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India

Consumer



Our Tastes of India (ToI) series is an attempt to provide investors an insight into the Indian Consumption story. We would aim to capture different facets of consumption in our coming ToI series along with interesting tales of successful brands and products. The idea of ToI is more to pick up trends based on anecdotes, media reports, channel checks, etc. For investors with a longer-term commitment to Indian equities, we hope some of these insights will translate into profitable investment opportunities

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Patanjali Ayurved 2.0?

Interaction with Mr Deepak Singhal, Chief Strategy Officer

After redefining rules of the game, Patanjali Ayurved (PAL) seems to have set out the next course of its journey, as articulated by Deepak Singhal, Chief Strategy Officer. So, from being a mass-end Ayurvedic firm, the focus is shifting to premiumisation with a slew of launches but differentiated on 'ingredients' as compared to over-priced products from peers. There is also a realisation that current packaging aesthetics need to improve from pure functionality, and the journey has begun already. Distribution is another thrust area and PAL intends to more than double the reach to around 2m traditional outlets, but a striking difference is dedicated shelf space accorded to it even in the general trade, although not a compulsion by management. Isn't this 'Patanjali 2.0' in the making? Seems so to us!

#1: Focus on premiumisation

- ❑ Started as a rather mid-end brand, Patanjali has now upped the ante and premium products are now on its radar (the current focus however continues).
- ❑ Interestingly, management believes that its premiumisation strategy is ingredients-based as against competitors who are simply profiteering or spending recklessly.
- ❑ As a result, while its products are priced in-line with competitors or in some cases maybe at a premium, these are not strictly comparable to others.
- ❑ The company has already launched premium soaps, toothpastes, skin-care products and chocolates while hair colours will be launched soon.

#2: Distribution expansion but a twist

- ❑ The company has already increased its distribution reach four-fold and is currently reaching out to just short of a million traditional outlets...
- ❑ ... and its target is to more than double this to ~2m in the next 12 months.
- ❑ The striking difference from its peers is the dedicated shelf-space accorded to PAL not only in modern trade but also in traditional trade – something unimaginable!
- ❑ A dedicated shelf, we understand, helps to drive more trials as consumers using its popular products also end up trying its newer products, which expands revenues.
- ❑ Dedicated shelf space is however not a pre-condition from management.

#3: Packaging revamp

- ❑ PAL acknowledges the need for a revamp of product packaging across several segments based on frequent consumer feedback.
- ❑ When the company started, the focus was on cost optimisation and, hence, the functionality aspect had greater focus in product packaging.
- ❑ PAL's foray into premium products has also been a driver for a packaging revamp and Patanjali is taking help from professional agencies for several of its products.

#4: Future-ready initiatives

- ❑ HR is an important focus area as the organisation is rapidly growing. The company targets to be an 'employer of choice' within the FMCG space.
- ❑ Management also claims that PAL has already attracted talent from leading FMCG and e-commerce firms across functional lines such as production, sales and R&D.
- ❑ PAL plans to invest >Rs10bn in capex in FY17 and is working on five new locations to set up capacities which would mark its entry into places beyond Haridwar.
- ❑ Another important strategic initiative for the management is to automate the entire supply chain for better visibility and penetration of PAL brands.

Audacious targets but nothing new about that

- ❑ Biscuits contributed Rs2bn in revenues in FY16 which, management says, will rise 5x to Rs10bn in FY17 and there would be series of launches in the portfolio.
- ❑ PAL expects to more than double its oral healthcare portfolio in FY17 which implies a 15% market share in toothpastes in FY17 vs ~8% now, in our understanding.
- ❑ Big investments, particularly at the back end, are underway to expand dairy.
- ❑ The target now is to attain Rs100bn in revenues which would make PAL the number two FMCG in India - well almost (as it would be neck-to-neck with ITC and Nestle).



Q&A with Mr Deepak Singhal, Chief Strategy Officer

Deepak Singhal has an MBA from Kurukshetra University and worked at different organisations like CMIE, Dainik Bhaskar and the Jindal group before he joined PAL in 2014. He currently heads Corporate Strategy along with HR, IT, e-commerce and is responsible for organisational development, IT excellence, business planning, new strategic initiatives, M&A, industry research, competition mapping, etc. He also partners with category and functional teams to proactively identify, develop and drive strategies and initiatives.

