Investor and Analyst Q4 & FY18 Conference Call

May 8, 2018

Moderator:

Ladies and gentlemen, good day and welcome to the Godrej Consumer Products Limited Q4 FY2018 Earnings Conference Call, hosted by Motilal Oswal 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. Krishnan Sambamoorthy from Motilal Oswal Securities.

Krishnan Sambamoorthy:

Good evening everyone. On behalf of Motilal Oswal Securities, I would like to welcome you all to the Q4 FY2018 Conference Call of Godrej Consumer Products Limited. We have with us the senior management team of GCPL. Over to the management for opening remarks, which will be followed by the Q&A.

Tapan Joshi:

Thank you, Krishnan. Good evening everyone and a very warm welcome to all of you. Thank you for joining us today on the conference call to discuss the quarterly performance. We have with us, Nisaba 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 all the previous quarters, we will start with the presentation with Vivek sharing his thoughts on our performance and then we can open up for Q&A.

Vivek Gambhir:

Good afternoon. I am pleased to share with you the highlights of our performance. Overall, as we reflect at FY2018, our focused strategy and balanced portfolio enabled us to deliver competitive profitable growth despite tough operating conditions in a few of our categories and geographies. Our constant currency sales for the year increased by 9% on a comparable basis, constant currency EBITDA increased by 12% led by robust gross margin expansion and EPS growth was at 25%.

The board has declared an interim dividend of Rs. 7 per share. This along with the earlier interim dividend aggregates to Rs. 10 per share dividend for the year. This results in a payout ratio of around 50%. Beyond the quarterly financial performance that we will discuss, we spent a lot of time last year in putting some significant building blocks across our operations. In Africa, it was about putting strong talent in place, creating our Dubai center, scaling up local manufacturing and launching our wet hair portfolio. In Indonesia, it was about reinvigorating our innovation engine and laying the groundwork for significant transformation of our go-to market approach.

In India, it was some very strong work in digital marketing, re-architecting our distribution and strengthening our analytics capability. Across the board, there has been some tremendous work done in terms of our NPD pipeline. So while all of this work may not show up in one quarter's financials, these efforts, we believe are making us stronger and resilient and will enable us to step up our performance and trajectory. We have really used the macroeconomic challenges over the last 12 months to learn and reinvigorate our approach to becoming much more agile.

Now turning towards the performance in the fourth quarter, if you look at page #3, this quarter we had a mixed performance with relatively softer sales growth while sustaining robust EBITDA growth. Our Indian business delivered a competitive 7% comparable growth driven by volume growth of 6%. Our secondary sales growth was higher at 10%. For the year, India delivered a 10% comparable sales growth driven by 8% volume growth, EBITDA for the year increased by 21%. As we mentioned before, the performance in our international business was relatively softer due to the weakness in Indonesia and Africa; however, we expect to see a strong turnaround in growth rates in FY2019. Many of the geographies that we operate in are projected to have stronger economic growth. So that should give us stronger consumer demand.

On the slide #4, we lay out the exceptional items and on slide #5 we show the bridge between reported to operating EBITDA. If you take a look at our balance sheet items on slide #6, our balance sheet keeps on getting stronger every year. Our net to debt equity ratio has come down to 0.41x, our Return on Equity, Return on Capital Employed, Working Capital are all heading in the right direction and in terms of other metrics as well, our teams continue to make good progress.

If you take a look at our India performance, as we mentioned, our India business delivered a sales growth of 7% on a comparable basis, this was based on the volume growth of 6%, the secondary sales growth of 10% was much higher than our primary growth led by initiatives to increase our channel partners ROI and what is encouraging here is that for the year, we have returned back to double digit growth and we have delivered strong profits while making competitive investments in our brands. Along with the 22% growth in EBITDA, our marketing investments also grew by 22%. So our gross margins have been increasing steadily, we are employing a lot of that back into increasing marketing spends along with a certain amount flowing into EBITDA.

Consistently our profit growth is being delivered while investing in our brands and we believe that these investments are strengthening our brands and are also setting up well to accelerate growth in the quarters ahead. We believe that in India, the platform is set well for us to get back to double-digit growth this year on the back of continued improvements in the economic environment, particularly stronger rural . Even in Q4, rural grew at a significantly higher pace than urban and given the focus of the government in rural development and assuming a normal monsoon, we should see further improvements in rural growth.

The other important thing to point out is that we had spent the last few months' post GST re-architecting our distribution approach and so we have a much stronger go-to market approach with expanding coverage, much more planning at the micro level, more effective use of technology, addressing coverage gaps, optimizing the ROI of our partners and stronger shopper visibility - all these building blocks certainly provide us a stronger platform to deliver stronger growth this year.

We are also very excited about our innovation calendar for this year. We have ten launches that are being planned in India across categories and we are targeting about at least a couple of launches in every quarter. Over the last month, we have launched a fairly exciting new product in the insecticides space.

If you take a look at our category performance on slide #10, our household insecticides clearly had a subdued performance. Some of it was driven by an adverse season particularly in January and February; however, what is encouraging is that the average growth rates are back to double-digit for March and for April. Our recent launch in personal repellents is scaling up well with double-digit market share. We launched Goodknight PowerChip. Goodknight PowerChip is a new electrical solution, with a concentrated gel technology and at a lower price than liquid vaporizers. Through this, we are targeting to upgrade coil users with a better solution.

