

GST rates broadly in line with expectations

Key points:

- The GST rates for categories like toothpastes, soaps and household insecticides are lower than the existing indirect rates (all these came as expected in the 18% bracket). However, a higher-than-expected rate of 28% has been applied to detergents, shampoos and coffee.
- Among the FMCG companies, the beneficiaries are Colgate, Pidlite and ITC (for cigarette companies, no increase in effective rates is always good news).
- Rates were marginally higher than expectations for Asian Paints, Glaxo Consumer, P&G Hygiene and Page Industries, but all these companies have adequate pricing power to pass on the rate differential.
- The only clear negative was for alcohol companies like United Spirits and United Breweries. Although alcohol is out of the GST ambit, these companies would bear the brunt of higher-than-expected rates on inputs like ENA, glass bottles and barley. In the absence of input tax credit, these GST rates on inputs could have more impact on EBITDA margins if states do not grant offsets or price increases.
- While GST implementation is likely to lead to pipeline issues and some hiccups are expected in the wholesale trade channel in the initial implementation phase, we expect longer-term benefits for many categories due to the likely shift in trade from unorganized to organized segment.
- We have Buy ratings on HUL, ITC, Colgate, Britannia (GST rate announcement on biscuits has been postponed), P&G Hygiene and Emami, and recently downgraded Glaxo Consumer and Nestle to Sell. With likely normal monsoon, implementation of government schemes like Direct Benefits Transfer, an increase in rural outlay by 24% for FY18 under the national budget and the farm loan waiver in UP, we believe rural growth is on the cusp of recovery, especially given the weak base of past three years and likely moderate food inflation.

Key beneficiaries

- **Colgate** (18% GST rate has been fixed for toothpastes, as against earlier indirect tax incidence of ~25%): The lower GST rate levels the playing field versus competitors like Dabur and Patanjali which enjoy tax benefits. The company, being the clear market leader in the category, is the price maker and could choose to (1) pass on benefits to consumers in order to spur growth and market share or (2) spend more on ads and promotion to boost growth.
- **Pidilite** (indirect tax incidence of 22-23% on adhesives has been reduced to 18%): While volume growth is fairly healthy in mid-single-digits, management (which has frequently talked about maintaining margins in a band) could pass on the benefits to some extent in a bid to boost growth further.

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Neutral

- **Dabur** (rates close to earlier indirect tax incidence of 16-17%): Among the key categories, the GST rate on juices was lower than the expected 18%. Rate gap between natural honey at 5% and artificial honey at 18% should fuel demand for Dabur's natural honey. According to management, the disappointment was 12% rate on Ayurvedic products v/s expectation of 5%. Rates for other products were in line with expectations.
- **Emami** was expecting a 12% rate on its Ayurvedic products, which came in line. Same was the case with hair oils.
- **Godrej Consumer:** Domestic sales are only half of GCPL's revenues, and thus, the impact was anyway going to be smaller than peers. For soaps and insecticides (rate of 18%), the impact was positive, while it was negative for hair color (28%). On the premium Crème part of hair color, the company may not have difficulty in passing on higher indirect tax rate; however, our interaction with management indicates that gross margin on hair color is high and the company may choose to absorb the hike.
- **Hindustan Unilever:** It may reap benefits on soaps and toothpastes, but the disappointment was on detergents, coffee and shampoos.
- **ITC:** Rate remains similar to ~60% earlier, and thus the impact is neutral. No increase in rates has historically proved to be a positive for ITC.
- **Jyothy Labs:** From earlier 20% weighted-average, the GST rate was 18% for soaps, household insecticides and Ujala. The company had anticipated an increase in tax for Ujala, and taken an 8% price hike recently. Detergent (at 28%) was a negative surprise, but the decision to pass on the increase in this segment depends on HUL's strategy, according to management.
- **Marico:** The big fear was what rate would be fixed for coconut oil and safflower oil, both of which had indirect tax incidence of only 5-6%. However, with both copra and safflower oil witnessing GST at the lowest slab of 5%, these fears were unfounded. GST rate in VAHO at 18% was in line.
- **Parag Milk Foods:** Witnessed lower-than-expected rate at 12% on cheese, but the same rate on ghee was higher than management's expectations; management thus cited it may require a price increase.

Marginally negative

- **Asian Paints:** From an effective indirect tax rate of 25-26%, the GST rate increased to 28%. However, Asian Paints has one of the best pricing power advantages among consumer peers, and thus passing on the higher rate may not be a problem.
- **Glaxo SmithKline Consumer Healthcare:** It saw a 28% rate for malt extracts, as against ~24% earlier. Here again, management has adequate pricing power to pass on, but whether it chooses to do so in an era for abysmal volumes and market share loss remains to be seen.
- **P&G Hygiene and Healthcare** witnessed a 12% GST on sanitary napkins (69% of its segmental sales), as against 7-8% indirect tax rate earlier. While there has been no separate rate shared for its Vicks medicated lozenges or cough drops, even if we apply 28% for confectionaries, the rate is marginally higher than previously. P&G is the dominant market leader in both its key categories and has adequate pricing power to pass on rate increases.

- **Page Industries:** While prima facie the increase under GST to 18% for branded apparels may appear to be a negative, it was in line with expectations (although management was hoping for 12%). Page has huge pricing power in its key brands Jockey and Speedo; it also has the advantage of being a small part of the consumer apparel basket, which means that price increases are less likely to bother customers.