Key comments in this note by Mr Singhal

- ❑ In our market research studies, we have found that there is a strong and increasing demand for good quality products at the higher end. The consumer in this space wants some level of exclusivity and for this, he/she is ready to pay a price. At the same time, our research shows that the satisfaction level with the existing products is relatively less which provides a great opportunity.
- ❑ We believe some of the companies were exploiting these premium consumers by selling products at 10x prices by just creating a brand and not offering quality content.
- ❑ The important aspect here also is the ingredients and not the marketing spends. This is in contrast to what Cadbury does which has to endorse these products using big celebrities like Amitabh Bachchan and run extensive campaigns which increases the costs. Our message is: if you want to have chocolate, why not have healthy ones?
- ❑ We agree there were issues in the past related to attractiveness and ease of use for packaging of some of Patanjali's products. However, when we started, our idea was to save as much cost as possible and to work on just the packaging functionality. And we realised that our competition was way ahead of us in this area.
- ❑ We plan to enter the dairy segment in a big way and develop it as a full-fledged vertical. We would be having a wide bouquet of dairy products.
- ❑ In biscuits, we are planning a lot of exciting new launches. There would be an entirely new range which would shake the market and there would be unprecedented level of innovations – something that the biscuit market may have never seen, thus far. In some cases, we would actually play the role of market creation. All these initiatives are expected to increase our revenues from biscuits by 5x to Rs10bn from Rs2bn currently.
- ❑ We are confident that we can become the biggest face-wash player by next year.
- ❑ We have hired a lot of people from several leading FMCG firms and even e-commerce and other modern trade companies. We are also planning to recruit from premier institutions like IIMs and IITs.
- ❑ I would not be in a position to confirm the quantum of (A&P) spends but this Rs3.5bn number certainly is an overstated figure.
- ❑ We are a family of around 16,000 members (employees – direct and indirect), spread across different functions and verticals.

CLSA

Deepak Singhal

You recently achieved an important milestone of Rs50bn of revenues in FY16. Could you talk about this journey?

We are a people's phenomenon and Patanjali Ayurveda is not just about products. We encompass the entire lifestyle and Patanjali is not just a product brand. It represents something which stands for a healthy lifestyle and revolves around the core of humankind.

We believe in the sense of living for the nation and there needs to be a feeling of making sacrifice. This is difficult but with firm determination and passion, we have been able to do so. Each of our employees follows the core organisational beliefs and ideology of a pure, sacred and healthy life.

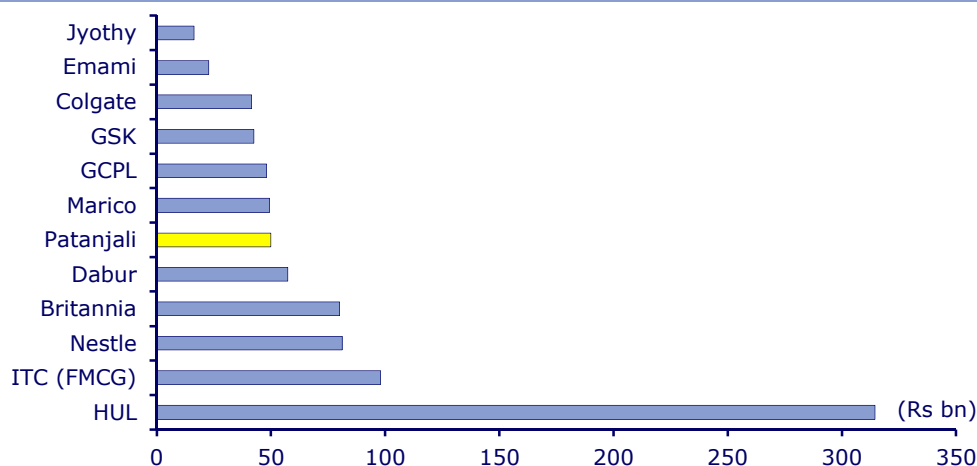
Our products are close to nature, free from any adulteration and hence better than the other products available in the market. We have brought back some of the old traditions from the past. For example, Indians almost stopped consuming *aloe vera* and *amla* (Indian gooseberry) juices which we brought back through our offerings. These products are great for health but people needed to be reminded of these, which is what we have done.