We believe that the opportunity to upgrade coil users is significant. This will also enable us to recruit new users. The PowerChip is a very affordable product with the price per night at two-thirds of a coil. It is more effective and more efficacious than coils with a unique gel solution. It is quite convenient with its simple plug-in use and particularly given the government's efforts for rural electrification, this should give us a tremendous growth boost.

The other important point is that this is a registered design, which we believe will make it difficult for competitors to copy the product. Towards the end of the quarter, we also launched a higher efficacy liquid vaporizer under the Goodknight brand.

On the hair color side on slide #11, the growth was 3% but this was followed by 33% growth in the third quarter driven by channel upstocking post GST led MRP cut. So therefore it is more appropriate to look at this growth over a six months' period where the growth stoodat a healthy 18%. Godrej Expert Rich Crème continues to improve penetration and gain market share and again in this category also, we have a couple of fairly exciting launches planned for later this year.

On soaps, the double-digit growth momentum continues with a 19% growth. The growth was driven by very effective micro marketing initiatives, right pricing our products and strong on-the-ground execution. Both Godrej No.1 and Cinthol did well and we continue to gain market share during the quarter.

The focus on our innovation agenda continues. Last year, the pace of new launches had slowed down a little bit but we used the volatility of last year to take a step back and figure out how to reinvigorate our innovation pipeline and our expectation is that this year will probably be the most active new product launch calendar ever in our history, so we are very excited about the kind of disruptive products that we are creating at different price points. In terms of air fresheners, we continue to maintain a leadership position in the overall market and gain share.

If you turn to international, clearly the performance of international business was softer due to the weakness in Indonesia and Africa, but certainly we are expecting a strong turnaround in growth rates this year. In our Indonesia business, the macro environment continues to be challenging. The good news is that we sustained our robust margin expansion. Our EBITDA margin increased by 370 basis points despite a 160 basis points increase in A&P. So we have definitely been investing in our brands and at the same time finding ways to improve gross margin and manage our cost to deliver a strong margin.

Earlier in the year as we had mentioned, we had lost share in Household Insecticides, our main category there. The good news is that we have regained back all the lost share. The growth in this quarter was unfortunately impacted due to some of the modern retail partners reducing their inventory but the sellout rates have been much better and the fact that our share gains are now showing up gives us enough confidence that the worst is probably over and we should start seeing recovery happen in the quarters ahead. We have been getting much more strategic in our promotion spending guided by a strong playbook that has been put into place. Our Expert platform under Household Insecticides has been launched to create a new platform under HIT that has been doing quite well. We have done a brand restage on our Stella air freshener brand and we are backing these new products through media investments. There is lot of great work happening in terms of both innovation and the transformation of our go-to market approach and we should start seeing the impact of this from Q1 FY19 onwards.

On our Africa, US and the Middle East business on slide #20 this was a relatively weak quarter with constant currency sales growth of 7% in the quarter led entirely by volume. For the year as a whole, sales grew by 14% on the constant currency basis. The sales were impacted by a continued sluggishness in Kenya, the business excluding Kenya, grew in double-digits in constant currency terms. The margins were impacted due to some upfront investments we are making in talent, brand building and factory infrastructure to strengthen the foundations of the business.

The scale up of wet hair portfolio is seeing good traction. It had fallen behind a little bit but we are now regaining momentum in terms of local manufacturing scale up. We have launched a naturals range under African Pride in the US, we will bring that to Africa at some point soon. We are planning for very exciting relaunch of the Darling brand this year and there is significant investment going on in go-to market along with salon engagement with a robust pipeline of NPDs that have been put into place. We have set up test centers and consumer insighting capabilities in each sub-cluster in Africa. We have also launched very exciting online presence called the 'Black Hair Hub' to drive consumer engagement and advocacy, the marketing talent has been ramped up across sub clusters so we believe that given all the building blocks that have been putting up in place, the performance should be much better this year and going ahead, we remain very excited by the potential in Africa.

On Latin America, we saw recovery in performance with a 28% constant currency growth and in Europe as well, while the profits were a little bit on the lower side this quarter, for the year as a whole, the European business has done very well.

The remainder of the slides is just to provide a summary of our financial performance. We will be now happy to take your questions. Thank you.

Continue: - Q&A…

Questions and Answers:

Moderator:

Thank you. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Amit Sinha from Macquarie. Please go ahead.

Amit Sinha:

On your Household Insecticides business, what is giving you the confidence apart from a good April month on the revival of the segment? Is it the industry growth coming back or your new launches have done exceedingly well?

