary sales and our primary sales. Our sales team actually measure themselves on secondary sales not on primary sales. Cinthol has done very well. Godrej No.1, we have multiple variants. All of them are doing very well. We have had a very strong focus in terms of targeting specific states and making sure that our portfolio applies to a broad set of consumers in the state. I cannot comment on the impact of any other competitor, but from our perspective, we have been pleased. Our shares have been inching up as you know and we are pleased with our performance consistently over multiple quarters now.

Abneesh Roy:

Going ahead, the base is not favorable, so do you still expect to grow faster than the industry and will this be largely led by Godrej No.1 and who are you gaining share from?

Vivek Gambhir:

It is difficult to comment on exactly who are we gaining share from but you know, it would be several players in the market, but this is a category where clearly we do believe that our story is quite differentiated. We have the best quality soaps i.e. grade one soaps. Cinthol also has a very unique proposition and our marketing is working for us. Overtime, the growth will stabilize, as you know this is a very penetrated category, but through tapping into additional states, that we will focus on, probably expanding the portfolio with more adjacencies, intensifying our focus on things like handwash and liquid washes, etc., we do see the potential for us to be able to grow faster than the industry. This is an industry or a category which does grow on a slower pace, and so we know that the growth will stabilise over the medium term, but certainly from our perspective, we feel confident that given our innovations and our go-to-market execution, we should be able to outperform category growth.

Abneesh Roy:

How much is the percentage of coils currently and how much is value-added, you mentioned value-added is doing much better. In coils, did you see impact of wholesale in Q3 FY18 because some of the companies are still seeing a very tough Q3. Household insecticides over the last five quarters has been flattish to a mid-single digit growth, but earlier, we never saw this kind of lower growth in household insecticides, so there seems to be something more beyond the seasonal or the GST impact, could you address that part?

Sameer Shah:

The value-added portfolio would be more than 65% to 70% of our overall household insecticide and mass formats would be the rest which largely would comprise of coils as well as paper-based mosquito repellents. Through this quarter, we have begun to see a little bit of seasonal impact. The issues in terms of wholesale impacting mass formats are a little better in Q3 as compared to what it was in Q2. It is still there though, so that also in its own way would have smaller impact although it is difficult to quantify. In the last three to four quarters, consistently we have seen relatively softer growth. The category is somewhere in between the staple to a classic discretionary so to that extent we have seen a little bit of slower consumption at the category level and we have been market leaders, are also seeing relatively softer growth. Having said that, we are working towards multiple initiatives whether it be increasing the consumption, driving penetration and we will see a couple of very interesting launches over the next quarter or two, which we think should help us in terms of driving both the consumption as well as the higher penetration objectives and in turn should result in growth rates, which will be much better than what you have seen over the last five to six quarters.

Vivek Gambhir:

We are not happy with our performance over the last few quarters, as we have mentioned, the big objective for us is to grow the category. We have done very well in terms of share gain and we continue to believe that our portfolio and our distribution allows us to incrementally gain share, but the focus needs to be to grow the category and to grow the category requires a strong innovation because of the lead time required in launching new products, this can be an advantage, but it does take time. So lot of the ground work that we have been doing over the last two or three years, you will see a very exciting launches over the next one to two years, which should allow us to drive penetration. So the need of the hour is for us to be able to find ways to increase penetration and if we can do that we will start seeing growth return back to the historical numbers that we have delivered.

Moderator:

Thank you. We will take the next question from the line of Amit Sinha from Macquarie. Please go ahead.

Amit Sinha:

The Household Insecticides category is a bit discretionary in nature and that would have led to some softness in the demand in the last few quarters. At the current level of pricing, especially in the liquid format, do you think affordability is a major issue and will some of the innovations address this?

Vivek Gambhir:

There are four drivers in insecticides - affordability, efficacy, safety and convenience. As a market leader, we have to address all those consumer needs and have a full format of products that will address the needs. Some products will focus more on efficacy, some might be on affordability, some might try and do both, some will be focused on convenience and across the board we will make sure that our products are very safe. So that is a part we need to play, it has just taken us some time to get the portfolio right. But as a market leader, we have to find a way to be able to uptrade our coil consumers, find ways to create more affordable products. So what you see from us over the next one or two years will be a fairly exciting set of new launches that address all the issues that you have outlined.

Amit Sinha:

Liquid is a high margin product, is there a risk of the new product or any of these innovations, that might be affordable, to eat away into the margins of this segment?