Our objective is also very different. We are not a profit-hungry organisation. We do generate healthy cash flows but a lot of this is ploughed back for society on projects in healthcare, education. We also invest a lot of our resources in R&D to come out with new products as well as improvise the existing ones in terms of further cost and quality effectiveness.

This belief of ours allowed us to hit this important milestone of Rs50bn and we expect steady growth as more and more people pose their faith on us.

Figure 1

PAL is already among the largest FMCG firms in India



Note: Domestic revenues for the companies; Source: Companies' data, CLSA

CLSA

Deepak Singhal

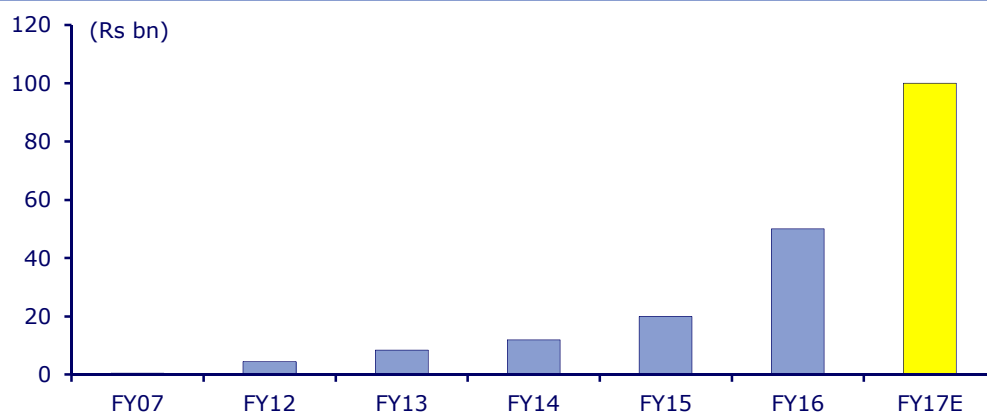
You have been rapidly growing as an organisation and Baba Ramdev has indicated that the company would achieve revenues of Rs100bn in FY17. Could you indicate the key growth drivers and which segments are driving this – is this going to be mainly the new launches?

Yes, we are targeting to achieve over Rs100bn as mentioned by Baba Ramdev. As I mentioned, we are focussed on all the segments and we are seeing strong growth rates across the board.

For example, oral care where we have been an early entrant, the portfolio has grown at a rapid pace and the sales more than doubled in FY16 to achieve over Rs5bn in revenues. Next year, we again expect more than doubling in oral care revenue and there are new launches also to support this kind of growth. Similarly, if you look at biscuits – we did Rs2bn in revenues in FY16 and I think this would go up 5x in FY17 – so Rs10bn is the minimum that we would have from the biscuit portfolio next year.

The above two examples highlight that our new products are doing well and adding to growth but our base business is also doing quite well.

Figure 2

Trend in PAL's revenues over the years

Source: Company data

CLSA

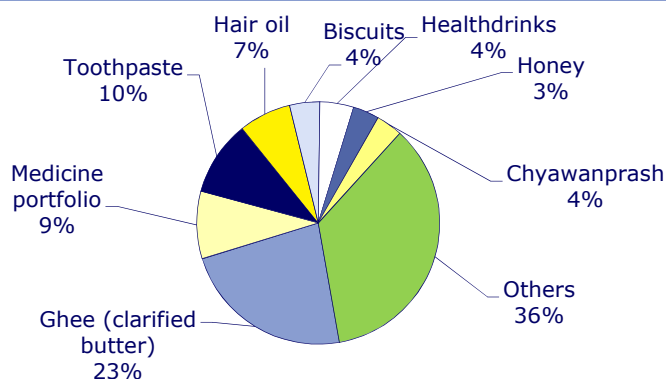
Deepak Singhal

Could you provide the portfolio mix and how different categories are managed, and which part you would invest behind?

