Management discussion **and analysis**

Senior management team

Standing (L to R): Rana Banerjee, Vivek Dhir, Madan Pandey, N H Bhansali, Venkata Rao Damera, Dhiraj Agarwal, Mohan Panchabhai, Nihar Ranjan Ghosh

Sitting (L to R): Punita Kalra, Dr CK Katiyar

Global economic overview

In 2017, a decade after the global economy spiralled into a meltdown, a revival is visible. Consider the realities: Every major economy is expanding, a wave of growth is creating jobs and enhancing prosperity. This reality is marked by ongoing growth in the eurozone, some growth in Japan, a revival in China and improving conditions in Russia and Brazil leading to an estimated 3.7% growth in the global economy in 2017, a good 60 bps higher than the previous year.

Crude oil prices increased in 2017, despite a further rebound in American rig counts and growing efficiency gains in shale oil production. In 2017, oil prices recovered in June and hovered ~US$60 per barrel. Metal prices rose sharply, on the back of China's strong demand-supply restrictions. Agricultural commodity prices, which stabilised in 2017, are anticipated to make only marginal gains in 2018 as global stocks remain at multi-year highs.

Global economic growth in the past five years

Year	2014	2015	2016	2017 (E)	2018 (F)	2019 (F)
Real GDP Growth (%)	3.5	3.2	3.1	3.7	3.9	3.0

Source: World Economic Outlook, January 2018 (e: estimated f: forecasted)

The US: The world's largest economy entered its ninth straight year of growth in 2017 (2.3% compared to 1.6% in 2016) catalysed by a government spending spillover coupled with US$1.5 trillion worth of tax cuts, stimulating investments. Private consumption growth continued to be robust despite modest real income gains and moderate wage growth, as personal savings rate declined.

Eurozone: The eurozone experienced the upside arising out of cheap money provided by the Central Bank. In 2017, Euro zone is estimated to grow 2.4% compared to 1.8% in 2016, the broad-based growth visible in all eurozone economies and sectors. Unemployment levels declined in almost all economies. *(Source: WEO January 2018)*

China: China's growth estimated at 6.8% in 2017 up from a 26-year (6.7%) low in 2016, and beating the government's target of 6.5%. China witnessed in Q4 a growth rate of 6.8%, which remain unchanged from Q3. This was a result of tighter monetary and financial policies, as well as slower real estate and infrastructure investments. Consumption should outpace investment and demand for services should remain strong (52% of economic output). China's exports rose by 6.9% from the previous year to $188.98 billion in October 2017. In 2018, the Chinese economy is projected to grow at a rate of 6.6%. *(Source: WEO, NBS data)*

Emerging Asia: The GDP of emerging Asian nations is estimated at 6.4% in 2017, unchanged from 2016, even as growth in ASEAN and China is steeper following trade rebound and domestic consumption; India's growth is expected to nudge downward as a result of taxation and monetary reforms. The region is being transformed by technologies and the internet of things, strengthening the digital economy. Cambodia, Laos and Myanmar are projected to grow the fastest in the ASEAN, while Philippines and Vietnam are expected to lead growth in the ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand and Vietnam). The region is being driven by increasing infrastructural spendings and stabilising economies.

GCC: Being oil economies, GCC countries have been deeply affected by the recent oil price drop (~60% since 2013), causing macroeconomic instabilities that have hindered job creation and slowed growth. The GDP growth across the region remained subdued at 1.8% in 2017 despite efforts to boost the non-oil private sector economic activities amid a plethora of fiscal consolidation measures. *(Source: World Bank)*

Emami's corporate office, Kolkata

Russia: The economy exited a two-year long recession, thanks to an effective governmental policy response and deployment of robust buffers. In 2017, Russia was estimated to grow at a rate of 1.9% following a negative growth of 0.6% in 2016. In 2018, Russia's GDP growth is projected to stay at 1.8%. *(Source: MOMR)*

Brazil: In 2017, Brazil estimatedly grew at 1.1% following a deceleration of 3.5% in 2016. Improving demand, higher commodity prices and robust agricultural output boosted overseas sales in Q3.