Nisaba Godrej:

It is not that we do not play in affordable segments - if you look at Fast Card or coils, and actually the per night cost of LV is lower than the per night cost of a coil. It is because of the machine, the electricity, the put down price of the LV gets higher. We are not going to tell you exactly what we are going to launch, but we are confident of covering all growth vectors in this market. And do not forget even something like personal repellents, our Fabric Roll-On, has been doing really well. That is at Rs.75 price point. We also have a Rs. 20 personal repellent product, so we will cover all price points and penetration is the name of the game for us. We are not necessarily a premium player and we play across all price segments and we continue to do so with better and better products.

Amit Sinha:

No. 1 and powder has gained significantly, and the growth rates on two year CAGR basis is definitely supernormal. How should we look at it going forward, is it a one-quarter phenomenon, or you believe that powder and both No. 1 can continue to grow at least for the next two-three quarters? What is your commentary on the market share gain from the unorganized segment?

Sameer Shah:

It is not just powders, but crème, which has also grown strongly, and it continues to be the case over the last two, three years. Yes, the powder performance has been better compared to what we have seen in some of the earlier quarters and also on soaps, it is not just Godrej No. 1, but Cinthol is also growing consistently at strong growth rates. But the performance of Godrej No. 1 is tad better than Cinthol's growth rate. We need to read these numbers baselined with what was the growth in the base quarter, but even if we look at two-year CAGR, they are strong growth rates. Optically, these growth rates will normalize. We remain very confident of gaining market shares, which we have been driving over the last three, four quarters both in soaps and hair colors. And also of maintaining two years CAGR growth rates, which we have been clocking over the last two-three quarters, even going ahead.

Vivek Gambhir:

To put this in context, two-year CAGR in soaps was 9%, and two-year CAGR in hair colors was 15%, and so in that context, the growth rates going forward ought to mirror this from the work that we are doing. To your other question around the shift of unorganized to organized, we have not seen any clear trend there. The unorganized channel in some ways in India has been quite resilient, so overtime as GST creates a more level playing field, some of the players who are not ethical may find it difficult to do business. So far we have not seen any significant trends that we can call out, partly this might be the fact that we are still in the midst of a GST implementation and not every single piece has been put in place. So there is still room for non-compliance, but over time it will get harder, and if it gets harder, definitely you will see some shift towards the more organized players, but at this stage it is very difficult to extrapolate and draw trends on what you have seen in the market.

Moderator:

Thank you. We will take the next question from the line of Vivek Maheshwari from CLSA. Please go ahead.

Vivek Maheshwari:

On Indonesia, last quarter you had a 1% decline adjusting for promotion spends and 7% on a reported basis. Is the trend broadly similar and if so does that mean that adjusting or netting off promotion spends, you are actually positive in this quarter?

Sameer Shah:

The trend has more or less been similar. The quantum of sale promotion has gone down as a percentage of gross sales in this quarter compared to the previous quarter.

Vivek Maheshwari:

Given that Indonesia was such a big pressure point for last few quarters, can you just elaborate on how the competitive landscape is over there?

Vivek Gambhir:

Generally, in insecticides, the level of promotional intensity still continues to be high. While it might be a tad bit lower than say a quarter or two ago, but the intensity seems to be quite high on the insecticides front but not in the other part of the portfolio, which is the remaining two-thirds of the portfolio. We have also been competitive in our promotions but we are trying to be far more surgical, far more analytical in terms of our capability, in terms of where to best direct promotions and having a much higher threshold in terms of measuring ROI of the kind of promotions we are launching, in parallel with a much more stronger focus on brand building and innovation.

Vivek Maheshwari:

Where we are in the commodity cycle right now, where the brent being around $70, do you expect bottom line growing either in line or tad lower than the topline in the next couple of years?

Vivek Gambhir:

Our single most important objective is driving volume growth, strengthening our brands, and also ensuring that we are continuing to have a broad portfolio of new launches. We start with that premise. At a consolidated level, there is still opportunity for us to be able to drive profit growth ahead of sales growth. Now we may have a year or so, where we start making some investments and that is a conscious call we will take, but if I look at our profit profile, the kind of cost reduction programs that we have both in India and in Africa, we do see opportunities to be able to drive profit growth ahead of sales growth. Indonesia we will have to wait and watch given the competitive environment and profit margins are quite high and also Latin America margins have been somewhat volatile, but there again, there is opportunity to be able to drive stronger profit growth by driving better synergies between Argentina and Chile. With regards to the near term, of the two most important input costs that can affect some of our costs, one is palm oil. While it is very difficult to have a long-term view on palm, at least in the near term the feeling is that palm oil prices should remain somewhat stable. With regards to crude, that is an indirect variable and so any impact of crude typically will not be seen for one or two quarters. Now in one or two quarters what happens to crude oil prices depending on what US shale manufacturers end up doing etc., is very difficult to predict, but at this stage we are still quite comfortable that barring any significant new launches that we decide to do for competitive reasons, our abilities to drive profit growth in line, if not ahead of sales growth, still is something that we stand by.