Vivek Gambhir:

What gives us the first level of confidence is that given the fact that we have over 50% of the market, to a large degree, category growth rates are driven by both the kind of actions that we take along with the environment. January, February were the seasons wherein mosquito infestation was on a lower side, we cannot do too much about that but what is in our control is to keep on finding ways through strong marketing and a very active NPD pipeline to keep on expanding the category. We are now seeing the personal repellent business gain a certain scale and along with that, we have at least two more launches that are in the market. There are few of others that are in the pipeline for the remainder of this year, so as we do our initial consumer testing, as we look at the proposition and the kind of NPD calendar that we have, the level of confidence is high. With the things that are in our control, we should be able to execute much better. Having said that, this is a seasonal category so there could be some quarterly volatility but suffice it to say that we have learnt a lot from the last 12 months in terms of the innovations that we can bring to the market.

Amit Sinha:

Earlier also we used to see quarterly volatilities, but on an annual basis, the Household Insecticides numbers used to be much higher than what we have seen in the last two years. You have given a broad indication of a double-digit number next year, do you share the same confidence for this segment or this segment will be lower than the rest of the India numbers?

Vivek Gambhir:

It is difficult to say because in the last couple of years given demonetization, GST, some drought conditions and unfavorable season, there are far too many factors to actually diagnose why category growths went down. From market share perspective, we have been holding steady but clearly if you look at our new launches over the last two years apart from personal repellents, which is still in its early days, we have not had any significant launches over the last two years. If you were to look at our performance over four or five years ago, a lot of our success was driven by some very strong launches. This is a category where you sometimes need two or three years to get the launch calendar right given the registrations, etc., so a lot of the work that we have been doing over the last two years will now hopefully start showing a lot more fruition. So our hope is that you will see category growth rates improve but as I mentioned, lot of what we end up doing will influence category growth rates more than anything else.

Amit Sinha:

While your communication on the new product PowerChip is very clear and the strategy is to recruit from the coil users, but when I look at your TV commercial it seems to target the urban consumers again. Will this new product cannibalize a significant part of the liquid vapouriser product sales and what will then happen to the margin profile of the segment?

Nisaba Godrej:

The way the films are made is to make the product aspirational. Before we release the product, we do quantitatively very significant research and what we found in that research is that this product will be a very attractive for coil users because of the differentiation and price point and we are also seeing much more electrification in India. So it was very appealing both as a concept and at the product level. Liquid Vapourisers has its own benefits; LV users did not react to this product in the same way so we did take in account the possibility of cannibalization. But we can't say that there will be zero percent cannibalization. In India, if you look at any category, detergent and other products, there is always a price ladder and people pay for the value. The other thing that we have launched is a new Liquid Vapouriser, which has double the power of our current Liquid Vapouriser. We have not launched that at a higher price but as a replacement. So we are also at the same time giving Liquid Vapouriser users a much more efficacious and powerful product. Also, in an Liquid Vapouriser, there is a power boost where you can adjust the speed of the Liquid Vapouriser up and get a much higher release, this is not an option you have in the PowerChip. So they is a significant delta in terms of product value delivered for the price that we demand.

Moderator:

Thank you. The next question is from the line of Percy Panthaki from India Infoline. Please go ahead.

Percy Panthaki:

In this quarter's accounts, there is an exceptional gain of Rs. 194 crore, what is it regarding to?

Sameer Shah:

This is a refresh of profits for our Strength of Nature US-based business. In FY2017, we had certain profit estimates, which were quite aggressive and this was done consciously to ensure enough skin in the game for the erstwhile promoters, who are operationally driving this business alongside us. We have revisited this profit estimate since it is more than two years of the business and that has resulted in the overall financial liabilities, which was booked in FY2017, coming down in the balance sheet and the corresponding impact of is is flowing into the P&L which has been shown as an exceptional income of around Rs. 195 Crore. The refreshed profits are also quite healthy, while it is difficult to carve out only for Strength of Nature's business in US but it is close to high teens towards 20% in terms of margins profile.

Percy Panthaki:

In FY2017, what is the provision which you had booked in the balance sheet?

Sameer Shah:

The total provision was close to around Rs. 1,000 crore.

Percy Panthaki:

One-fifth of that is getting shaved off, so would it be fair to say that the profit estimates are also shaved off by one-fifth?

Sameer Shah:

In absolute terms, yes, from the estimates at that point in time.

Percy Panthaki:

In Indonesia, in Q4 FY17 also, you had said that there was a modern trade down stocking, is that correct?

Sameer Shah:

Partially, yes.

Percy Panthaki:

There has been a further down stocking on a low base also?

Sameer Shah:

If you track some of the other listed HPC player performances and listed retailer performances, on working capital, we are seeing a huge pressure on a lot of modern retailers to reduce down the stock level. We have seen this in our business over last three to four months with some of these mini-marts kind of retailers in Indonesia. It is quite widespread as what we understand from the listed large players.

Percy Panthaki:

So there would still be a decline in Indonesia for FY2018 and given that you have increased market shares and yet seen a decline in sales adjusted for inventory levels that would mean that the industry size itself has materially shrunk by around almost 10%, is that correct?

Sameer Shah:

If you look at Household Insecticides category growth in Indonesia, in Q1 FY2018, it was in positive zone but in last three quarters, the growth has been in negative zone. Also, sell ins and sell outs are happening at healthy pace so this is more of a lead indicator that recovery in market share will result in a better primary sales growth for us in the coming quarters. So that is the way to read this share gain correlating to the primary sales, which we will have in the coming quarters to modern retail partners.

