

## **Slowdown in Consumerism**

**December 22, 2008**

How the picture has changed over the last 11 months! From the unprecedented optimism at the beginning of the year, to all-round panic since September... Indeed not just the 5-year bull-run, but hope itself seems to have come to an end these days.

The differences in sentiment are quite marked. Prevalent at the beginning of this year were spiralling real estate prices, booming construction activity, a prospering retail sector, and a fast expanding entertainment segment. The growth however was funded primarily by borrowings rather than by savings. Personal loans, car loans, loans against shares, not to forget home loans, were suddenly the "in-thing". Credit card outstandings too were reaching unheard of levels, thanks to the limitless consumerism of the "Great Indian Middle Class".

The boom has been seen giving way to "bust" particularly over the last three months or so. Exuberance has given way to cautious rethinking. Even the GDP growth estimates for the country have been cut from 7.8%, three months ago, to 6.7% recently.

The real estate sector has been severely impacted. High prices and high interest rates have come as a double whammy, reducing purchases of residential units to but a trickle. Liquidity has suddenly become a major issue for real estate developers, with banks refusing to lend further. Some private equity (PE) players have either already exited real estate (RE) deals or renegotiating valuations with developers.

### **How will the slowdown/recession impact consumer spending?**

We analysed the financial performance of 54 listed companies from **personal consumption driven industries**, viz., FMCG, food products, multiplex operators, automobile (passenger vehicles), consumer durables, newspaper publishing, retailing and jewellery manufacturing, on three criteria, viz., revenue growth, EBITDA margin and net profit growth.

The periods considered were (i) FY06 through FY08, and (ii) the trailing 4 quarters upto Q2-FY09, over trailing 4 quarters upto Q2-FY08, with a view to understand whether there are any signs of slowdown in consumer spending, whether consumer habits have been altered over the last few quarters, etc.

We also compared the relative stock price performance of these sectors vis-à-vis the BSE Sensex over the last two years (January 1, 2007 through December 15, 2008). We then computed forward p/e multiples of a number of these companies, on the basis of consensus analyst estimates.

### **Summary Conclusions**

#### **Financial performance of the entire domain group**

- Sales growth for the entire domain group slowed down from 23.5% in FY07 to 9.1% in FY08. However, during the trailing 4 quarters upto Q2-FY09, sales growth picked up to 14.9% y-o-y.
- Absolute EBITDA growth too tapered off, from 17.3% in FY07 to 4.1% in FY08. Again, EBITDA grew by 6.8% during the trailing 4 quarters upto Q2-FY09, y-o-y.
- PAT growth too slowed down, from 19.2% in FY07 to 8.6% in FY08, and further to 4.7% during the trailing 4 quarters upto Q2-FY09, y-o-y.

#### **Financial performance of individual sectors**

- Consumer (FMCG) and food product companies have been steady performers over the said periods.
- Automobile sector has been hit badly in FY08. However, the sector bucked the trend in terms of sales growth during the trailing 4 quarters upto Q2-FY09, growing by 7.6% y-o-y.
- Sales growth of consumer durables, newspapers, jewellery and retail companies either slowed down or turned negative during the trailing 4 quarters upto Q2-FY09, compared to growth in FY08.
- Food products, automobiles, jewellery and retail sectors reported margin expansion in trailing 4 quarters upto Q2-FY09, compared to FY08.
- All sectors except food products reported de-growth in net profit in trailing 4 quarters upto Q2-FY09, compared to growth in FY08.

**In other words, the broad scenario for consumption driven industries is slowdown in growth and deteriorating profitability.** There may be a distinct slowdown in personal consumption driven industries, going forward. However, Consumer product (FMCG) companies may remain relatively unaffected, as they manufacture the necessities; however margin impact cannot be ruled out.

### **Stock price performance of individual sectors vis-à-vis the BSE Sensex**

Only two sectors, viz., consumer and food products, outperformed the BSE Sensex during the better part of the last two years till date. This substantiates our view that consumer and food product stocks have been preferred by the market, over other consumption driven sectors.