Vivek Maheshwari:

Have you taken up any product price changes other than the GST cuts particularly in the context of where palm and crude is?

Vivek Gambhir:

No, and we also do not intend to in the near term change any prices.

Moderator:

Thank you. We will take the next question from the line of Prakash Kapadia from Anived Portfolio Managers. Please go ahead.

Prakash Kapadia:

On the India business what has worked - is it lesser wholesale channel dependence, is it price sensitive kind of products, which we operate, which have grown faster in our portfolio as compared to premium products? How sustainable the growth looks? What kind of products are we focusing on in near term specifically for rural India?

Vivek Gambhir:

At the end of the day, there is no silver bullet answer that I can offer to you. It typically tends to be a function of four different things. One is very good products, at the end of the day you create good products, the consumers will buy and we have some of the best and the highest quality products in the market. We continue to focus on our product story. The second is the products are backed by very compelling marketing and the marketing activations on the ground, sampling, activation programs; all seems to have worked well for us at least over this quarter. The third is distribution, which is getting far more analytic and direct distribution, how we engage the distribution partners, how we engage our wholesaler partners, how we work with them, how our sales force execute on the ground is the third piece of what drives qualitative growth. Finally, the secret sauce does tend to be the agility and the passion of any team and there again our team has been extremely agile and entrepreneurial, so honestly there is no one single answer that I can give you. Our intent is to keep on learning and driving these four levers to be able to sustain this growth, going forward.

Prakash Kapadia:

How much would be the wholesale for us for the India part of the business?

Sameer Shah:

Around half of our general trade would be wholesale driven.

Prakash Kapadia:

Godrej Aer has done well for us, could you give us some sense on size, reach, in terms of outlets, levers of growth from here on?

Nisaba Godrej:

We unfortunately don't share such category information. We believe that we are number one in the category across car and home now and the brand continues to grow very well. So we are very excited about the potential about the air freshener category and getting new products. We are the market leaders in Indonesia, in air fresheners also, you will see a lot of good things from us at all sorts of price points and different usages. I think we are talking about a very nascent category because penetration is only 6% or 7%.

Vivek Gambhir:

That is why there is plenty of growth for any company that brings in very innovative products to market.

Prakash Kapadia:

On rural, we see growth coming across the strata of products for us in the next 12 months given the state of elections and government focused spending. Which one or two key products, which you think, will grow much faster than others?

Vivek Gambhir:

The good thing for us is across the portfolio. Obviously air fresheners will not grow as quickly in rural, so we are seeing some growth there, but so hair colors, insecticides, these are all products, some of them are staples, some of them are little bit less, little more discretionary but across the board, once you see a pickup in rural demand, it should start providing a meaningful uptick to most of the portfolio apart from air fresheners and perhaps liquid detergents. But there again we do sell a fair amount in sachets. There is opportunity also on the detergent side of the business.

Moderator:

Thank you. The next question is from the line of Manoj Menon from Deutsche Bank. Please go ahead.

Manoj Menon:

Could you just take us through the milestones broadly what you had on the Wet Hair portfolio and where are we in that journey in Africa? Secondly, on LATAM - given the generally high inflationary environment which those countries are having, are you happy with this constant currency growth? Thirdly, on Indonesia - while the trajectory has improved significantly, if we remove the fact that there was some bit of irrational competition earlier and it is probably not there anymore, I am not sure that we have actually improved the trajectory. Is that the right way to interpret Indonesia?

Vivek Gambhir:

On Africa, the potential for Wet Hair is huge and a lot of our work over the last couple of quarters has been to localize manufacturing. That probably has taken a little bit longer time to stabilise but a lot of the manufacturing is local and we have spent time in trying to craft the right proposition for the consumers across all the major markets. The products have gone into market. The initial feedback is positive but the real test will be over the next 12 months or so. The teams are very excited, but the scale up now will start accelerating quite a bit, you will see some improvements in Q4 but FY19 should be the year where we will see a meaningful contribution from the wet hair portfolio across Sub-Saharan Africa. So we remain very excited, but the focus really has been a lot more to try and get the manufacturing scale up done in the right manner across various countries in Africa and that is now largely over.