Percy Panthaki:

There seems to be a disconnect between Nielsen data and the derived market growth looking at your market share and sales growth. Say, you have about 40%-50% of sales from Household Insecticides and the remaining is other products, which are growing by around 10%, so if you derive your Household Insecticides sales for FY2018 and even adjusting for modern trade destocking etc., your Household Insecticides sales might be double-digit negative and you have still grown market share, so there seems to be a disconnect either in the Nielsen data or in the fact that you have grown market share?

Sameer Shah:

The reported sales which we report, not just for Indonesia but across our businesses is after sales promotion spend, so that could be one disconnect in what Nielsen is tracking which is a retail price versus what you report in sales, so there is no direct correlation to some extent between both absolute numbers. But directionally, we have degrown in Household Insecticides category in FY2018 in Indonesia by double-digits and as I mentioned earlier, this is exit market share so this is comparing March 2018 market share with the March 2017, the first six-seven months where we lost the share and the last five-six months where we have regained back most of the lost market share.

Percy Panthaki:

You have huge amount of launches lined up in this year. In the past, you have been saying that the profits will grow ahead of sales or in line with sales, so would you say that there is a possibility that for FY2019, your operating profit might grow slower than your topline?

Sameer Shah:

In FY2019, across board, we are going to see very strong innovation led growth at least in some of the large clusters in which we operate in. Having said that, at this point in time, we remain very optimistic of having profitable growth and the way we would define profitable growth is expanding margins. There are enough vectors whether it be favorable mix, cost saving programs and even media spend optimization. The drivers are in place, which gives us lot of comfort to reinvest back for growth as well as to expand this historic high margins which we have had in FY2018.

Moderator:

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

Manoj Menon:

Could you just help us understand the margin bridge for the quarter in India? The question is that you have 29% EBITDA margin despite a lower contribution from the higher margin insecticides in India and a 20% growth in soaps.

Sameer Shah:

Some of the drivers have been largely gross margins. Within gross margins, it has been lower price cover which we have on palm oil. We have also activated and fast tracked strategic sourcing, and strategic sourcing would be for some of the key ingredients like say 'actives', which is the molecules in household insecticides and even good covers on perfume. I think cost saving programs and lower covers on palm oil has resulted in this meaningful gross margin expansion, part of which has got reinvested back for growth and part of it is flowing to bottomline.

Manoj Menon:

Is that something, which can repeat into FY2019 in terms of covers, etc?

Sameer Shah:

At this stage, at least for the next couple of quarters, we remain very optimistic of this gross margin trajectory.

Manoj Menon:

How do we think about margins into the medium term - one the sustainability of it, secondly, do you actually wanted to be here because it will end up attracting more competition just because of the profit pool?

Vivek Gambhir:

I would not read too much into one quarter's margins. If I look at the entire year, our margins have been around 25%. Clearly for us, the formula has to be higher gross margin expansion, some of it will come from revenue growth management, some of it will come from better sourcing, manufacturing and some from premiumisation but ultimately we are comfortable with the level of India margins. Our focus is far more on aggregate GCPL consolidated margins and we do still believe that there is more room in Latin America and Africa to increase margin. So rather than us focusing only on India margins, our efforts will be to look at consolidated margins and try and ensure that they remain ahead of sales growth. Having said that, again if we need to invest in brand building in new innovations, that would be the single most important priority, but our belief though is that there is still enough opportunity to be able to drive consolidated margins.

Manoj Menon:

On the Indonesia part, is there anything other than the narrative of election year, which would rejuvenate the consumption there or any bottom-up activities which is in the pipeline we could talk about, and looking back, if you could help us understand the drivers of the market share gains?

Vivek Gambhir:

On the macro front, things are still looking more of the same. We are not seeing any significant green shoots for more recovery. Having said that, though Indonesia does tend to be fairly commodity-dependent and as commodity prices globally go up, Indonesia should start seeing some benefits and typically with provincial elections this year and national elections next year, there should be some boost in the economy, which should lead to a better consumer spend. We will have to wait and watch but apart from that, we are not seeing any significant uptick in the economy. On the market share gain, a lot of this was driven by some of the innovations that we have launched. One of the main innovations that we have launched has been the HIT Expert range of more premium insecticides that has done quite well and given the kind of momentum we are seeing with that, there are some more products that are being planned later on this year to build up Expert platform and that is one of the key reasons that led to the market share gain that we saw in the insecticides category.

Moderator:

Thank you. The next question is from the line of Aditya Gupta from Goldman Sachs. Please go ahead.

Aditya Gupta:

On soaps, the market share gains is mostly coming in from the unorganized players or are you getting market share from other players also?

Vivek Gambhir:

It is a combination of both. See, from the Nielsen data, we are seeing some players who are losing shares, so some share gains are coming in from existing players but this is not fully quantifiable in the Nielsen data because our growth rates are much higher than what Nielsen reports and the delta is also being driven by some of the challenges that the smaller players are facing in this category in certain geographies. This is more anecdotal, but our hypothesis is that a certain amount of share gain is coming for us and some other players as well from a shift towards slightly larger organized players.