Outlook

The outlook for advanced economies has improved, notably in the eurozone, but in many countries inflation remains weak, indicating that prospects of GDP growth per capita are being held back by weak productivity levels and rising dependency ratios. Prospects for many emerging markets and developing economies in sub-Saharan Africa, the Middle East, and Latin America remain lacklustre, with stagnating per capita incomes. Fuel exporters have been hit hard by the protracted adjustment to lower commodity revenues. Global growth forecasts for 2018 and 2019 have been revised upward by 20 bps to 3.9%, reflecting improved momentum and impact of tax policy changes in the US. *(Source: WEO, IMF)*

Indian economic overview

After registering a GDP growth of >7% for the third successive year in FY17, the Indian economy headed for slower growth (estimated 6.7%) in FY18. This was lower than the range (6.75%) projected based on recent developments. Nevertheless, GDP growth averaged 7.3% for the period between FY15 and FY18, the highest among major economies. This growth was accompanied by lower inflation, improved current account balance and reduction in the fiscal deficit-to-GDP ratio. In addition to GST introduction, the year was marked by significant steps being taken towards resolving problems associated with the rising NPA levels and FDI liberalisation, among others. Export growth strengthened in FY18 with foreign exchange reserves growing to US$ 414 billion as on 12th January 2018. Average crude oil prices rose by ~14% (mid-January 2018) vis-à-vis FY17. Going by recent trends, average crude oil prices could remain in the vicinity of US$ 56-57 per barrel and rise by 10-15% in FY19. Some of these factors could dampen GDP growth in 2018. Although with global growth likely to improve moderately in 2018, expectations of the GST regime stabilising and investment levels recovering coupled with the decisive structural reforms being undertaken, among others, could escalate growth. Various reforms undertaken by the Government of India improved India's ranking in the World Bank's Ease of Doing Business Index (from 130 in 2017 to 100 in 2018). *(Source: Economic Survey FY18)*

Inflation and monetary policy: Average retail inflation, measured in terms of consumer price index in FY18 (April – December) stood at 3.3%. Average wholesale price index inflation in FY18 (April – December) stood at 2.9% compared to 1.7% in FY17. The RBI cut the repo rate by 25 bps to 6% in August 2017.

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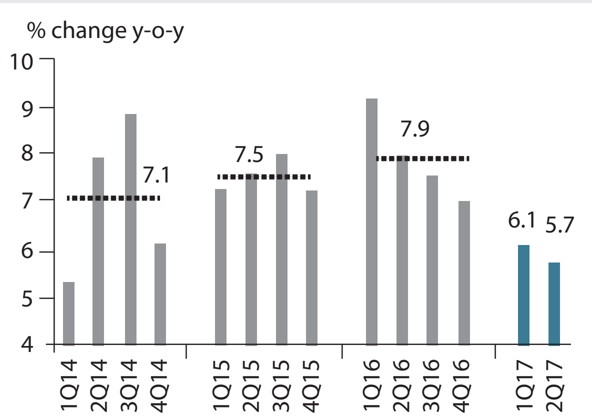
External sector: The current account deficit declined to ~1.8% of the GDP in H1 of FY2018. During April-December 2017, trade deficit increased by 46.4% over the corresponding period of the previous year. During April-December 2017, exports grew by 12.1% to US$ 223.5 billion, while imports increased by 21.8% to US$ 338.4 billion. Private transfer receipts, mostly comprising remittances from Indians abroad, increased by 10% to US$ 33.5 billion in H1 of FY18.

Tax base: The number of indirect taxpayers in India grew by 50% to 9.8 million unique GST registrants by December 2017. India's internal trade in goods and services (excluding non-GST goods and services) at 60% was substantially higher than the estimates announced in the previous year's economic survey.

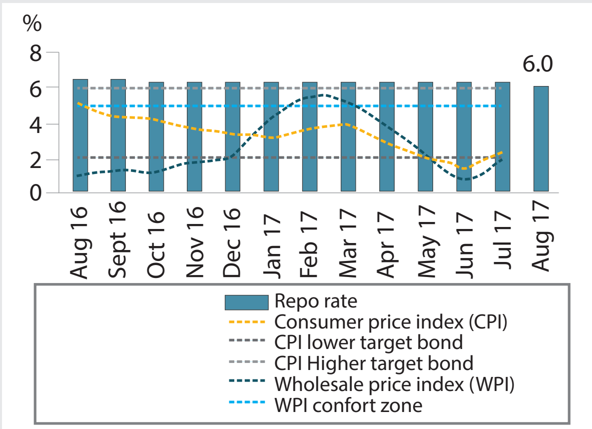
Fiscal deficit: The Indian Government achieved a fiscal deficit of 3.2% of GDP for FY18. The fiscal deficit during April-November 2017 stood at 112% of the budgeted expenditure compared to 85.8% during the corresponding period of the previous year. Revenue and fiscal deficits of states as a percentage of the corresponding budget were lower than the estimated levels for FY18.