### **Forward valuations**

The BSE Sensex is currently trading at around 11.2x FY09 earnings. We observed that most of the consumer stocks continue to trade at a huge premium to the Sensex. Same is the case with food products and retail stocks and a few stocks from the auto and newspaper sectors.

We believe while consumer and food product stocks may continue to fetch premium valuations going forward, retail sector valuations may be under pressure.

Investor sentiment for multiplex, consumer durables, newspapers and jewellery stocks is unlikely to improve in the near future. However, auto stocks by virtue of extremely modest valuations may be considered as value buys and therefore buck the recent trend.

## **The Domain Sectors**

### **Fast-moving Consumer Goods (FMCG) companies**

Hindustan Unilever, Colgate-Palmolive India, Nestlé India, Britannia Industries, Procter & Gamble Hygiene & Healthcare, Marico, Jyothy Labs, Tata Tea, Dabur, Glaxo Smithkline Consumer Healthcare, Camlin

### **Food product companies** (mainly branded rice manufacturers)

Kohinoor Foods, KRBL, REI Agro, Temptation Foods, Lakshmi Energy, LT Foods, ITC Agro Tech

### **Retailing companies**

Pantaloon Retail, Shoppers Stop, Koutons Retail, Provogue, Kewal Kiran Clothing, Bata India

### **Multiplex operators**

Adlabs, PVR, Inox Leisure, Fame India, Cinemax, Pyramid Saimira Theatre

### **Automobiles (passenger vehicles)**

Bajaj Auto, Tata Motors, TVS Motors, Maruti Suzuki, Hero Honda Motors

### **Newspaper publishing companies**

HT Media, Jagran Prakashan, Deccan Chronicle, Mid-day Multimedia, Sandesh

### **Consumer Durables companies**

Blue Star, MIRC Electronics, Salora, Videocon

### **Jewellery companies**

Gitanjali Gems, Asian Star, Classic Diamonds, Rajesh Exports, Flawless Diamonds, Suashish Diamonds

## **Methodology**

- i) We considered stand-alone financial performance for two periods, (i) trailing 4 quarters upto Q2-FY08 (October 1, 2006 to September 30, 2007) and (ii) trailing 4 quarters upto Q2-FY09 (October 1, 2007 to September 30, 2008). We compared

# KEYNOTE

these with the performance of these companies on stand-alone basis, during FY06, FY07 and FY08 (year ending December 31 or March 31, as the case may be).

- ii) We computed sector aggregates for sales, EBITDA and net profit for these periods and summarised these as follows. We also compute aggregate absolute EBITDA for all sectors.

## Summary Data

### 1) Net Sales trends

(RsCr)

Sector	Net Sales			% Change		Sales		% Change
	FY06	FY07	FY08	FY07 y-o-y	FY08 y-o-y	200612-200709	200712-200809	
Consumer	21834.17	24674.15	28620.76	13.0%	16.0%	27153.87	32306.74	19.0%
Multiplexes	423.89	964.68	1656.54	127.6%	71.7%	1236.05	2150.21	74.0%
Food Products	4694.05	5520.97	7090.6	17.6%	28.4%	5284.54	7673.43	45.2%
Automobiles	59848.76	74797.88	71608.08	25.0%	-4.3%	88285.45	95029.47	7.6%
Con. Durables	10551.68	12701.38	14976.21	20.4%	17.9%	13232.53	15079	14.0%
Newspapers	1975.74	2589.73	3158.34	31.1%	22.0%	3980.17	4558.52	14.5%
Jewellery	9880.1	11895.68	14817.44	20.4%	24.6%	15215.7	18541.82	21.9%
Retail	5472.81	8531.36	12671.84	55.9%	48.5%	8525.8	11795.37	38.3%
<b>Total</b>	<b>114681.2</b>	<b>141675.83</b>	<b>154599.81</b>	<b>23.5%</b>	<b>9.1%</b>	<b>162914.11</b>	<b>187134.56</b>	<b>14.9%</b>