Sameer Shah:

LATAM is more of a one-off. There were some kind of on-ground issues mostly in terms of macro in Argentina, which led to the kind of growth and it is much below compared to even our internal expectation but teams, also we remain extremely optimistic that from Q4, we should see extremely strong overall financial performance, primarily driven by sales growth. So net-net on a full year basis, LATAM should be fine in terms of overall business performance, and not just financially, but also gaining market share across key categories. This is more of just a one-quarter phenomenon. By the end of the year, it should be doing quite well.

Sameer Shah:

On Indonesia - the competitive intensity is more or less, much of the same. It has marginally diluted but it has not changed dramatically. What we have done is from where we were at in the first quarter in terms of our quantum of spends, nature of spends, on trade promotions, we have kind of made it much more crispier with respect to few SKUs in few specific channels. That quantum has reduced down and continues to reduce down starting with first quarter and then second quarter and now the third quarter. To add to that we have also launched a couple of interesting innovation - early days, but those are also kind of contributing to this gradual recovery. Finally within this, it is going to be gradual and not going to be V-shaped kind of recovery, but we maintain our stand, we will continue to see gradual recovery in Indonesia sales and the profits will be a fall out of how the sales performance is going to shape up, but yes, we remain very confident that there will be continuation of gradual recovery in Indonesia with every passing quarter.

Manoj Menon:

On Africa - of the constant currency revenue, what proportion would be broadly ballpark volume?

Sameer Shah:

In Africa business, close to around three-fourths of our growth is price-led and the rest is volume led.

Manoj Menon:

What would be the top two to three reasons for the gross margin expansion?

Sameer Shah:

If you look at the gross margin expansion for standalone business is close to around 220 to 230 basis points. So that is one data point to keep at the back of our mind. There are multiple reasons. Specific to this quarter, while Household Insecticides growth has been lower, but hair colors growth has been extremely strong and also the growth for air fresheners has been healthy. Now both hair colors and air freshener are the categories, which get maximum gross margins in our portfolio, much higher than what household insecticides gets as well as much higher than what soap gets. There is definitely a favorable category mix in this quarter. The other is we continue to still enjoy the benefits of low cost palm oil, which has resulted in meaningful expansion in soaps gross margins and in terms of overall business' gross margin. The third is the cost saving program which we have been running since last three or four years and that keeps on adding in a very meaningful way to our gross margins expansion. These are the three or four drivers which have resulted in close to 200 bps gross margin expansion, something which we also saw in some of the previous quarters, but it is more a continuation of the same.

Vivek Gambhir:

Within household insecticides, we have had some formats which have done better and these formats are higher gross margins formats. So even in that, while household insecticides performance as a whole was challenging, from profitability perspective, we did see some of the higher gross margin formats to do better.

Moderator:

Thank you. We will take the next question from the line of Kunal Vora from BNP Paribas. Please go ahead.

Kunal Vora:

How has Strength of Nature done after the acquisition? How has the revenue trajectory been post acquisition and whether it is delivering in line with what you were expecting? Secondly, if I look at the quarter, how has been the growth before and after the GST rate cut was announced in November? Did you see a strong volume growth because of the 6% to 7% lowering of prices in certain categories?

Vivek Gambhir:

On Strength of Nature, the US market is far more mature and penetrated and so the investment thesis was to maintain a steady growth in the US, but leverage the portfolio and bring the portfolio to countries in Africa, where the headroom for growth is extremely significant in the category. In terms of how the investment thesis is playing out, it is playing out the way we had expected. We have localized manufacturing of the Strength of Nature portfolio, a few brands have already been manufactured locally, a few more will be added over time, but the story will play out in terms of localizing manufacturing and using the portfolio to drive growth and provide a great products for our consumers based in Africa. Within the Strength of Nature portfolio, if I look at year-to-date for our US consumers also the growth is in line with our expectations. However, in Q3, the growth was below our expectations and as I mentioned, we went through a fairly complex implementation of a new ERP system that resulted in sales slowing down in October and November. Whilst the sales picked up in December, we could not make up for the shortfall in October and November but beyond this temporary hiccup that we saw in the business, largely from an investment thesis perspective, things have been in line with the way that we wanted the SON acquisition to play out.