India's GDP growth



Sources: National Informatics Centre (NIC) and Haver Analytics.

Indian inflation versus repo rate



Sources: Ministry of Commerce and Industry, Reserve bank of India and Haver Analytics

Financial health indicators

	2013	2014	2015	2016	2017	2018
GDP (US$ trillion)	1.92	2.04	2.11	2.26	2.4	2.6
Real GDP growth (%)	6.6	7.2	7.6	7.6	7.1	7.4
Inflation (%)	10.9	6.4	5.9	5.0	4.9	4.3
Exchange rate against the dollar	58.6	61.0	64.1	67.2	64.6	65.1

(Source: IMF, Euromonitor) (p: projected)

The Indian advantage

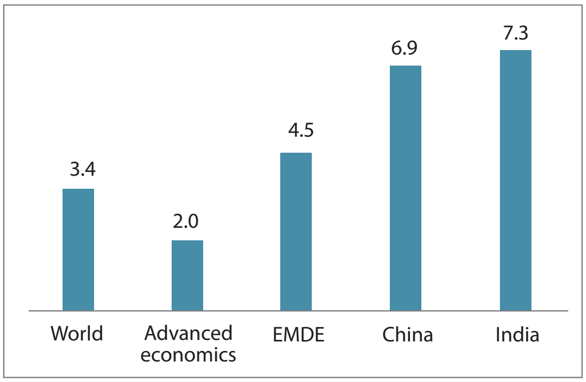
India is the world's seventh-largest economy, sitting between France and Italy and growing faster than any other large economy except China's. By 2050, India's economy is projected to be the world's second-largest (behind China). India is home to 1.34 billion people – 18% of the world's population and expected to overtake China as the world's most populous country by 2024.

The newly-published 2017 edition of the World Economic Forum's Global Competitiveness Report indicates that India now ranks an impressive 23rd in the Global Competitiveness Index for enhanced public spending efficiency. The newly-introduced GST is expected to boost India's tax collection efficiency. Demonetisation increased digital transactions, which are easier to track and tax. Besides, India reported improvements in internet bandwidth per user, mobile phone and broadband subscriptions as well as internet access.

Key government initiatives

- **Bank recapitalisation scheme:** The Central Government announced a capital infusion of ₹2.1 lac crore in public sector banks. The measure entailed a budgetary allocation of ₹76,000 crore by the Central Government, while the remaining amount is to be raised by the sale of recapitalisation bonds. *(Source: KPMG)*
- **Expanding road network:** To boost India's road infrastructure and jobs, the Indian Government announced a ₹6.9 lac crore investment outlay to construct 83,677 kilometres of road network over five years. The ambitious programme is expected to generate 14.2 crore person-day jobs for the country. *(Source: KPMG)*
- **Improving business ecosystem:** The country was ranked at the 100th position in the World Bank's Ease of Doing Business Index in 2018, registering an improvement of 30 places. The jump was a result of the Central Government's pro-reform agenda, comprising the passing of the Insolvency and Bankruptcy Code, simplification of the tax computation and merging of applications for PAN and TAN. In addition, Aadhaar-based identification could help overcome regulatory challenges. *(Source: KPMG)*
- **Goods and Services Tax:** The Government of India overhauled the indirect tax regime and launched the GST in July 2017 to create a unified market. Under this regime, various goods and services are to be taxed as per five slabs (28%, 18%, 12%, 5% and zero tax). To reduce the short-term inflation resulting from the introduction of the GST, the GST Council cut tax rates on more than 250 goods and services by moving them to lower tax slabs. Post-GST implementation, India's tax net expanded, reflected in a 50% increase in unique indirect taxpayers. *(Source: KPMG)*

Average GDP growth between 2014 and 2017 (%)



Sources: Based on IMF's World Economic Outlook Database (October 2017)

India versus China GDP growth (%)

Year	India	China
2013-14	6.6	7.8
2014-15	7.2	7.3
2015-16	7.9	6.9
2016-17	7.1	6.5
2017-18	6.7	6.8

Outlook

In its World Economic Outlook Update, the IMF estimated that the Indian economy would grow by 7.8% in 2019, making it the world's fastest-growing economy in 2018 and 2019. This projection is in line with CSO estimates, which pegged GDP growth at 6.5% during this fiscal. Strong private consumption is expected to support economic activity. Private investment is expected to revive as India's corporate sector adjusts to the GST. Infrastructure spending will also increase and help mitigate the risks faced by private sector Balance Sheets, with help from the RBI.