### 2) EBITDA trends

(RsCr)

Sector	EBITDA			Change		EBITDA		% Change
	FY06	FY07	FY08	FY07 y-o-y	FY08 y-o-y	200612-200709	200712-200809	
Consumer	2955.13	3181.13	4036.47	7.6%	26.9%	3823.86	4465.92	16.8%
Multiplexes	105.21	232.51	321.03	121.0%	38.1%	183.99	226.19	22.9%
Food Products	419.89	647.81	873.09	54.3%	34.8%	669.34	1133.72	69.4%
Automobiles	6682.08	7214.04	5378.06	8.0%	-25.5%	10904.2	10309.84	-5.5%
Con. Durables	1494.64	1871.44	2307.75	25.2%	23.3%	1976.08	2320.23	17.4%
Newspapers	282.25	571.95	892.53	102.6%	56.1%	720.24	835.32	16.0%
Jewellery	94.99	211.84	322.26	123.0%	52.1%	755.55	739.71	-2.1%
Retail	408.41	669.45	1065.94	63.9%	59.2%	678.63	1020.51	50.4%
<b>Total</b>						<b>19711.89</b>	<b>21051.44</b>	<b>6.8%</b>

### 3) Net Profit trends

(RsCr)

Sector	Net Profit			Change		Net Profit		% Change
	FY06	FY07	FY08	FY07 y-o-y	FY08 y-o-y	200612-200709	200712-200809	
Consumer	2696.93	2976.3	3556.47	10.4%	19.5%	3399.78	4007.77	17.9%
Multiplexes	52.76	113.44	139.49	115.0%	23.0%	187.16	103.78	-44.6%
Food Products	304.58	415.8	493.84	36.5%	18.8%	314.77	411.12	30.6%
Automobiles	5306.75	6310.99	5754.66	18.9%	-8.8%	7047.37	6754.1	-4.2%
Con. Durables	911.44	971.65	1217.36	6.6%	25.3%	1101.62	1220.44	10.8%
Newspapers	164.76	355.13	533.46	115.5%	50.2%	467.92	466.73	-0.3%
Jewellery	170.3	281.79	557.93	65.5%	98.0%	383.84	455.54	18.7%
Retail	248.2	318.84	505.48	28.5%	58.5%	316.91	427.26	34.8%
<b>Total</b>						<b>13219.37</b>	<b>13846.74</b>	<b>4.7%</b>

4) EBITDA margin (%) trends

Sector	EBITDA Margin (%)			Change		EBITDA Margin (%)		% Change
	FY06	FY07	FY08	FY07 y-o-y	FY08 y-o-y	200612-200709	200712-200809	
Consumer	13.5%	12.9%	14.1%	-0.6%	1.2%	14.1%	13.8%	-0.3%
Multiplexes	24.8%	24.1%	19.4%	-0.7%	-4.7%	14.9%	10.5%	-4.4%
Food Products	8.9%	11.7%	12.3%	2.8%	0.6%	12.7%	14.8%	2.1%
Automobiles	11.2%	9.6%	7.5%	-1.5%	-2.1%	12.4%	10.8%	-1.5%
Con. Durables	14.2%	14.7%	15.4%	0.6%	0.7%	14.9%	15.4%	0.5%
Newspapers	14.3%	22.1%	28.3%	7.8%	6.2%	18.1%	18.3%	0.2%
Jewellery	1.0%	1.8%	2.2%	0.8%	0.4%	5.0%	4.0%	-1.0%
Retail	7.5%	7.8%	8.4%	0.4%	0.6%	8.0%	8.7%	0.7%
<b>Total</b>						<b>12.1%</b>	<b>11.2%</b>	