Sameer Shah:

On the second question, we have seen that post GST and more importantly the rate cut and also in terms of price reduction, we have seen pickup in volumes. We did see that for hair colors as well as air fresheners post mid-November, and we also had similar experience post June, when the MRP dropped primarily driven by GST rate cut.

Kunal Vora:

In general, are you getting more positive on the macro situation in the international markets, with rising commodity prices and growth outlook? Are you more confident about the macro situation in your International operations?

Vivek Gambhir:

It depends country-by-country, so clearly if you look at some of the larger countries the macro outlook in the US is very positive for next year. For Indonesia, the outlook is actually quite positive and Indonesia is projected to be amongst the higher growth emerging geographies next year. The outlook for Kenya is also more positive. The outlook for Nigeria is also quite stable to positive. There are worries on South Africa in terms of how reform agenda will play out. So South Africa has been a macro economically an area of concern, but again in some of these geographies, there is plenty of opportunity for growth but as I look at our entire portfolio across most of our geographies, the sense of the outlook is much more positive next year than it was in the last year.

Moderator:

Thank you. We have the next question from the line of Nillai Shah from Morgan Stanley. Please go ahead.

Nillai Shah:

On Indonesia, have you lost market share in that market for household insecticides?

Vivek Gambhir:

We have lost market share, but not at the same level at which we have reduced price discounts.

Nillai Shah:

I understand the cost saving programs etc., which are underway, but why would the margins be expanding like this in a market where primarily there's a cost led issue and you are losing market share?

Sameer Shah:

The high competitive intensity was more driven by the consumer offers and not actually the price cuts.

Nillai Shah:

That is indirect pricing, right?

Sameer Shah:

There are few drivers to margin expansion. One is, we have cross-pollinated cost saving program right from India to Indonesia, which got cross-pollinated at the beginning of the year - end of last year and that is paying rich dividends. Second, there is a skew from media investments through trade promotion, because the nature of market or nature of category is such that right now everyone is skewed towards consumer offers at least in household insecticides as compared to media investments. That also at lower level is resulting in lower advertisements and sales promotion spends on a y-y basis. These are the two primary reasons why despite not having the sales leverage, we are seeing margin expansion in Indonesia.

Nillai Shah:

Extending this question to the India business, you are seeing a massive elasticity at least in the hair color business with lower pricing, and given that you are the market leader and you want to grow the category with innovation, do you think we have been too aggressive with pricing in the past and is this is a lesson to that effect?

Nisaba Godrej:

We have had the same competitors, sometimes people want to play the market in a certain way and we are making a certain set of choices. Discounting also is not a very sustainable long-term business model.

Vivek Gambhir:

If you look at two year CAGR, because if you compare things to an abnormally low base, it does inflate the numbers. As we look at it, on a two-year CAGR basis it hair colors have delivered 12%-14% growth.

Nillai Shah:

Why has there been this overall volatility in the hair business? What is the underlying growth driver for hair colors apart from pricing that we see in this quarter? What really drives the category growth?

Vivek Gambhir:

If I look over the last three or four years, what has consistently done very well for us has been the journey towards premiumisation and as we try to upgrade consumers from powder to crème, our crème has been a very consistently strong story for us for almost four years now. The volatility has been caused a little bit by the challenges of trying to retain some of our powder consumers. And so the powder segment is the one where we have seen volatility and there again we are now looking at various ways to drive some more innovation to be able to drive growth in powders so that is really been the strategic challenge which creates some choppiness in terms of the powder segment. Long-term if we continue and persist on the crème story, which should continue playing out for long time in terms of better growth but the challenge has been how to stem the erosion under the powder side.

Nillai Shah:

What is the application ratio that we have for powder versus crème in terms of number of applications?

Nisaba Godrej:

You can look it at a per application basis. Some people mostly use it once; some people use even crème and powder twice.

Moderator:

Thank you. We will take the next question from the line of Prasad Deshmukh from Bank of America. Please go ahead.

Prasad Deshmukh:

Now that the raw material prices are moving up and assuming that the trend continues, will the new launches be still margin accretive at the gross margin level? What gives you confidence that the PAT growth in that context will still be in sync with revenue growth?