Over the medium-term, GST is expected to catalyse economic activity and fiscal sustainability by reducing compliance costs across multiple state tax systems, drawing informal activity into the formal sector and expanding the tax base. The recent recapitalisation package for public sector banks announced by the Government of India is expected to resolve banking sector Balance Sheets, enhance credit to the private sector and spur investment. *(Source: IMF, World Bank)*

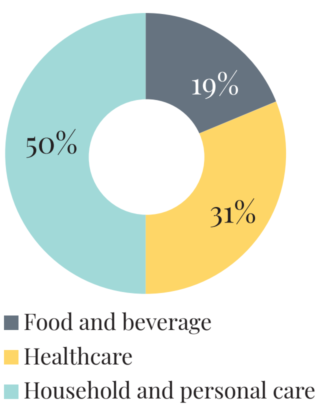
FMCG sector in India

India is at the cusp of a FMCG S-curve with significant growth transpiring over the coming decade. Growth accelerated in 2016 over the previous two years, with 18 of the 22 categories recording an uptick driven by the rural markets.

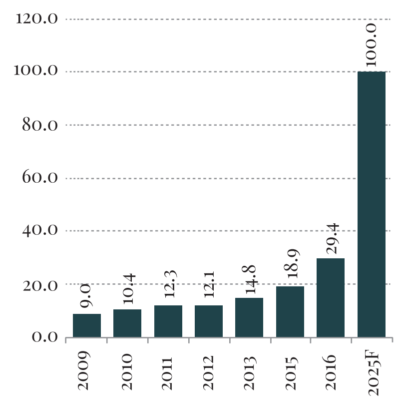
In 2017, India's FMCG industry grew at a snail's pace even as rural growth stood at 1.7x of the urban. The FMCG sector grew from US$ 31.6 billion in 2011 to US$ 49 billion in 2016 (sector expected to grow at a CAGR of 20.6% to US$ 103.7 billion by 2020). The rural market is a key contributor to India's FMCG growth. Consider this: Rural India spent US$26 billion on 'looking better' in 2017, with 64% of spending on apparel and footwear, followed by 23% on personal care and 9% on jewelry.

Online portals are expected to play a key role in helping FMCG companies enter the hinterlands through cheaper and convenient access. Growing awareness, easier access and changing lifestyles are key consumption growth drivers. A focus on agriculture, MSMEs, education, healthcare, infrastructure creation and employment in Union Budget FY19 is expected to catalyse India's FMCG sector. *(Source: CII, Bain & Company, IBEF, Goldman Sachs)*

The Indian FMCG sector



Rural FMCG market (US$ billion)



[Source: IBEF] (f – forecasted)

Michael Porter's five force framework analysis

Threat of substitutes (high)

- Multiple brands
- Narrow product differentiation under different brands
- Aggressive price wars

Bargaining power of suppliers (low)

- Larger FMCG companies are able to dictate the price through local sourcing from a fragmented group of key commodity suppliers

Competitive rivalry (high)

- Private label brands by retailers are priced at a discount limiting competition from weak brands
- Highly fragmented industry with multiple MNCs entering the market

Bargaining power of buyers (high)

- Low switching cost reduced brand loyalty
- Strong influence of marketing strategies
- Availability of me-too or alternatives

Threat of new entrants (medium)

- Substantial investments required in setting up distribution network and promoting brands
- Aggressive spending on advertisements