**Conclusions**

**1. Net Sales**

**I. Sectors where growth either slowed down or turned negative in FY08, on y-o-y basis:**

Multiplexes, automobiles, Consumer durables and newspapers

**II. Multiplexes and retail sectors had the highest revenue growth in FY08, of 71.7% and 48.5% respectively.**

**III. Sectors where growth either slowed down or turned negative trailing 4 quarters upto Q2-FY09, compared to growth in FY08:**

Consumer durables, newspapers, jewellery and retail

**IV. Consumer product companies, multiplexes, food product companies and retail companies either maintained or accelerated their growth trajectory in the trailing 4 quarters upto Q2-FY09.**

**V. Surprisingly, automobile sector sales bucked the trend in the trailing 4 quarters upto Q2-FY09, growing by 7.6% y-o-y, and reversing the negative growth in FY08 y-o-y.**

**2. Absolute EBITDA**

**I. Sectors where growth either slowed down or turned negative in FY08, on y-o-y basis:**

Multiplexes, food products, automobiles, consumer durables, newspapers, jewellery and retail. In other words, all sectors except consumer companies, reported de-growth in EBITDA.

**II. Sectors where growth either slowed down or turned negative in the trailing 4 quarters upto Q2-FY09, compared to growth in FY08:**

Consumer, multiplexes, automobiles, consumer durables, newspapers, jewellery and retail. In other words, all sectors except food products, reported de-growth in EBITDA.

**3. EBITDA margin**

**I. Sectors reporting margin expansion in FY08, y-o-y**

Consumer, food products, consumer durables, newspapers, jewellery and retail

**II. Sectors reporting margin expansion in trailing 4 quarters upto Q2-FY09, compared to FY08**

Food products, automobiles, jewellery and retail

**III. Sectors where margin contracted in the trailing 4 quarters upto Q2-FY09, y-o-y:**

Consumer, multiplexes, automobiles, jewellery

**IV. Sectors where margin contracted in the trailing 4 quarters upto Q2-FY09, compared to FY08:**

Consumer, multiplexes, newspapers

**4. Net Profit**

**I. Sectors where growth either slowed down or turned negative in FY08, on y-o-y basis:**

Multiplexes, food products, automobiles, newspapers

**II. Sectors where growth either slowed down or turned negative in the trailing 4 quarters upto Q2-FY09, compared to growth in FY08:**

Consumer, multiplexes, automobiles, consumer durables, newspapers, jewellery and retail. In other words, all sectors except food products reported de-growth in net profit.

**Our Views**

Consumer products and food products being more or less necessities, there has been no major impact on revenues. However, EBITDA margins of consumer, multiplexes and newspapers have been impacted the trailing 4 quarters upto Q2-FY09, compared to FY08.

We believe this may be attributable to loss of pricing power, cost pressures for consumer and newspaper companies, while in case of multiplexes it may have been a function of reduced occupancies and average ticket sales.

All sectors except food products reported de-growth in net profit in trailing 4 quarters upto Q2-FY09, compared to growth in FY08.

Therefore there is a clear trend of decelerating sales growth and pressure on bottomlines.

**The way ahead**

In view of the fact that the global financial turmoil took place towards the fag end of Q2-FY09, we believe the worst may not far from over. This is amply evident in the steep correction in property prices, layoffs across sectors, shutdown of organised retail stores at a number of locations, etc.

There already are signs that US consumerism may be slowing down. Household borrowings in the US have been declining every quarter during the last five quarters. In fact in Q3, borrowings reduced for the first time in several years. There are reports of below average shopping for Christmas in the US.

We believe the phenomenon may be replicated in India as well. With GDP growth slowing down, there are indications that personal income growth may be under pressure in the near future.

We therefore believe there may in fact be a distinct slowdown in personal consumption driven industries. Consumer companies may remain relatively unaffected, as they represent the necessities; however margin impact cannot be ruled out, as consumers, whose purchasing power may stand severely impacted, may opt for lower priced products (known as down-trading).

Also in case of branded rice manufacturers both revenue growth and margins may be under pressure, as consumers may opt for unbranded rice.