Aditya Gupta:

On the others segment, can you give some granularity on which brands are the top three, four brands which are getting clubbed over here and how have they been growing?

Sameer Shah:

Yes, so largely this would be categories like air freshener where we have Aer brand, liquid detergents where we have the Ezee & Genteel as our lead brands and then there would be toiletries wherein we would have Cinthol Deostick, Cinthol deodorant and Protekt range of hand wash and hand sanitizers.

Moderator:

Thank you. The next question is from the line of Anubhav Sahu from MCA Research. Please go ahead.

Anubhav Sahu:

On Indonesia, do you see that the 26%-27% kind of margin profile can be seen for the near-term for FY2019?

Sameer Shah:

Our efforts initially would be to get the growth back on track. We have had an internally disappointing year in terms of Indonesia's sales performance and we would want to invest in go-to market, most of the general trade as well as new product launches to get the growth back on track. If we get the growth to a respectable level, then we will have scale leverage and hopefully we will be able to maintain margins but our entire focus in this fiscal year for Indonesia is going to be towards driving sales growth.

Anubhav Sahu:

Can you provide some guidance on the raw material cost? Are we willing to go for a price hike because largely we have seen a volume led growth this quarter?

Sameer Shah:

We do have low cost palm oil covers at least for next two quarters. The impact of crude is an indirect one. We do not directly import crude. There are materials, most of the packaging ones, which have adverse impact of crude but normally it is a lag of six months so we honestly have six months of time to react to any price changes but at least for next couple of quarters, we are protected against any increase in input cost. For the period beyond that we will evaluate calibrated price increases or maybe some other cost saving initiatives to continue profitable growth momentum.

Anubhav Sahu:

Regarding the pass on of a price cut as per GST, so is that process done from our side?

Sameer Shah:

Yes, we did pass on the GST rate cuts in the first round in soaps and then mid-November, we did pass on the benefits in hair color, air fresheners, toiletries as well as liquid detergents and that is the reason why over last three to four quarters in our India business, you are seeing a relatively higher volume growth and a lower value growth because of the price led de-growth, which is nothing but the GST-cut benefits, which have been passed on to the consumers in form of lower MRP.

Anubhav Sahu:

Regarding BBlunt, how is it now integrated into the system?

Vivek Gambhir:

BBlunt for us is a very exciting Horizon 2.0 brand. We are still experimenting, testing and learning in terms of some of the propositions that we are creating and a lot of the businesses now being limited to become a more digital only brand so still very early days but in terms of the plans that we have for BBlunt, we are very excited but I do not think it will be a meaningful contributor to revenues for the next two or three years but there is a huge amount of learning that we are getting. It is also fitting in with the rest of the portfolio. So it is on track but it is more of a Horizon 2.0 as opposed to our current horizon growth opportunity.

Moderator:

Thank you. We will take the next question from the line of Percy Panthaki from India Infoline. Please go ahead.

Percy Panthaki:

On soaps, it is a hypercompetitive category and it always has been like that and in the past, sometimes we have seen when the growth for two or three quarters is very high then in the next two or three quarters it averages out, so do you envisage that the next two-three quarters could be below average and then over a longer period of time, this will average out?

Vivek Gambhir:

We are not seeing any significant concerns to the point where growth would significantly slide down. Having said that, this is a mature category and so we do know that the actual category rates tend to be on the lower side. Clearly, some of the work that we have done on pricing, revenue growth management, marketing activations, micro planning, strong marketing at a state level seems to be working quite well for us because we are gaining certain amount of share. From our planning point of view, this is a low double-digit growth category and as we look at our plans in the next 12 to 24 months, we are not counting on this kind of growth to be sustained. We will continue trying for it but from our planning point of view, this is a low double-digit growth category.

Percy Panthaki:

What is driving the market share gain and what is that competitors are not doing?

Vivek Gambhir:

This is not a one quarter story - if you look at our growth performance over the last four or five quarters, it has been a sustained level of growth while there has been GST and demonetization. We would not like to comment on the competitors strategies.

Percy Panthaki:

Do you think the main reason is because the relative pricing has changed?

Vivek Gambhir:

It is less about pricing here. It is far more about execution and sometimes for some companies some marketing tends to work better than others. In the past when things have not worked for us, maybe our marketing has not worked quite well, or we have not executed quite well. I do not think there is any secret formula here beyond pricing, good marketing, good execution and good focus. We feel confident that we will keep on sustaining it. Having said that, I do not think we can count on this level of performance to be sustained so we have to create further growth vectors as well because this is a more penetrated category.

Percy Panthaki:

Is this market share growth coming from a few states or is it across the country?

Vivek Gambhir:

It is across a few states because our focus has been on a few states and the states that we are focused on, that is where we are seeing these advantages.

Percy Panthaki:

On household insecticides, if I look at your growth on an average over the last eight quarters it is around 2% and if I look at the soaps or hair colors growth, it is about 7% to 8% and traditionally, we have seen household insecticides as a fast growing industry and within that, we are gaining market share so we have actually grown even faster. Now it seems that the industry growth itself has come down and market shares are happening at a much slower pace, so what is the future of household insecticides? Why do you think household insecticides in the next two years will behave differently from the last two years?

