Blog

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Indian Consumer Sector - Strong long term growth prospects

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Indian Consumer Sector - Strong long term growth prospects

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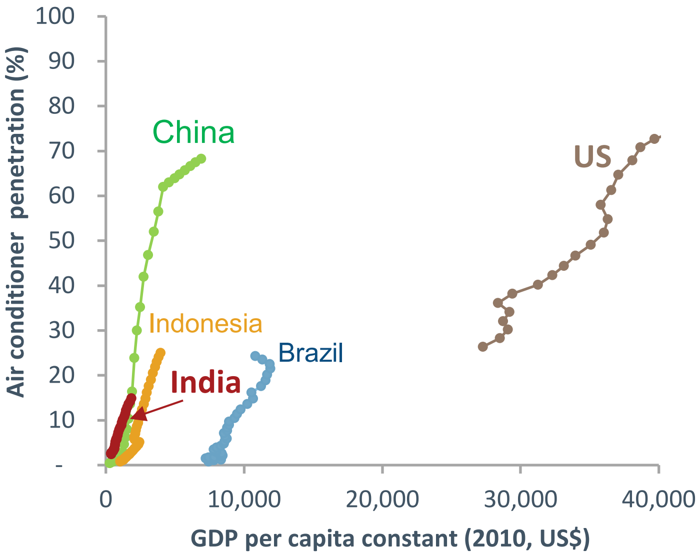
The consumer sector in India is being powered by twin engines of growth. First is structural growth, as ownership of goods and services, which is among the lowest in Asia, increases with rising incomes. Second is the expansion of the organized sector as consumer preferences shift towards better quality, branded products. In addition, the government's focus on indigenous manufacturing over imports for employment generation and deficit reduction, is benefiting the domestic players. However, making money from this trend will depend on being able to pick the best companies within higher growth sub-segments.

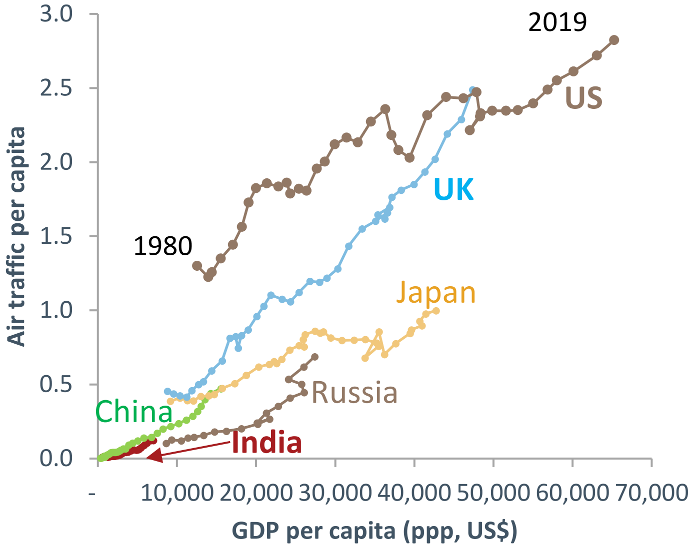
In a country that is already home to the world's second largest population and that is expected to add 200million working age-people (20-64 years) to its workforce by 2050 according to United Nation's World Population Prospects data, per capita income levels are growing at a fast pace. From about US$1600 in 2015, India's per capita income rose to US$2,000 in 2018, according to World Economic Outlook (WEO) Database, 2021. Despite a significant COVID disruption in 2020-21, as per WEO data the per capita income is expected to bounce back and rise to over US$2700 in 2025.

This rapid growth in income level means that a substantial number of Indian households are joining the middle and the upper middle class. In the process, many of them are buying their first air conditioners, washing machines, water heaters and vacuum cleaners, while others are gaining access to more aspirational products such as luxury cars. There is also a corresponding increase in demand for consumer services, such as travel, food & beverages, entertainment, and hotels.

For instance, the below charts show that the penetration of air conditions and air travel has been growing fast but is far behind even the other emerging economies of the world.

Chart 1: India's AC penetration and passenger traffic per capita - long runway for growth ahead





Source: Bernstein. IATA Economics, IMF, World Bank

It is important to invest in the best companies

While this broader trend of rising demand benefits all consumer companies, emerging markets have a mix of successful businesses and those which will not been able to survive due to bad business models or bad managements. Hence, while it is important focus on the most profitable segments, it is even more crucial to back the best quality companies within these segments to generate sustainable long-term returns. We at Fidelity use our experience and understanding of the domestic Indian market together with our experience of investing in other emerging markets that are ahead of India in the development curve to narrow down on the most profitable investment opportunities available within India.