We have a fairly diversified portfolio which is spread across cosmetics and personal care, which is around 40%; another 40% is food and beverages; and the remaining 20% is therapeutic.

We have vertical heads for these three businesses who have various sub-portfolios under these. We are investing behind all of these and are quite excited about each of these opportunities and expect strong growth. The proportion of foods is likely to rise further in FY17 and may well be over 45% but our focus is on all three segments and the innovation pipeline is equally strong across.

Figure 3

PAL's revenue mix for FY16

Source: Company data, CLSA calculations

CLSA

Deepak Singhal

One of the important aspects of your growth so far has been the affordable price points across your products. We have however seen launches now at the premium end. Could you provide details on your strategy and products that you have launched at the premium-end?

Let me first say that the so-called premium products from a lot of players in the market need not be superior in quality by itself. This is because there is a lot of cost bundling in these products such as high advertising expenses, premium packaging costs and high supply chain cost for that product.

To me, what makes the product premium is not these cost heads but the ingredients. This is where we are very different – Patanjali for example is trying to differentiate its premium products by using better ingredients and there is a clear science behind these.

So, most of the premium products launched by us are either at prices similar to other competitors' products or have a small premium. And that premium is not because we want to over-charge – in fact, we continue to make nominal profits – it is just our cost of manufacture, which is mainly ingredient cost.

There are several brands in the market currently which include MNCs such as Garnier, L'Oréal and other local players such as VLCC, Shahnaz Husain. While their products are popular, overall efficacy is poor and there is nothing Ayurvedic/herbal about them even while some of these players claim so.

In Ayurvedic FMCG products, there are some basic products which all can use. However, there was a burst of demand in the premium space creating price distortions in the market. Moreover, India over the last decade has become a diverse nation creating different categories of consumers. We believe some of the companies were exploiting these premium consumers by selling products at 10x prices by just creating a brand and not offering quality content.

CLSA

Deepak Singhal

Could you provide details on the products that you have launched or plan to launch in the premium segment and your target consumer?

In our market research studies, we have found that there is strong and increasing demand for good quality products at the higher end. The consumer in this space wants some level of exclusivity and for this, he/she is ready to pay a price. At the same time, our research shows that the satisfaction level with the existing products is relatively less which provides a great opportunity.

Figure 4

PAL's cream beauty soap...



Figure 5

... and Mysore 'super sandal' soap



Source: CLSA

As a result, we are launching premium products in the beauty segment under the 'Saundarya' range and have already started rolling-out products with lot more to come. We are launching Swarn Kanti, which is real gold based cream and would retail at Rs399 for 15gms – while pricing appears premium, I can

confirm it has normalised margins and if one of the competitors were launching this product – the pricing would have been in multiples of that.

Figure 6

Anti-aging cream

Source: CLSA

Figure 7

Gold-based fairness cream

Like all our products, even premium products have a social side. These products are targeted for upper segment and youth but suppliers continue to be farmers and rural population. While urban India would be chief consumers we do expect some level of traction even in rural/semi-urban markets.

We have strong R&D capabilities and can create our formulations and we do plan to roll-out more premium products. But our focus is not only to develop specialised premium products but also improve the mass products along with these. Since we have a huge portfolio at the mass end, you may find us launching a lot more products at the premium end. Regarding launches, there are several products that we are developing in the luxury Ayurveda space. We believe if there is a big opportunity in the premium space, we should be there in it in a big way. However, as of now, we do not have a product-wise strategy for this area. We believe, wherever we find an opportunity, we will be able to create a space for ourselves in it.

Some of the products that we have launched or are close to launch include toothpaste, where we have launched Dant Kanti advanced, or skin cream, under Saundarya. Hair colour is another new segment which we would be venturing into soon. This would be a completely natural colour, having no ammonia and paraphenylenediamine (PPD). Some of the popular organic herbs in this product include *heena*, *khadir*, *manjistha rakta*, *manjupalm amla*, *bhringraj*, and *shikakai*. The colour, as of now, will be available in three variants and can be used by both men and women. These colours would be available in a complete kit including gloves and colour brush.