Vivek Gambhir:

If you were to dissect the household insecticides opportunity, there is clearly an opportunity which is far more penetration-driven than the opportunity which is consumption driven. The consumption opportunity tends to play a little bit more on the urban side of things. Given the economic volatility with demonetization and the economic environment and this is the nature of the category, with a certain amount of seasonality, consumption has always been a bit of a challenge over the last two quarters. We have tried to address the consumption issue by some newer products such as personal repellents, still early days, but the potential to drive consumption through things like personal repellents I think will play out in a stronger fashion as that category of the format gains traction.

The challenge we have had about the last two years has been that the penetration has slowed down and we have not been successful in terms of attracting new users to the category but four or five years ago, we saw a tremendous opportunity with Fast Card driving rural penetration. Just to give you a context about five or six years ago, penetration for rural was stuck at about 30% or so, that penetration level went up by a meaningful number once Fast Card was introduced. The Fast Card has been a very strong top-up format but because of the duration and longevity of the Fast Card proposition, there is only a certain amount to which Fast Cards could drive penetration, and strategically we had taken a call to de-prioritize coil because it is more of a commodity and a lower margin category but we never really had a substitute, and coils in the past have been a fairly good recruitment driver for people into the category. But because over the last couple of years, as a market leader, we did not have an effective substitute for an upgrade solution and a recruitment solution for new users, across the board, penetration of new users in this category has been plateauing and that is what has driven some of the challenges in the category along with a certain amount that comes through seasons and the combination of those is what really led to the kind of situation which spanned over the last eight quarters, wherein our growths have not been good.

This is where the PowerChip comes in because our belief is that, with PowerChip we have a product that is two-thirds the price of coil, it is affordable, it is extremely efficacious, it is easy to use and now given some of the efforts that are happening in rural electrification, we believe that the next recruitment vehicle and the next vehicle to upgrade coil usage, will be PowerChip. If that plays out along with the other formats and products that we are creating, then that gives us the confidence that while the last two years has not been good for household insecticides, then at least the growth vector that we are putting in place, if we execute them well, should allow us to get growth back in a positive territory regardless of seasonal impacts. While season will have an impact, if we can create these growth vectors across various formats it will allow us to drive penetration back to where it should be.

Moderator:

Thank you. The next question is from the line of Rishabh Bhatla from ACK Capital Management Private Limited. Please go ahead.

Rishabh Bhatla:

Regarding the debt to equity ratio, we have seen that the debt has declined by around 12.6%, do we expect the same thing happening over this year as well?

Sameer Shah:

As of March 2018, our net debt to equity has been 0.41x and 0.64x as of March 2017. The answer to your question is also in turn dependent on whether we are going to have any inorganic growth in FY2019 or not because at this point in time, if we assume that we are not going to have any inorganic growth in FY2019 and read with the fact that we are in categories which are not very capital intensive, then my sense is with the free cash flows which will get generated in the business, our net debt equity should come down further from 0.41x level during the course of FY2019.

Rishabh Bhatla:

Can you give me the sales breakup for rural and urban?

Sameer Shah:

In terms of saliency, rural is close to 30% of our general trade sales in India and 70% is urban. General trade, itself is 85% and modern trade plus institutions CSD would be around 15. If we decompose the overall sales growth around 2% to 3% of the growth has come from urban, rural has been 7% to 8% growth for us in Q4 FY18.

Vivek Gambhir:

For the year, rural growth is close to about 1.2x to 1.3x of urban growth.

Moderator:

Thank you. The next question is from the line of Amit Kumar from Investec Capital. Please go ahead.

Amit Kumar:

On the palm oil side, there has been this increase in duty, which has come through in March, so about a 14% increase both on the crude palm oil side and the refined palm oil side. Does this drive you to look at domestic sourcing and if not then what kind of impact would it have and who bears the increased duties?

Sameer Shah:

The changes are not on the crude palm oil, it is more on the refined palm oil. In parallel, we anyways evaluate buying locally versus importing, so wherever we see cost benefit we press the lever in terms of making our buy decision. On your other question, it is our liability to bear the increased duties and the change in duty is on crude palm oil so to that extent, there is no impact as such on any palm oil consuming companies in India.

Moderator:

Thank you. The next question is from the line of Binoy Jariwala from Sunidhi Securities. Please go ahead.

Binoy Jariwala:

My question is on the Indonesian business, what kind of headroom do we have to grow in the household insecticides category in Indonesia? You have got a presence in about 50% of the overall household insecticides market so are you looking at entering the remaining 50%?

Vivek Gambhir:

Certainly, I think the remaining 50% of the opportunity is something that we are looking at. I do not think we will enter the coil category but certainly there are opportunities to upgrade coil users like the way we are doing in India.

Nisaba Godrej:

Yes, so if you look at the PowerChip and the other options that we have, so we definitely will enter that market to serve the consumer need but we would not do coils.

Binoy Jariwala:

Which essentially is personal repellents only?

Nisaba Godrej:

No, it is not personal repellents. There is a big market for coils and there is a big personal repellent market, which is much, much bigger than in India and consumer use is also very different than what it is in India.