Segments like multiplexes, automobiles and jewellery manufacturers may be affected the most, within the domain group. Expenditure on entertainment (multiplexes), and

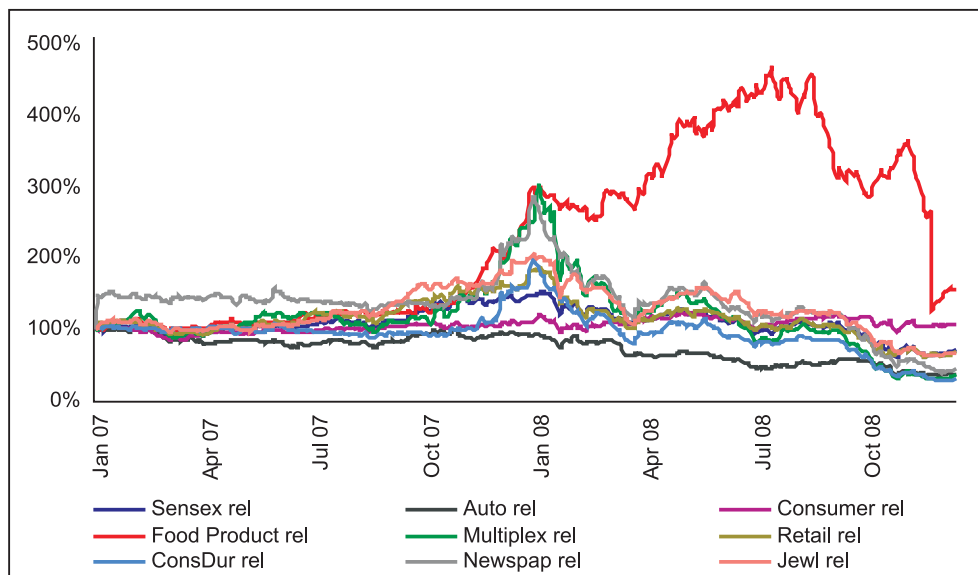
more particularly, jewellery, may be curbed by households. However, the recent reduction in excise duties, reducing trend of interest rates and falling petroleum product prices may bring respite to automobile companies.

Newspaper companies did well in terms of revenue and bottomline growth in FY07 and FY08, as advertisement rates went up and a number of households have been subscribing to multiple newspapers. In an economic downturn, however, these companies may face the double whammy of reducing advertisement rates and declining revenue growth.

We believe the recent reduction by 4% in central excise duty may also give partial relief to all manufacturing industries, including those included in our domain group.

### Relative stock price performance

We analysed the relative performance of the above sectors vis-à-vis the Sensex over the last two years till date, and found that only two, viz., consumer and food products outperformed the former.



It is clear that, among the consumerism driven sectors, only the FMCGs and food product companies have managed to outperform the Sensex, since January 1, 2007 till date.

### Forward valuations

We computed forward p/e multiples of many of these companies, based on consensus analyst estimates for FY09 and FY10.

While The BSE Sensex currently trades at around 11.2x FY09 earnings, most of the consumer stocks continue to trade at a huge premium to the Sensex. Same is the case in case of food products and retail stocks and a few stocks from the auto and newspaper sectors.

In our view, consumer and food product stocks may continue to fetch better-than-Sensex valuations going forward. Retail sector valuations may be under pressure.

Underperformance of multiplex, consumer durables, newspapers and jewellery stocks is likely to continue. However, auto stocks by virtue of extremely modest valuations may be considered as value buys and therefore buck the trend.