In this blog, we focus on some fast-growing consumer segments and look at the companies best placed to benefit from these trends.

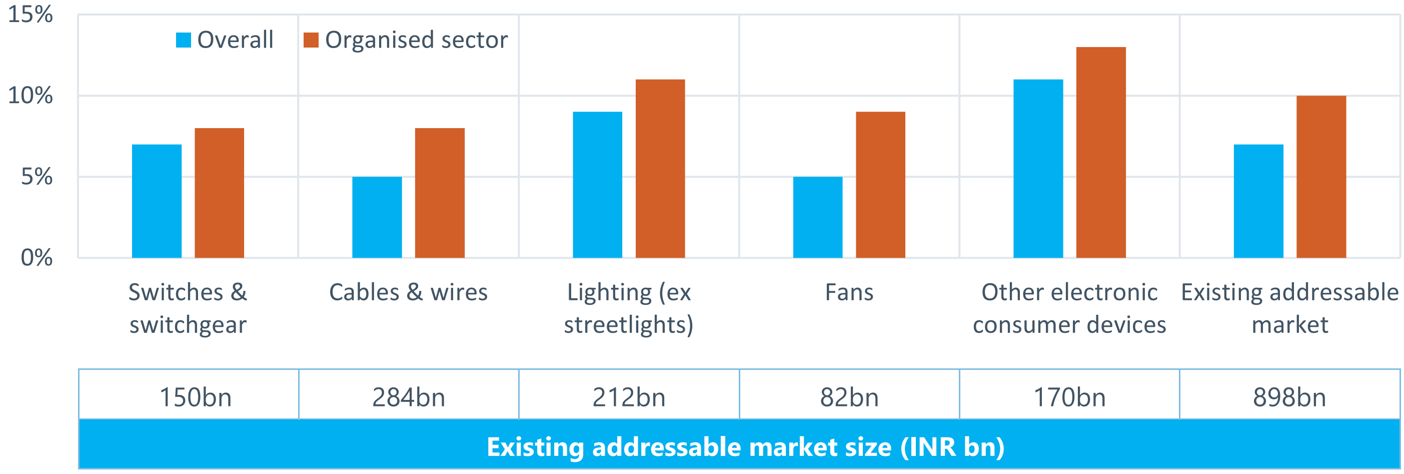
1. Consumer appliances and white goods

New home sales play a key role in driving demand for consumer appliances and white goods. Notably, India's home affordability, a measure of house prices versus income levels, has improved substantially in the last few years due to increasing income levels, lower interest rates and steady home prices. This, coupled with rising aspiration levels and willingness to spend more on home improvement, has been a positive driver for the consumer appliances and white goods industry.

a. Consumer appliances (fans, lights, air-coolers and other small appliances)

Similar to our experience in other emerging markets such as China, the consumer appliances industry in India is also seeing a steady shift towards higher end products. This is because most of consumer appliances demand is driven by replacements, and customers tend to upgrade their existing products when they buy a new one. This leads to an increase in sales for the organized sector that offers better quality, branded and more premium categories of products.

Chart 2: Stronger growth for the organized sector and premium product categories



*Source: Euromonitor, Polycab Draft Red Herring Prospectus. * considered only addressable part of markets. CAGR is cumulative annual growth rate*

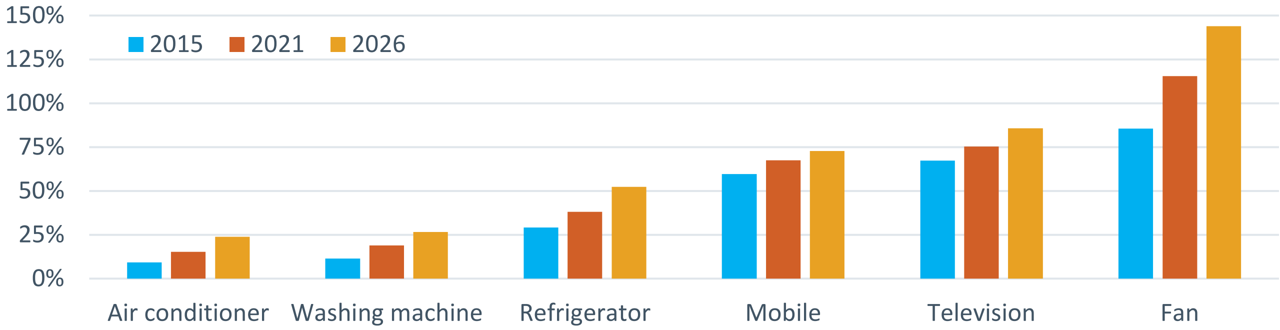
Hence, while the US$12billion consumer appliance market in India has grown 7%-8% over last six years, the organized segment has been gaining market share and growing in double digits. Notably, the larger companies within this sector grow faster than the market, driven by increasing formalization, higher premiumization, and product innovation.