Figure 8

PAL set to foray into hair colour segment

Source: CLSA

Figure 9

PAL's premium toothpaste, Patanjali Advanced

CLSA

Deepak Singhal

You started with a focus on Ayurvedic products but we recently saw the launch of premium chocolates. How does this category fit into your ideology?

To begin with – we have positioned these products as a healthy alternative compared to what is available in the market. For example, we have launched cocoa-based energy bars as premium products, or our noodles are *atta*-based. So, in cocoa-based, we have not positioned them the way Cadbury does, but as a healthy alternative to existing chocolates. This strategy while reducing competitive pressure for us, it also provides a better alternative to consumers. The important aspect here is also the ingredients and not the marketing spends. This is in contrast to what Cadbury does which has to endorse these products using big celebrities like Amitabh Bachchan and run extensive campaigns which increases the costs. Our message is: if you want to have chocolate, why not have healthy ones?

Figure 10

Atta noodles

Source: CLSA

Figure 11

"Healthy alternative" to chocolates...

Figure 12

... as well as energy bars segment

CLSA

Deepak Singhal

Your packaging historically is quite functional but that seems to be changing now with contemporary packaging in the case of toothpaste. Could you provide some insights into this?

We agree there were issues in the past related to attractiveness and ease of use for packaging of some of Patanjali's products. However, when we started, our idea was to save as much costs as possible and to work on just functionality. And we realised that the competition was ahead of us in this area.

However, we have learnt from the experience and in recent times, we have been focusing product-by-product in this area and have caught up on this. Having said that, our focus would still be to keep costs under tight control and we need to think and work innovatively to attain this. We have roped in some of the best industry experts which are working with us in this area.

Also, we are cognisant of the fact that premium products would require packaging innovation. We target to do so and have been using value-added packaging material yet keeping unnecessary wastage at bay.

Figure 13

Old Patanjali toothpaste pack

Figure 14

Revamped Patanjali toothpaste pack

Source: Company, CLSA

CLSA
Deepak Singhal

What are your plans for the dairy segment?

We plan to enter the dairy segment in a big way and develop it as a full-fledged vertical. We would be having a wide bouquet of dairy products. We have already launched our dairy whitener and will soon be launching other products such as buttermilk and cheese. Our buttermilk would be in a tetra pack so we would not compromise on technology for sure. Moreover, as our focus always remains on quality, we plan to have a complete end-to-end setup. This would include a proper R&D centre for breeding of dairy animals, quality control set-up, etc. We already have a milk processing unit in Maharashtra towards this.

Figure 15

Patanjali Ghee at modern trade

Figure 16

Patanjali milk powder

Source: Company, CLSA

CLSA
Deepak Singhal

There are some media articles about a foray into animal feed – could you elaborate on this – would it be under Patanjali Ayurved?

No, it would not be a part of this company but would come under another entity, 'Patanjali Yogpeeth'. While I am not the official spokesperson for that entity but this comes as a part of our corporate social responsibility programme. Under this, we would be undertaking contract farming activities with farmers on their land, which would be used for cultivating high-quality animal fodder. Acharya Balkrishnaji has a special interest in this project and is keen to take this project pan-India.

CLSA
Deepak Singhal

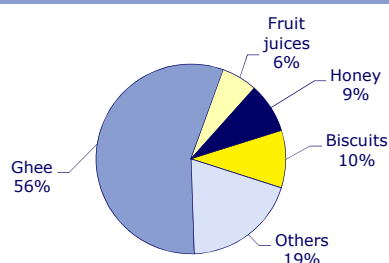
You mentioned that biscuit revenues would be 5x in FY17 – how do you plan to do that in just one single year?

In biscuits, we are planning a lot of exciting new launches. There would be an entirely new range which would shake the market and there would be an unprecedented level of innovations – something that the biscuit market may have never seen, thus far. In some cases, we would actually play the role of market creation.

Our key premise is – the current biscuit category currently lacks awareness. Consumers have not been paying attention to the ingredients of biscuits and just use them as munchies in between meals. However, just like what we have done in energy bars in a limited, we would do that at a much bigger level in biscuits because of the market size and level of differentiation which is possible in the category.