Binoy Jariwala:

On the hair care, which is an overall about $200 million category in Indonesia and in FY2017, we entered hair color which is a sub segment to the overall category, so over a period of two to three years, do we look ourselves as playing in each of the areas?

Nisaba Godrej:

We started with hair colors, we do have other products in the pipeline but our first focus is on hair colors and building our market share and success there, and the brand has been doing quite well and it has been very well received so we do have other products in the pipeline but our first goal is to get a significant market share in hair colors before we start investing in any other products.

Binoy Jariwala:

Distribution presence wise, are the products available across the entire distribution universe, which is around 250,000-300,000 outlets in Indonesia?

Vivek Gambhir:

Our reach is about over 500,000 and our direct coverage is around 120,000. In the next three years or so, our intent would be to double our direct reach as well and some of these products like hair color, some of the lower price points that we have in insecticides, baby tissues, etc., the bouquet of product is there for us to now start driving general trade much more aggressively and that is a big growth opportunity for us over the next three years in Indonesia, because we are significantly over weight in the modern trade part of the market.

Binoy Jariwala:

On Project PI, what kind of savings have we cultivated in FY2018 for India and Indonesia?

Sameer Shah:

Project PI in India would have contributed anywhere between 150 and 200 basis points to gross margin expansion. In Indonesia, this project scaled up during H2 FY18, in the first half it did not have the scale to kind of leverage upon so the big impact of Project PI in Indonesia will be seen in FY2019. In fact that is going to be one of the big pillar to support the go-to market initiatives, new product launches and also perhaps maintain / expand these historic high margins.

Moderator:

Thank you so much. The next question is from the line of Kunal Vora from BNP Paribas. Please go ahead.

Kunal Vora:

Can you share your thoughts on how crude price, if it remains elevated, will impact your business in the next few quarters?

Sameer Shah:

In India business, the impact is relatively lower, that is because close to, say, 40% on an average of our cost basket is palm oil and rest is non-palm, of which crude would be a meaningful component. In Indonesia business as well as in Africa business, we do see impact of crude prices, but as I mentioned earlier, we have couple of quarters of comfort either through locked in volumes or prices with our suppliers. And once we see the gradual impact of higher crude in terms of affecting our gross margin, we will either work harder in terms of cost saving initiatives or even evaluate gradual select price increases at that point in time. So at this stage, we are not too worried of crude being at 70 or 70-plus at this point in time because we do have the comfort of continuing this gross margin momentum at least for next couple of quarters and in this period, we will plan out as to what will be our action, if any starting mid FY2019 across our clusters.

Kunal Vora:

Do you see some benefits of higher crude price in some markets which are commodity driven, could macro situation improve?

Vivek Gambhir:

Yes, in markets like Nigeria for instance, certainly there is expectation of stronger economic growth that could be driven by higher crude prices. So in some geographies we do see some economic growth benefits.

Kunal Vora:

You mentioned 10%-12% volume growth and there are some margin headwinds, some impact on RM price, slight increase in the advertisement spends, so would you take some price increases this year?

Vivek Gambhir:

Our focus is on trying to drive volume growth. A little bit of pricing depends on the competitive environment and how the overall economic environment is shaping up and so whenever input costs go up, our first bias is to try and reduce costs, to try and see if we can make up for the increase and if we cannot do it then we try and find ways to increase price. There is some pricing increase that will happen through premiumization and new product innovations, but there are consumers willing to pay for that but our model is focused far more on driving volume growth given the penetration ways that we have in emerging markets. The volume growth focus is more important. Through revenue growth management and new innovations if we can get some pricing growth then that is nice and historically if you look at the last ten years of our performance, it is largely been in India about a 70%- 75% volume growth story and a 25% price-led growth story. That can happen over time but our focus will be far more on driving volume growth.

Moderator:

Thank you. The next question is from the line of Aditya Seth from Investec Capital. Please go ahead.

Aditya Seth:

In the 'other' brands, which category out of Aer pocket, Protekt etc., would be the biggest contributor for us?

Vivek Gambhir:

Air fresheners will be the biggest category in Others.

Aditya Seth:

So in other brands, Aer would be the first one and what would be the second one?

Vivek Gambhir:

Liquid detergents - Ezee would be the second one.

Moderator:

Thank you. The next question is from the line of Prakash Kapadia from Anived Portfolio Managers. Please go ahead.

Prakash Kapadia:

Could you give us some sense on feedback from channel partners in terms of adaption to new ways of doing business, billing within wholesaler, retailer, stockiest and what are we doing to ensure to avoid disruptions at our end? And secondly on the ads and sales promotion, what percentage you have in mind and what works, given the launches that we are having in this particular financial year, would it be more sales promotion or will it be more ads spend?

Vivek Gambhir:

If you look at our secondary versus primary growth, our secondary growth was 10%, our primary growth was 7% so this delta in some ways is driving the optimization that we are doing to ensure that our channel partners are getting the right kind of return on investment and we are very committed to ensuring a win-win partnership with the channels partners. On the second question, with regards to the mix of ATL and BTL, that is slight dynamic and it is varied by category. The primary focus does tend to be more on ATL driven strategy but to the extent that we need promotional expenses, we do that. The ratio typically tends to be 60%-65% ATL-led and 30%-35% BTL-led, though that number can vary by category, coils for instance, it would be a high BTL but roughly rule of thumb that we use is somewhere on 60%-40% between ATL and BTL.