b. White goods (air conditioners, refrigerators, washing machines and TVs)

The US$15 billion white goods market in India has been growing at 10-12% cumulative annual growth rate (CAGR) in the last five years. Over the last decade we have seen penetration levels for products such as mobile phones and televisions improve significantly, which we believe happened due to growing affluence, availability of right-priced products and ease of financing.

Similar tailwinds are now building up for the larger products categories, such as air conditioners, refrigerators and washing machines. Further, the increased focus on localisation and indigenisation in India is benefiting domestic companies with strong brand recall and better understanding of consumer preferences.

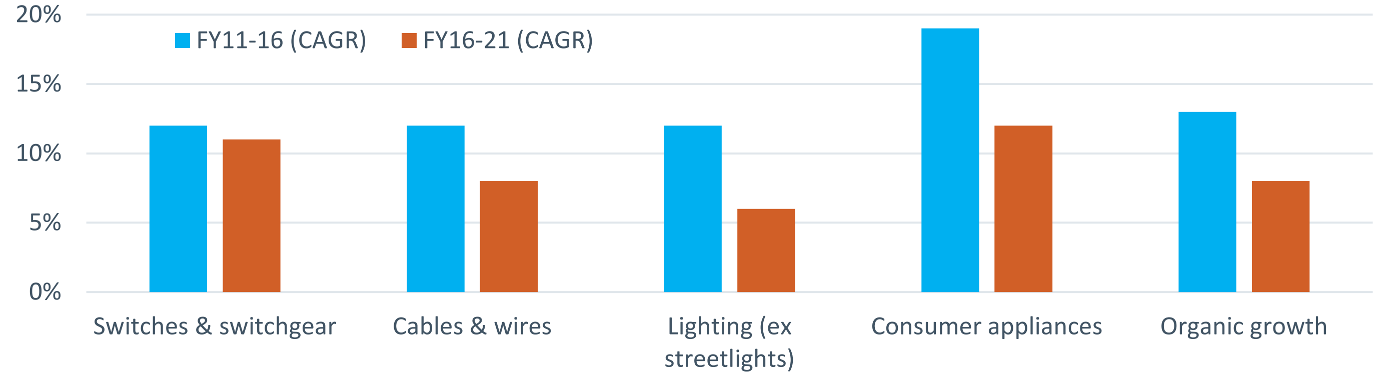
Chart 3: Growing penetration across white goods categories



*Source: Euromonitor, Government of India statistics * Mobile penetration based on total penetration, Rest based on number of households*

We like market leaders such as **Havells** and **Crompton Greaves** for their formidable brands and management teams with a mindset to increase total addressable market by entering new product categories and expanding geographical coverage. These companies have a track record of innovation and a strong management team to execute their expansion plans. We believe these companies can replicate the successes of Midea Group and Gree Electric Appliances that we have seen in China over the last 10-15 years.

Chart 4: Havells should see sustainable high growth



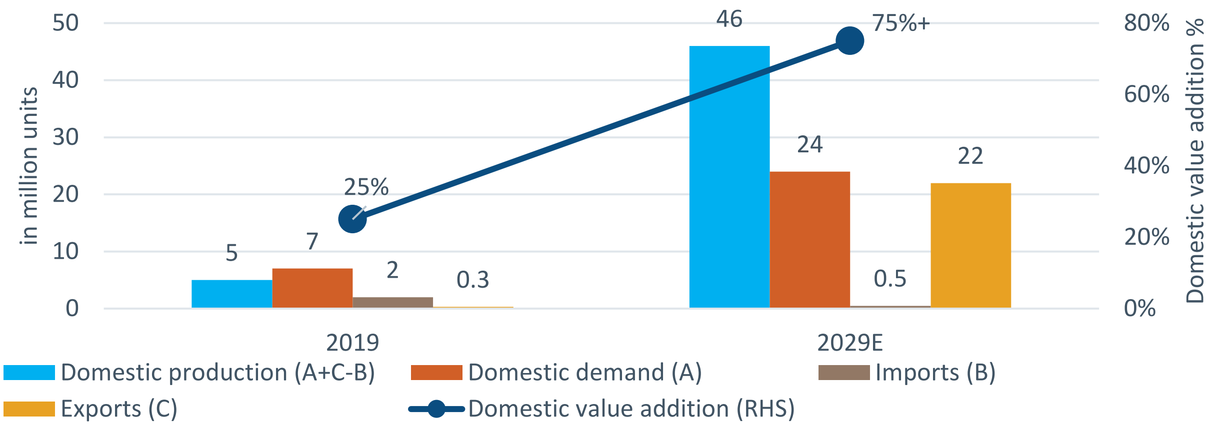
*Source: Company data. *Organic lighting and fixtures growth of about 11% but change in indirect taxation methodology impacts reported numbers. Reported growth is higher than organic growth due to acquisition of Lloyds business.*