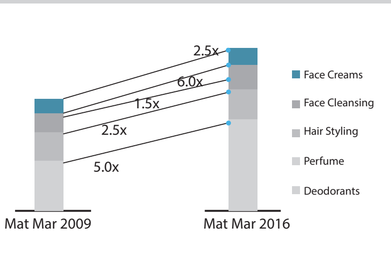
Beauty and personal care segment

The beauty and personal care segment is one of the fastest-growing retail segments in India. The Indian market, traditionally a stronghold of a few major players, has witnessed a number of global entrants and the emergence of several new brands in the last two decades. The industry is dynamic, attractive, innovative and fast-paced. Shorter life cycles, varying climatic conditions and changing trends are inspiring manufacturing, packaging and marketing innovations. The domestic market for personal care products is projected to grow at a CAGR of ~22% between 2017 and 2020. Currently, India accounts for a share of >1% of the total global personal care, cosmetics and cosmeceutical market and is expected to grow significantly. *(Source: ASSOCHAM)*

Growth drivers

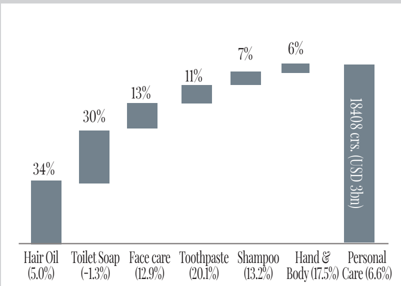
- **Bigger population, stronger income and higher demand:** The country is reporting an annual population growth of 1.1% and is expected to emerge as the most populous country in the world by 2024. Nearly half of India's population is under the age of 25 and two-thirds are less than 35. India is expected to have the world's largest workforce by 2027, with a billion people aged between 15 and 64. The country is witnessing strong growth in per capita incomes, increasing from US$945.9 in FY12 to US$1,538.5 in FY17. The IMF expects nominal per capita incomes to grow at a CAGR of 4.94% between 2010 and 2019. With the population increasing and per capita incomes growing, consumer demand is expected to grow exponentially in the coming years.
- **Demand for specialised products:** Data suggests that there is a disproportionate focus on the face (excluding the staple fare of toilet soaps) in the personal care category. Hair and face care products dominate >50% the market. Growth is now being fuelled by products catering to body care: specialised dermatological applications, moisturisers, and specialised facial applications (face washes and lip balms). *(Source: Nielsen)*
- **The 'other' segment:** The beauty industry was largely woven around women users, a reality that is transforming with the emergence of the male grooming segment. The sale of men's face creams has doubled while the use of face cleansing products among men surged by 60x between 2009 and 2016. Growth in the category is driven by a growing consumer confidence and career competitiveness levels. *(Source: Nielsen)*
- **The GST game-changer:** The GST has been a game-changer for the Indian economy and the FMCG sector in particular. In the pre-GST period, FMCG products were taxed at 22-24%. Following the implementation of the GST, this declined to 5-18%. Logistics expenses declined from 2-7% of the total cost to 1.5% (with input tax credit benefits). The earlier system required FMCG companies to set up warehouses in low-tax regions to capitalise on the different tax rates across states. Following the implementation of a single tax system, companies can build warehouses at strategic locations to rationalise logistics cost and turnaround times. Besides, anti-profiteering provisions state that any reduction in the rate of tax or any supply of goods or services or the benefit of input tax credit shall be passed through a commensurate reduction in prices. *(Source: IBEF)*
- **Ayurveda to the fore:** The AYUSH Ministry expects a 3x increase in the ayurvedic products market size – from US$2.5 billion currently to US$8 billion by 2022. Sales of personal care products made of natural, herbal and ayurvedic ingredients, the so-called 'natural' category, are growing by 1.7x (as fast as the overall market). The category comprises 41% of the Indian personal care products market, valued at ₹18,500 crore. Ayurvedic products reach 77% of Indian homes (69%, two years ago). The growth is being driven by 'rest of urban' towns comprising Tier-II and III cities. The category grew by 9% in value and 8.4% in the metros. *(Source: Nielsen)*
- **Increasing R&D activities:** Large FMCG players are investing in R&D to bring out innovative cosmetics and cosmeceuticals like hypoallergenic creams with minimal health impact. Cosmeceuticals generally enjoy lower pesticide residues, making them an attractive choice for consumers. *(Source: ASSOCHAM)*

Male grooming segment



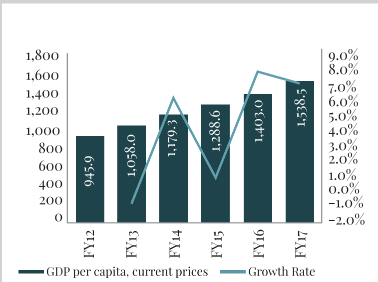
[Source: Nielsen]