We plan to create a lot of consumer awareness in this segment. This would also help us to position our biscuits not just as munchies, but also as dietary supplements, meal replacers, etc. You will soon start seeing some intense activity in this space from our end. All these initiatives are expected to increase our revenues from biscuits by 5x to Rs10bn from Rs2bn currently.

Figure 17

Break-up of PAL's food portfolio

Source: Company, CLSA

Figure 18

PAL biscuits in modern trade

CLSA

Deepak Singhal

Could you also elaborate on some of the variants that you plan in the current portfolio?

There are a lot of things that we are working on in the existing portfolio and I may not be able to share these with you at this stage. Still, I will share some of the instances where the launches are imminent. For example, in juices, we plan to have unique flavours such as Apricot and Sea Thorn. Again, our focus on healthy alternatives would continue to drive growth in the segment for us. Similarly, we have lined up some serious initiatives in the soaps segment. We would be soon launching new and interesting products across the range. This could be really a big segment for us in coming months. Again, some launches would be fairly soon in the marketplace. We would also be launching two more variants – Classic and *Chatpatta* in our noodles.

In the face wash category, we would be launching new products and also undertake some massive marketing initiatives. We are confident that we can become the biggest face-wash player by next year. Also, our aloe vera gel product is expected to gain huge popularity and we expect a strong increase in sales of this product this year. We have a strong R&D capability to drive this growth.

Figure 19

R&D centre

Source: Company, CLSA

Figure 20

Product testing facility

CLSA

Deepak Singhal

You are increasingly becoming a complex organisation with presence across several categories. How do you approach the HR-related policies. Have you been able to target talent from other FMCG companies?

We have hired a lot of people from several leading FMCG firms and even e-commerce and other modern trade companies. We are also planning to recruit from premier institutions like IIMs and IITs. We are taking several initiatives on the HR front as well.

We believe these initiatives are structurally very essential if one wants to build a long-term sustainable organisation. As an organisation, we are focusing on several HR-related hygiene issues, employee motivation, employee friendliness, career progression, responsibility matrix, 360 degree scorecard and other soft issues. Going forward, we would be positioning ourselves as the Employer of Choice in the consumer space. Attracting the best talent will help us to further drive growth and also fortify our position in the industry.

CLSA

Deepak Singhal

Could you elaborate on your expansion plans?

We plan to set up at least six more centres across India this year. We are planning units in Vidharbha in Maharashtra, Bundelkhand in Uttar Pradesh, and in Madhya Pradesh. Besides we are also going digital. We have earmarked capex of at least Rs10bn for expansion this year. We also plan to invest Rs1.5bn in research and development to further develop new products and enhance the quality of existing products. Most of the cash would come from our internal accruals and a little bit from bank funding.

CLSA

Deepak Singhal

One of the most important things in the consumer sector is A&P spend. You were initially averse to this but the media indicates that between Dec-16 and Mar-16, you have spent nearly Rs3.5bn. Could you elaborate on this?

Every company goes through a lifecycle and that is the case for us also. When we started, word of mouth played a very important role in our business and that is the case today also, and that we believe is most sustainable. Till mid-2015, we had not done any business scale oriented advertising and even our packs were quite simple and devoid of any catchy lines. For example, in case of biscuits, we just mentioned "no maida, no trans fats and no cholesterol".

There is a rub-off on other brands given the same mother brand. The negligible A&P spends allow us to price our products lower than competitors.

We have however expanded our distribution rapidly in the past 12 months and, hence, started to advertise in a big manner. We started advertising in the print media and expanded to television. However, like our products, our

ads are also quite unique as we attempt to stress on the functional aspect of the product in a market – this is quite different from our peers where brands try to outshine each other. A simple example of this is our advertisement for cow *ghee*, where we are highlighting how cow *ghee* is good for health.

I would not be in a position to confirm the quantum of spends but this Rs3.5bn number certainly is an overstated figure.

CLSA

Deepak Singhal

What are your views on exports?