Negative

- **United Breweries:** Rate for malted barley has been fixed at 18% v/s management's expectation of 12%. Since beer is out of the ambit of GST, there would not be an input tax credit. A higher rate on barley thus will have a higher impact on EBITDA of companies if states refuse to provide offsets or price increases. Management said that there is no clarity yet on GST on used bottles or abatement on service tax on freight.
- **United Spirits:** Rate for ENA as well as glass bottles has been fixed at 18% v/s expectation of 12%. Since spirits is out of the ambit of GST, there would not be an input tax credit. A higher rate on ENA and glass bottles thus has a higher impact on EBITDA of companies if states refuse to provide offsets or price increases.

Exhibit 1: Company-wise impact of GST

Company	Effective indirect tax incidence earlier	GST rate	Impact	Comment
Asian Paints	25%-26%	28%	Marginally negative	Company has adequate pricing power to pass on the higher rate.
Britannia Inds.	14-15%	Announcement of rate on biscuits postponed to next month	Yet to be disclosed	Yet to be disclosed.
Colgate-Palm.	25%	18%	Positive	Likely to be passed either through price action or through adspend/promotionspend to boost growth.
Dabur India	16-17% on average	Among key products GST rates on toothpaste is 18%, juices at 12%, natural honey at 5%, mustard oil at 5%, other hair oils at 18% and insecticides at 18%	Neutral	Rate on juices was lower than fears of 18%. Rate between natural honey at 5% and artificial honey at 18% should fuel demand for Dabur honey. Disappointment was 12% GST on Ayurvedic products versus expectation of 5%. Other products were in line with expectations and earlier rates.
Emami	Low for Ayurvedic products and 24% for personal products	12% on Ayurvedic products, 18% on oils	Neutral	
Godrej Consumer	23-24%	18% for soaps, 18% for Insecticides, 28% for Hair Colour	Neutral	Domestic sales are only half of GCPLs revenues so impact was anyway going to be smaller than peers. For Soaps and insecticides impact was positive while it was negative for hair colour. On The Crème part of Hair colour the company will have no difficulty in passing on the higher indirect tax rate. Gross margin on hair colour is high and the company may choose to absorb the hike.
GlaxoSmith C H L	~24%	28% on malt extract	Marginally negative	We believe the company will pass on the small differential in indirect tax.
Hind. Unilever	21-24%	Toothpaste 18%, soaps 18%, detergents 28%, tea 5%, instant coffee 28%, icecreams at 18%, noodles 18%, jams 18%, shampoo 28%, deodorants 28%	Neutral	Benefits on soaps and toothpastes compared to earlier rates but disappointment on detergents, coffee and shampoos, which are to be taxed at 28%.
ITC	28% plus cess plus rate per stick	28% plus excise depending on length	Neutral	Incidence of indirect tax remains at ~60% and thus neutral. No increase in rates is historically a positive for ITC
Jyothy Lab.	20% weighted average	Detergents 28%, HI 18%, Ujala 18%, soaps 18%	Neutral	Detergents was a negative surprise at 28% while soaps and HI were lower than current rates. Decision to increase prices in detergents is dependent on HUL, the market leader.
Marico	5-6% in Parachute and Saffola- 14-16% in VAHO	5% rate for Copra and Safflower Oil, 18% for VAHO	Neutral	Fears of higher rate in Copra Oils did not materialize.
P & G Hygiene	7-8% in sanitary napkins, 24% in Vicks	12% for Sanitary Napkins, 28% for confectionaries	Marginally negative	We believe the company will pass on slightly higher rates in both products. There was some discussion of Zero GST on feminine hygiene segment and so from an expectations perspective the announcement was a dampener.
Page Industries	9%	18% rate for branded apparel	Marginally negative	Hope was for 12% rate but came in at 18%. We do not think a brand like Jockey will have a problem passing on this additional cost.
Parag Milk Foods	0% for milk, 5-14% for value added products	Fresh Milk 0%, Curd 0%, UHT milk at 5%, Flavoured milk at 5%, cheese at 12%, ghee 12%, butter 12%	Neutral	Lesser than expected on cheese, in case of ghee rates were higher than current rate and may require 2-3% price increase.
Pidilite Inds.	22-23%	18% rate for adhesives	Positive	The reduction in the duty rates may be passed on to generate volume benefits or may be partially retained to improve margins.
United Breweries	No rate on products as alcohol is out of GST ambit	No rate on products as alcohol is out of GST ambit	Negative	Rate for malted barley has been allotted at 18% as against expectation of 12%. Since beer is out of ambit of GST, there wont be an input tax credit. A higher rate on barley thus has a higher impact on EBITDA if states refuse to give offsets or price increases. There is no clarity yet on GST on used bottles or abatement on service tax on freight.
United Spirits	No rate on products as alcohol is out of GST ambit	No rate on products as alcohol is out of GST ambit	Negative	Rate for ENA as well as glass bottles has been allotted at 18% as against expectation of 12%. Since spirits is out of ambit of GST, there wont be an input tax credit. A higher rate on ENA and glass bottles thus has a higher impact on EBITDA if states refuse to give offsets or price increases.

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