Ayurvedic sector – category-wise breakdown



[Source: Nielsen]

India's nominal per capita income (US$)



[Source: IBEF]

Growing rural prosperity

• **Wages:** The growth in nominal rural wages remained stable at 6-6.5% in FY17 and the first four months of FY18 owing to a sharp fall in inflation and real rural wages. After remaining flat in H1 FY17, growth improved to 3.3% in H2 FY17 and 4.8% during April-July 2017, the fastest in four years. The sustained improvement in real rural wages catalysed rural demand.

• **Direct benefit transfers:** Transfer of governmental subsidies and payments directly into beneficiary bank accounts helped plug systemic leakages. The number of schemes covered under DBT increased from 59 in FY16 to 140 in FY17 and 412 in FY18.

• **MSPs**: The Central Government announced MSPs for *rabi* crops in October 2017. On a simple average basis, MSP hike for *rabi* crops stood at 8.3% for FY18. Although this is lower than the 11.3% hike in FY17, it is higher than the average 7.1% hike across the past five years. Importantly, the MSP for wheat, which is the most-procured *rabi* crop, increased by 6.8% in FY18, the fastest in six years. With the Central Government announcing MSPs around at least 1.5x of farm costs, earnings are expected to strengthen.

• **Farm loan waivers:** A number of State Governments announced farm credit waivers. This is expected to enhance farmer cash flows and rural demand.

Government initiatives

• The Government of India's decision to allow 100%-FDI in online retail of goods and services through the automatic route has provided clarity to the existing e-commerce companies operating in India.

• With the demand for skilled labour growing, the Central Government plans to train 500 million people by 2022, encouraging private entrepreneurs to invest.

• The Government of India drafted a new Consumer Protection Bill simplifying and hastening accessible and affordable redressal of issues.

Budgetary provisions

• Announced a food subsidy at ₹1.69 trillion and fertiliser subsidy of ₹701 billion

• Reduced corporate tax to 25% for companies with a turnover of up to ₹2.5 billion

• Allocated up to ₹11 trillion credit for agriculture

• Increased MSP of all crops to at least 1.5x of production costs

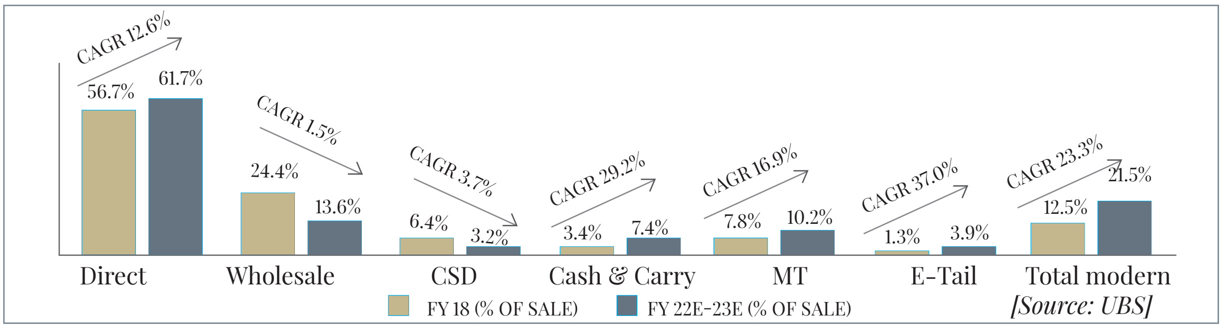
• Liberalised export of agriculture commodities

• Provided 100% tax deduction for the first five years to companies registered as farmer-producer companies (turnover ₹1 billion and above)

The evolution of the distribution channel in India

With the implementation of the demonetisation and the GST, the Indian distribution system is undergoing a structural shift. Consequently, the modern trade segment is expected to grow the fastest, increasing from 12.5% of overall total sales in FY18 to 21.5% in FY22-23. It also indicates that the direct distribution channel will remain the most important (56.7% in FY18 to 61.7% in FY22-23), while the wholesale distribution channel is pegged to decline from 24.4% to 13.6%.

The evolution of the Indian consumer distribution framework



[Source: UBS]