

Research Note

GST brings back Mojo to FMCG sector

22-May-17

GST Council came out with Tax rate on 18th and 19th May 2017. The important takeaways and list of different FMCG companies which might benefit from this are as follows:

Different items	Current Tax rate	GST rate
Hair Oil	26-28%	18%
Tooth Paste	26-28%	18%
Soaps	26-28%	18%
Sugar confectionery	26-28%	18%
Corn flakes	26-28%	18%
Sauces	26-28%	18%
Soups	26-28%	18%

Our FMCG universe Companies which may get benefitted from this are as follows:

COLPAL: Being a major player in toothpaste segment, COLPAL will be the key beneficiary of this as the company pays indirect tax in the range of 23-24%. Another company in this space is DABUR but it is in the ayurvedic segment and it has excise benefits so in our opinion it will be tax Neutral for DABUR.

HINDUNILVR: As approx. 47% of company's revenue comes from soaps and detergent segment, hence reduction in taxes in soaps from 26-28% to 18% may benefit company. Secondly company will benefit in Toothpaste segment also.

EMAMILTD: Presently company pays 11-11.5% indirect tax for Ayurvedic products and 24% for personal care products. Hence company might benefit marginally from latest tax rate.

Our FMCG universe Companies which may tax Neutral as follows:

MARICO and BAJAJCORP: The Companies are already paying less excise duty. Hence reduction in Hair oil tax will not benefit them too much.

Non Profiteering Clause:

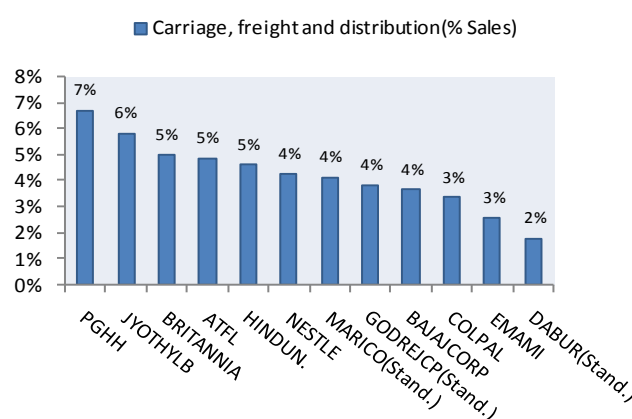
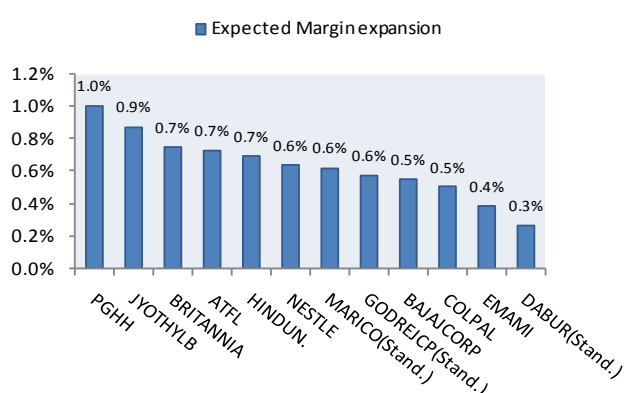
The companies have to transfer tax differential to consumers in terms of reduction in prices due to non profiteering clause imposed by government. **Then question arises here that how consumer companies will benefit by GST tax change?** The answer of this question is that as consumer companies will reduce their prices, their competitiveness will improve which will lead to market share gain and improvement in volume going forward. Major shift in market share will happen from unorganized sector to organized sector. GST will lead better compliance and transparency hence tax evasion from unorganized players will reduce and this will benefit organized consumer companies. **In our opinion MARICO will be greatly benefitted as in Hair oil segment approx. 50% is unorganized players. Britannia is another player which might benefit from this as in biscuits segment there is approx. 35%-40% market are unorganized Whereas COLPAL may able to arrest its market share decline and improve in further as competitiveness of its products will improve with respect to DABUR and Patanjali.** This shift will happen gradually and it may take 5-8 years. Almost all consumer companies will benefit from GST but extent will vary as per the presence of unorganized sector in that segment and tax differential.

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What are the other ways by which FMCG companies may benefit from GST? GST will lead to smoother movement of goods, which will lead to improvement in working capital of already cash-rich FMCG companies. Inventory days might come down significantly. Secondly, it might reduce the transporting cost of consumer companies by 15-20%, which will lead to margin improvement of consumer companies. Presently, approx. 60% of transportation time is consumed in interstate check points, which will shorten sharply.

Simplification of whole process: GST will reduce from approx. 20 different taxes at present to 3 taxes. Simplification of the present tax system will lead to less paperwork, saving more time in turn, improving efficiency.

Expecting margin improvement due to 15% reduction in carriage cost



Our View on GST

In our opinion, GST will be beneficial for almost all consumer companies, but the extent will vary. We expect transportation cost to come down by 15-20% for these companies, which will lead to margin improvement going forward. Working capital improvement will also be on cards, which will make these cash-rich companies even richer. But destocking due to realignment of the supply chain can create some hiccups in the near term, but for the longer term, we have a positive view on the FMCG sector as a whole. The extent of market share gain from unorganized to organized players will depend upon the quantum of unorganized players present in the industry and the tax differential under GST. **In our opinion, BRITANNIA, GODREJCP, MARICO, EMAMILTD, HINDUNILVR and COLPAL will be the biggest beneficiaries of GST in the longer run.**

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