# KEYNOTE

Name of Sector / Company	Year/year ending	Sales (RsCr)	EPS (Rs)	Price (Rs)	Forward p/e (x)
<b>Consumer</b>					
Hindustan Unilever	FY09	18,160	10.69	256.20	24.0
	FY10	18,759	11.53		22.2
Tata Tea	FY09	4,745	67.79	545.10	8.0
	FY10	5,026	78.22		7.0
Nestle India	Dec-08	4,263	57.94	1360.45	23.5
	Dec-09	4,988	70.13		19.4
Britannia Industries	FY09	2,995	93.27	1192.10	12.8
	FY10	3,443	111.17		10.7
Dabur India	FY09	2,767	4.41	83.30	18.9
	FY10	3,259	5.17		16.1
Marico	FY09	2,287	3.05	53.10	17.4
	FY10	2,659	3.70		14.4
Colgate-Palmolive India	FY09	1,693	19.94	401.00	20.1
	FY10	1,920	23.16		17.3
Jyothy Laboratories	Jun-09	463	44.33	72.80	1.6
	Jun-10	540	60.30		1.2
<b>Food products</b>					
REI Agro	FY09	3,644	36.90	698.75	18.9
	FY10	6,789	63.20		11.1
KRBL Ltd	FY09	1,606	38.30	68.25	1.8
	FY10	2,104	42.80		1.6
Lakshmi Energy & Foods	FY09	1,507	28.27	201.30	7.1
	FY10	1,972	36.27		5.6
Kohinoor Foods	FY09	716	11.20	87.05	7.8
	FY10	838	13.40		6.5
Temptation Foods	FY09	447	11.79	161.60	13.7
	FY10	631	13.66		11.8
<b>Retail</b>					
Shoppers' Stop	FY09	1,556	11.62	184.00	15.8
	FY10	2,082	13.49		13.6
Provogue	FY09	558	22.61	44.45	2.0
	FY10	762	31.82		1.4
Pantaloon Retail	Jun-08	5,484	7.83	213.60	27.3
	Jun-09	8,519	12.31		17.4
Titan Industries	FY09	3,895	43.58	955.95	21.9
	FY10	4,793	56.16		17.0
Koutons Retail	FY09	1,233	35.23	468.20	13.3
	FY10	1,842	55.75		8.4
Kewal Kiran Clothing	FY09	150	12.83	152.60	11.9
	FY10	174	13.77		11.1
<b>Multiplex operators</b>					
Pyramid Saimira	FY09	772	13.58	64.80	4.8
	FY10	804	14.51		4.5
Adlabs	FY09	735	22.17	182.75	8.2
	FY10	950	31.87		5.7
PVR	FY09	362	12.44	84.70	6.8
	FY10	498	16.73		5.1
INOX Leisure	FY09	268	5.01	32.65	6.5
	FY10	358	6.48		5.0
Cinemax	FY09	149	5.63	39.95	7.1
	FY10	209	7.45		5.4
Fame India	FY09	139	1.79	18.11	10.1
	FY10	202	3.99		4.5

## Slowdown in Consumerism

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Name of Sector / Company	Year/year ending	Sales (RsCr)	EPS (Rs)	Price (Rs)	Forward p/e (x)
<b>Auto</b>					
Tata Motors	FY09	32,886	38.61	173.60	4.5
	FY10	38,127	41.88		4.1
Maruti Suzuki India	FY09	21,293	64.00	536.20	8.4
	FY10	25,324	72.86		7.4
Bajaj Auto	FY09	9,529	53.63	410.60	7.7
	FY10	10,342	59.64		6.9
TVS Motor Co.	FY09	3,753	1.97	26.45	13.4
	FY10	4,239	3.19		8.3
<b>Newspapers</b>					
HT Media	FY09	1,402	5.87	72.50	12.4
	FY10	1,615	7.76		9.3
Deccan Chronicle	FY09	1,040	9.93	54.35	5.5
	FY10	1,199	12.48		4.4
Jagran Prakashan	FY09	914	3.48	58.90	16.9
	FY10	1,082	4.70		12.5
<b>Jewellery</b>					
Gitanjali Gems	FY09	5,615	20.64	75.60	3.7
	FY10	6,194	22.28		3.4
Rajesh Exports	FY09	9,357	9.27	26.85	2.9
	FY10	10,166	12.19		2.2

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