Vivek Gambhir:

From our perspective, as a guiding rule, every new innovation that we launch ideally should have higher gross margin than the category. Unless it is for very strong defensive reasons, but from an innovation perspective, the team works on trying to make sure higher gross margins. So over time that gives us enough confidence that we will start seeing the gross margin of the overall portfolio continuing to improve largely led through innovations. At the same time, the team continues to do a very good job of trying to reduce costs whether it is through manufacturing efficiencies, better sourcing, more scale advantages to try and ensure that the core also gets better from a gross margin perspective as well. If I look at our gross margin performance and you can see that over the last many years, consistently we have managed to improve gross margins. Now if we start looking at the other parts of the P&L, generally our marketing, advertising and promotion spend does tend to be somewhere between 10% to 12% of sales and we believe that, thats good range for us to be in. There could be some changes quarter-on-quarter but through things like market mix modeling, and other tools, we can try and do more for the same amount of money. It is not about cutting spends, but how do we extract much more ROI from the kind of spends we are making. And then there is always opportunities for us to be more efficient whether it is in our overheads or in our G&A. Ultimately the team feels quite confident that we should be able to grow profits in line if not ahead of sales growth.

Sameer Shah:

In addition, we also have relatively lower cost covers for palm oil and also for other raw materials as well as packaging materials which are linked to crude. We do have a medium term committed contracts from a lot of our vendors, so that is also something which will ensure robust gross margins at least for the next couple of quarters.

Prasad Deshmukh:

Could you give us an update on rural one and also expansion in BBLUNT?

Sameer Shah:

Rural one is shaping up in line with our own internal expectations and if I have to give an example, what we are doing in terms of micro marketing initiatives in Godrej No.1 as we talked about, is in a way outcome of some of the rural one initiatives. So it is shaping up quite well, though there were channel disruptions whether it be demonization or whether it be GST, but those were temporary pauses, but it is up there whether it be the kind of investments, and also kind of on-ground activations, more feet on ground and so on and so forth. Hopefully, we will see much more richer dividends once we see a little bit of marginal recovery even on rural side over the next few quarters. BBLUNT is also shaping up quite well. The salon secret hair colour is doing quite well, in line with or may be better than our internal expectation.

Prasad Deshmukh:

Is it now present across India in the modern retail format or is there some time for that?

Sameer Shah:

It is present mostly in the premium general and modern trade outlets. That is our go-to market strategy for BBLUNT, so these are the two channels which we are tapping into for BBLUNT. In terms of reach as well as in terms of business size, it is ahead of our expectation. The growth opportunity is humongous for BBLUNT in terms of getting into much more number of outlets as well as beefing up its presence in modern retail and e-commerce.

Prasad Deshmukh:

The change in US dollar denominated debt is directly adjusted to the balance sheet, right? There is no pass through in the P&L?

V Srinivasan:

Yes, that is right.

Moderator:

Thank you. We will take the next question from the line of Amit Sachdeva from HSBC. Please go ahead.

Amit Sachdeva:

On Indonesia, can you give us a little bit more color on your journey in go-to-market strategy?

Vivek Gambhir:

At an overall broad level, overall the market is 60% general trade and 40% modern trade and our salience is the opposite. And now that we have hair colors in the portfolio and we have more affordable products, we do have the basket to be able to now push much more harder on the go-to-market model.

Amit Sachdeva:

Can you share some numbers around like how the household insecticides portfolio has actually done and non-household insecticides has done and what was the pricing versus volume in Indonesia?

Sameer Shah:

Household insecticides portfolio continues to be the laggard. In the 2% decline, household insecticides has declined much higher than 2% overall decline and non-household insecticides portfolio is in the positive zone.

Amit Sachdeva:

What sort of price discounting or pricing pressure is reflecting on this growth? From household insecticides point of view, how much discounting you have been doing and how it is tapering off?

Sameer Shah:

The competitive intensity is the same, may be marginally diluted down over the last two quarters, three quarters. For us though the percentage of trade/consumer offers or sales promotion spends has come down, but it is more driven by our efforts in terms of making the spends much more crisper, analytically driving a lot of these investments, tracking the ROIs and seeing that what is working really well for us in terms of the eventual offtakes.

Amit Sachdeva:

How the journey would look like in FY2019? Are you willing to step up that spend or would this be much more promotional led and how these two tradeoffs are happening?

Sameer Shah:

It is going to be eventually a fine balance, but more so, we would not shy away from investments, if we see recovery in macro, which we think gradually would be to begin with as well as some of our new product launches will need some upfront marketing investment. So we will see uptick in advertisement spends and hopefully by then, we will see gradual withdrawal of this high competitive intensity and hence sales promotion.

