Why should MNC FMCGs enjoy a premium?

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(Stocks of multinational...)

Stocks of multinational firms are top investment picks locally as investors flock to these companies since they boast of professional and clean management, backed by access to advanced technologies and deeper pockets.

A consistent dividend paying track record serves as an incentive for some while others latch on in hope of making a quick buck from potential delisting. With few home-grown firms where strong growth prospects are married to good corporate governance, MNC stocks enjoy a 'scarcity premium' over their rivals due to the low 'free float' or shares available for public trading.

FMCG and pharma companies, apart from some in engineering, form the bulk of multinational firms in India. While MNC stocks in the pharma space have no edge over local firms, those in the FMCG business continue to top domestic peers.But with some home-grown FMCG firms outpacing MNC rivals in recent years, can the lopsided valuation differentials sustain? Should investors be placing bets on Dabur and Emami instead of ColgatePalmolive and HUL?

DOMESTIC JUGGERNAUT

Over the past five to 10 years, homegrown FMCG firms have outpaced MNC firms in revenue and earnings growth. Anand Rathi Institutional Research says in a recent report that domestic FMCG companies' revenues have grown at a compounded annualised rate of 21% over 10 years between fiscal 2005-06 and 2014-15. Profits have grown at 24% CAGR in the same period. During the same period, listed FMCG MNCs have registered a lower 13% registered a lower 13% CAGR in revenue while profits have seen a modest 14% growth rate.Dabur, Emami, Godrej Consumer Products and Marico have also clocked higher earnings growth than their MNC rivals over the past five years, except Britannia Industries.Besides, in the past five to 10 years, domestic FMCG firms' margins have grown faster than those of MNCs. Surprisingly, MNC stock premiums have only widened over this period with the valuation differential between home-grown companies and mul tinationals listed in India has doubled in the past five years, points out domestic brokerage firm Ambit.

P&G Hygiene and Britannia Industries now trade at multiples of 52 and 49 times trailing 12-month earnings. While domestic FMCG stocks also trade at expensive valuations, these are relatively soft.Dabur India and Marico trade at around 40 times trailing earnings.

Experts say such differential cannot be sustained much longer.Ritwik Rai, vice-president, Kotak Securities, says: "There is no reason for the premium to remain this high when domestic firms have per formed better or in line with their MNC counterparts."

He says domestic FMCG firms have displayed far more agility than MNCs and are also open to than MNCs and are also open to a lot of new ideas. "Domestic FMCG companies have grown from single-product companies to multi-product, multi-category fir ms," explains the Anand Rathi Institutional Research report. Product portfo lios have grown from niche offerings such as just chyawanprash to more offerings such as

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skincare products and beverages.

Company	MCAP (₹ cr)	PE	CMP ₹	Return % 1Yr	2Yr	3Yr	5-yr EPS Growth
Godrej Inds.	47,144	28.0	382	28.1	27.1	81.1	13.4
Dabur India	42,833	40.3	268	16.0	112.4	187.2	16.0
Emami	25,707	48.9	1,014	27.4	155.1	213.7	23.4
Marico	23,011	39.0	399	21.0	82.9	189.4	18.5
Godrej Consumer	12,827	42.2	1,258	28.9	85.6	193.7	19.3
Britannia Inds.	172,474	49.1	2,914	79.3	511.0	611.0	46.1
Colgate-Palmolive	34,963	45.6	948	-4.2	42.6	114.8	5.7
GlaxoSmith C H L	25,796	37.7	5,981	6.1	97.0	151.2	NA
Hindustan Unilever	25,154	40.2	797	5.3	52.9	167.5	16.0
P & G Hygiene	18,564	52.4	5,719	0.4	129.7	193.0	14.0

"Better India-consumer connect, innovation, inorganic growth and international forays have been the prime growth drivers for domestic firms. Barring innovation, most domestic firms have been able to leverage the other three 'I's far better than MNCs," adds the report.

But there are some who feel that MNCs will continue to find favour over domestic rivals. Vikas Gupta, executive vice-president-traded markets and investment research, Arthveda Fund Management, believes the sheer predictability of MNC businesses will attract investors. "In domestic firms, there is the possibility of management diversifying into newer lines. But the model of MNCs is cast in stone."

But Rai feels the time is ripe for local FMCG firms to outshine their foreign-owned peers. "These firms have gone through the learning curve and have grown big enough to challenge for a bigger share of the pie," he says. He is positive on Marico, Godrej Consumer Products and ITC, but Dabur India is his top pick given its presence in niche areas where its pricing ability is superior to peers and the competitive intensity is much lower.

Another dampener for MNC loyalists is the issue over rise in royalty payments by these firms to their foreign parents -rising steadily ever since India abolished a limit on royalty payments in 2010.

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