We do export from India but it is not a big focus area at the moment. For example, we export honey to the US in a big way. We however believe that India offers us tremendous opportunity and we do not want the Indian consumer to lose out at the cost of exports. Our first responsibility is towards the Indian consumer and that is what we are working for at this moment. We would however scale up exports also in a big way and you will see us selling a lot of medicines and natural products but in a phased manner.

CLSA

Deepak Singhal

Could you provide an overview of your distribution network?

We have currently around 10,000 outlets which are exclusive and classified as Patanjali Chikitsalaya and Patanjali Arogya Kendra.

Figure 21

Patanjali Arogya Kendra



Figure 22

Exclusive Patanjali store



Source: CLSA

On the modern trade, we have been indirectly present in this channel through our distributors. The deal that we have signed with the Future group essentially ensures that our products are available in a more structured manner and the company would be directly supplying to these retailers.

Figure 23

PAL dedicated shelf in modern trade...



Figure 24

... products also placed with others



Source: CLSA

We are now serious about our expansion in the general trade. We are already appointing distributors who would distribute the products to general trade in a systematic manner. There would be an exponential rise in our distribution in the next few years which would be there in both the urban as well as rural areas. We are currently present in less than 1m outlets which we would

expand to around 2m outlets in the next few months. We would have a network of 4,000 distributors.

Figure 25

Patanjali products...



Source: CLSA

Figure 26

... in grocery channels (general trade)



Figure 27

Retailers giving...



Source: CLSA

Figure 28

... separate shelf space to PAL



CLSA

Deepak Singhal

Could you share some details on the number of employees that you have and the broad policies?

We are a family of around 16,000 members, spread across different functions and verticals. We have a large and qualified team in place at each level having a strong technical and professional background. We pay our employees well and certainly in line with the market. However, there is an intangible factor that also plays out here which is the passion to make great products in addition to work for the society. We provide a challenging environment to our employees and provide an environment that allows freedom to express. Innovation is given a high priority in the organisation. Service to consumer is the motto with which we carry out our work and employee motivation is aligned to the same. Since we have a high focus on the consumer, training becomes an integral part of what we do. Safety also is a very important part of what we do.

CLSA

Deepak Singhal

What is the reaction of competitors to your rapid growth and success?

That probably you should be asking them. Still, I think, there is a lot of curiosity that our competitors have about what we are trying to do, which categories we are doing well in. I think we have also brought Ayurveda on the radar of lots of our competitors and we are very pleased about it. At the end, we want consumers to win.

CLSA

Deepak Singhal

Could you elaborate on the technology that you employ given the huge scale you have already achieved?

We employ modern technology and have sophisticated technology. Our entire process is integrated on the SAP platform so that we are future-ready as we aggressively build and expand newer categories.

CLSA

Deepak Singhal

Do you enjoy any fiscal benefits?

Yes, we do have some selective tax exemption in India which would last for another couple of years under the food park scheme of the Government of India.

CLSA

Deepak Singhal

Since you also head organisation development, could you elaborate on what it encompasses?

We realise the need for organisational development and future readiness in line with the scaling up of business volumes and we are very much in line with the initiatives required for the purpose. Besides corporate strategic initiatives, I, being patron of the Corporate HR & IT functions, have simultaneously taken up the task with equal zest and continuously work on strengthening the organisational structure in terms of best practices, procedures and policies to have them well in place.

Companies mentioned

Britannia Industries (N-R)
Colgate India (CLGT IB - RS844.0 - SELL)
Dabur (DABUR IS - RS281.3 - BUY)
Emami (N-R)
Godrej Consumer (GCPL IB - RS1,335.8 - OUTPERFORM)
GSK Consumer (SKB IS - RS5,867.2 - BUY)
Hindustan Unilever (HUVR IB - RS853.6 - UNDERPERFORM)
ITC (ITC IB - RS312.8 - BUY)
Jindal Steel & Power (N-R)
Jyothy Laboratories (N-R)
L'Oreal (N-R)
Marico (MRCO IB - RS250.8 - UNDERPERFORM)
Nestle India (NEST IB - RS5,554.4 - UNDERPERFORM)
SAP (N-R)

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