Vivek Gambhir:

We do believe that there are opportunities to be able to reduce some of our overhead costs there, and that money will get redirected towards higher advertising spend. So clearly, as we launch the innovation, we do want to invest more in A&P but the team is quite confident that through operational efficiencies and cost reduction projects, we will find the money to be able to deliver acceptable profit growth but invest in our brands as well next year.

Amit Sachdeva:

For Indonesia next year, can you envision a year where you have a high single digit revenue growth or are you looking at double-digit? How are you envisioning that trajectory?

Vivek Gambhir:

The intent is going to be to get to double-digit growth but a lot will depend on how well the innovations play out, and the macro environment. Indonesia has provincial elections next year, the presidential elections the year after. Typically the economies do quite well during election years because there will be pressure on minimum wage increases, or to increase consumer spend, so a lot of those factors honestly should help the business. I think we will have to at this stage just ensure even a transition to general trade (GT) or trying to push GT but it doesn't happen overnight. It takes time. So all the building blocks have been put in place, but frankly a lot will depend on the consumer spend environment and how would the innovations play out, so the team is definitely quite optimistic that next year should be much better than what this year was.

Moderator:

Thank you. We will take the next question from the line of Harit Kapoor from IDFC Securities. Please go ahead.

Harit Kapoor:

Just wanted to understand on the personal repellent space what proportion of the overall household insecticides piece would it now be and on that also what is the kind of growth trajectory there vis-à-vis at-home household insecticides space?

Nisaba Godrej:

In-home household insecticides space is about Rs. 5,000 crore, out of home space would be about Rs. 150 crore. Obviously the out of home space is now growing much faster than the in home space given the size. What we are seeing with our Fabric Roll-On is extremely encouraging, so if you give consumer a product which is very easy to use, it is natural, they just apply it on their clothes and they can go out. We are ahead of our plans, so we are really excited. If you look at the other countries, if you look at the US, Indonesia, as a percentage of the in-home markets, the out of home markets are much bigger. I think what happened in India was lack of right set of products for the Indian consumers, there has been very little investment in the habit creation and now you will see that growing. So we see this as an extremely strong vector for us.

Harit Kapoor:

On the working capital part, in your presentation, there seems to be a reduction in terms of days, it is reasonably sharp from September, just wanted to understand whether this is more seasonal in nature or there is something sustainable that you have done and if you have, then in which market is this reflecting?

Sameer Shah:

I think it is quite broad-based, largely originating from India and Africa. There are a few drivers. One is lower inventory levels versus September and there has been also higher payables also driven from our African business. And in India, we have also got close to about Rs. 40 crore of excise refund from tax authorities, which also helped in improving the working capital. To answer your question, this happens to be one of our key pivots to improve ROCE alongside driving profitable growth. So we will continue to see meaningful improvements in working capital levels.

Moderator:

Thank you. We will take the next question from the line of Naveen Kulkarni from Phillip Capital. Please go ahead.

Naveen Kulkarni:

If we look at the domestic margins this quarter, the margins were 28%, is this sustainable going ahead? Is this an opportunity to launch more new products or do more inorganic acquisitions in India? Third aspect is the international business, while there are a couple of countries which were not doing so well in terms of margins, but overall the margins are fairly reasonable. So how do you see that panning out going ahead especially for countries like Indonesia, where the margins are at 25%, reasonably at high levels?

Vivek Gambhir:

From a margin perspective, we focus on consolidated margins and the effort is to drive consolidated margins ahead of sales growth or in line with sales growth. So we do not actually try and optimize margins at the individual geography level because of competitive dynamics, innovation, strategic reasons dictate what the margin profile of the businesses. The choice of inorganic actions is not determined by margins. What drives acquisition is if it fits with strategy, how attractive the asset is and are we the rightful owner for the asset and can we buy it in a value-accretive manner? Are we actually being accretive in terms of right valuations? Those are the right reasons, so while the margins in

India have been very good, the margins in Africa have not been very good in this quarter. There could be some quarters where India margins may fall down, because of new launches, but then we will try and make sure at an aggregate level, our profit growth is in line if not ahead of sales growth.

Nisaba Godrej:

On margins in new product and investment in it, we have been really focused on products design whether be India, or Africa and we are building this up even more in making sure that we get to net contribution positive even in year one on some of our products. So it really means that you look at cost pricing very carefully, but you also make sure that you are very innovative and disruptive, so you are not going in with me to product because your advertising money which goes much, much further if you stand out in the market. You have seen this in our successes whether it is Expert Crème, Air Pockets, Fabric Roll-On, the kind of results we get with that. So it is one thing we will definitely see with GCPL is a really strong focus on that.