Moderator:

Thank you. The next question is from the line of Bhavesh Shah from CLSA. Please go ahead.

Bhavesh Shah:

On Africa region, our margins used to trend somewhere around 15%-16% during FY2016-2017 and today they are down somewhere close to 13% and this is after adding SON portfolio, which are at relatively higher margins of 18% to 20% so, what has really happened to Darling portfolio margins over the last couple of years and how do you see this trending, going forward?

Vivek Gambhir:

Good news is it will trend upwards. Margins are below expectations; there are two reasons for it. One, if you see even the growth rates from a 14% constant currency growth rate, we have reported around 8% for the year, so the implication of this, is that some of the raw materials that we end up buying tend to be dollar-denominated and we have taken a conscious call to not pass on all these costs to consumers in the form of price increases, so that led to a certain deterioration as far as margins is concerned. The second is we had taken a strategic call to add a lot more talent ahead of the market. Some of this talent is coming in the form in new center that we have in Dubai, we also supplemented the talent on the ground as far as marketing is concerned. In some operations like Strength of Nature, we have upgraded IT system like SAP, warehouse management systems etc., upfront expenditures being imposed there and then on a very low base, we have increased the marketing spend, particularly for our Wet Hair launch, all of these costs are very front-loaded. Having said that, the team is embarking on projects to drive more operational efficiency. The scale up of Wet Hair was probably slower than what we were expecting. It took us some time to get the local manufacturing right, now we are feeling far more comfortable, which is why you have seen some of the margin improvement getting a little bit delayed. Assuming that currencies remain stable or if they can go in the right direction, and as Wet Hair scales up and as we start seeing better scale leverage with some of the overheads that we have invested, next year ought to be a much better year. It may take some quarters still but overall for the whole year, we feel very confident that you will see significant margin improvement from our Africa business.

Bhavesh Shah:

On gap between constant currency and reported growth numbers, do you see this gap shrinking going forward as the base also is getting supportive and the way Indian currency is moving, do you expect this gap to narrow a bit assuming exchange rate remains where they are today?

Sameer Shah:

If you look at the translation effect over last couple of months, it has been in the positive zone for Africa cluster so that in a way should result in hardly any material impact at the overall consolidated level, but it is difficult to call out in which direction the currencies will move for the rest of the year. At least over the last couple of months, the trend is reversing.

V. Srinivasan:

Rupee also appreciated last year and is now returning back to normal level of Rs. 66-Rs.67, so that also will help in moderating the translation impact.

Vivek Gambhir:

Given what US decides to do in terms of its trade situation, Indonesia, South Africa, Nigeria, India are all going to go through an election phase over the next 12 to 18 months, so our operating assumption is that it should improve but from our point of view, ensuring that we can manage the business well on a constant currency basis and mitigate the forex risk is something we are getting better at as of today that what we were five years ago.

V. Srinivasan:

Translation does not involve any cash flow, this is basically only converting from one local currency to Indian rupee.

Moderator:

Thank you. The next question is from the line of Binoy Jariwala from Sunidhi Securities. Please go ahead.

Binoy Jariwala:

On taking the Africa cluster point ahead, is it correct to understand that the entire Wet Hair manufacturing has been localized now?

Vivek Gambhir:

Not the entire Wet Hair manufacturing. We have a tier branding strategy. So for some of the phase one priority brands that comprise the bulk of the focus areas, those have been localized. There are still a few smaller brands that are going to get exported from the US, over time as we gain more scale we will localize it but for the first two or three brands that we are prioritizing, those have been localized manufacturing in Kenya, in Nigeria and in South Africa.

Binoy Jariwala:

With regards to the launches, is Wet Hair launch already done in Nigeria and South Africa as well?

Vivek Gambhir:

Yes, the Wet Hair launch is already underway in Nigeria and in South Africa.

Binoy Jariwala:

Could you share something on household insecticides registrations and launch plans in Africa?

Vivek Gambhir:

All the groundwork with registrations etc., is underway. In terms of the sequencing, the focus for us in the immediate term is to ensure that the Darling brand gets relaunched, the Wet Hair scale up is successful. Once, we have those under control, my expectation is that this year, FY2019, we will lay the ground work, next year onwards, FY20 onwards, we start seeing some traction on the household insecticides front, but again from a focus point of view, we do want to ensure that the Darling relaunch and the Wet Hair scale up is our main focus this year.

Moderator:

Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to the management for their closing comments.

Vivek Gambhir:

Thank you very much for your time. Clearly, on an overall basis for the year, we feel good about the sustainable, profitable and competitive growth that we have delivered. While the results of Q4 were quite mixed, we do believe that we are putting in all the building blocks in place to deliver a much strong performance in FY2019. Thank you for your time.

Moderator:

Thank you. Ladies and gentlemen on behalf of Motilal Oswal Securities that concludes today's 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.