Vivek Gambhir:

The other important thing from a philosophy perspective is that we do not manage the business for margin. That is an outcome. We look at the underlying drivers in terms of gross margins, and marketing spends, are we gaining share, are we creating the right exciting products? If we do that, margins will be an outcome more than anything else but we are very careful not to try and over manage the business from a margin perspective and to some degree absolute profit growth is probably a more important indicator than necessarily quarter-over-quarter margins.

Naveen Kulkarni:

Absolute profit will be reasonably high if the margins are at these levels, so how do we see the sales growth based on the kind of margins that we are at this juncture? Is there a more opportunity to drive sales growth at a much higher pace from here?

Vivek Gambhir:

See at the end of the day, the biggest way to drive margins is to do better sales growth because operating leverage you get from higher sales growth is the best way to be able to ensure acceptable profit growth. Our intent and aspiration is to drive sales growth much higher than where we are today. In the categories that we are in and the adjacencies that we are pursuing, if you look at both penetration rates and consumption rates, across the board whether it is India, Indonesia or Africa, there is tremendous headroom for growth. Having said that, though, we do get constraint by the overall economic environment and if the environment improves that actually means higher disposable income in the hand of consumers, which allows them to spend money on branded affordable products that we provide. The aspiration is to drive sales growth much higher, but it will be a function of the overall economic and consumer spend growth as well.

Moderator:

Thank you. We will take the next question from the line of Binoy Jariwala from Sunidhi Securities & Finance. Please go ahead.

Binoy Jariwala:

Could you share some thoughts on where we are in terms of cross-pollinating various products?

Vivek Gambhir:

The companies look at cross-pollination in different ways. One form of cross-pollination is taking products and brands from one country to the other country, while we do that on a selective basis, behind the scenes, a lot of our cross-pollination tends to happen from a technology sharing perspective whether it is air freshener development in Indonesia and India, it cannot be visible to the external community.

Nisaba Godrej:

In Indonesia, the latest two launches have been Stella Pocket, which is basically Aer Pocket; and new hair color crème which is very much similar to Expert and BBLUNT. So while we do not bring them under the same brand, there is a lot of products sharing that is going on. A very interesting thing, which you will see in a year or so is some of our learning on African hair and straightening products there and things like that which we will bring to other markets, because the opportunity is pretty big and curly hair just doesn't exist in Africa, so you will see a lot of our learnings but you would not see the same brand.

Binoy Jariwala:

Is it practical and is it possible to build each of these geographies with the presence across all the three category may be over a timeframe of five years or seven years?

Nisaba Godrej:

We are doing household insecticides and air fresheners in India and in Indonesia. The product portfolios are very similar in both the markets. We are doing household insecticides in Africa and plans are to ramp that up significantly.

Vivek Gambhir:

I do not think we intend to get into soap category in Indonesia or Africa. Hair colors, air fresheners, insecticides, these are categories that we do believe we have clear right to win across multiple geographies.

Binoy Jariwala:

What would be the sales mix between urban India and rural India?

Sameer Shah:

Around 26-27% of our salience would be from rural and rest would be from urban in our general trade channel in India.

Binoy Jariwala:

In terms of gross margins across the categories, which categories have the highest gross margins?

Sameer Shah:

In terms of sequence, it is hair color followed by air fresheners followed by household insecticides and then soaps.

Binoy Jariwala:

Our costs savings program that we have done on an annual basis, what would be the quantum for FY2018 and FY2019 that we are targeting?

Sameer Shah:

For FY2018, in India the cost saving program has been contributing close to around 1% to 1.5% on the revenues and that trajectory and momentum should continue for us even in FY2019.

Binoy Jariwala:

The international geographies?

Sameer Shah:

The international geographies this has just kicked off. In Indonesia we are just cross-pollinating the Project PI so I think its very early stage right now. I think it should scale up and we should see a similar benefit as what we have seen in India even in Indonesia and perhaps other markets.

Moderator:

Thank you. Ladies and gentlemen that was the last question. I would like to hand the conference over to Mr. Harit Kapoor from IDFC Securities for closing comments.

Harit Kapoor:

Thank you. On behalf of IDFC we would like to thank all the participants as well as the management of Godrej Consumer Products for taking time out for this call. We can now close the call.

Moderator:

Thank you very much Sir. Ladies and gentlemen on behalf of IDFC Securities that concludes this conference. Thank you for joining us. 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.