c. Electronics manufacturing services (EMS)

A fast-growing end-market and trend towards sourcing from domestic players provides an strong growth opportunity for Indian electronics manufacturing services (EMS) players. The government is focused on self-reliance in this space. It has announced production-linked incentives for domestic manufacturing, banned import of gas-charged air conditioners and raised import duties.

For instance, in the room air conditioner (RAC) EMS production space, domestic companies are expected to benefit from the twin factors of rising domestic production along with increasing value addition. Some of the RAC components have a high likelihood for import substitution, hence leading to a rise in domestic value addition. Among others, these components include motors, printed circuit boards and crossflow fans.

Chart 5: Rise in domestic production and import substitution to drive indigenous production of room air conditioners



Source: Industry reports, Amber Enterprises

Amber Enterprises, India's largest RAC EMS company (about 25% market share), with its pan India plant network, scale advantages, wide component portfolio and strong client relationships is well-positioned to benefit from domestic growth, import substitution and evolving export opportunity. Its management team has executed well in the past couple of decades.

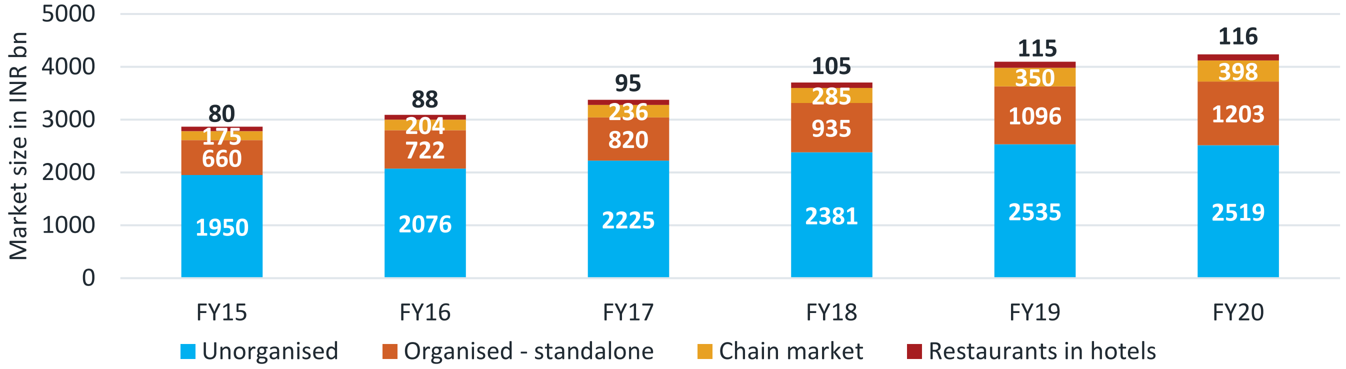
2. Restaurants and food services

Given its large demography, India's total food consumption spending of about US$650bn is close to 65% of the spending in the US and China. However, the share of India's food services industry as a part of the overall food consumption is only 10%, as compared to over

50% in both the US and China. Being in this nascent stage of development presents a strong long-term growth opportunity driven by increasing urbanisation, rising incomes, and changing food habits in favour of eating out and online food ordering.

Also, the organised players currently account for only about 40% of the overall market but are gaining share and growing at a low-to-mid-teen CAGR versus 8% growth in the overall food industry. Within this, quick service restaurants and casual dining restaurants are growing at high teens.

Chart 6: Organised players taking market share - faster growth for quick service and casual dining



Source: Technopark, Barbeque Nation Red Herring Prospectus (Mar-21), Zomato Red Herring Prospectus (Jul-21)

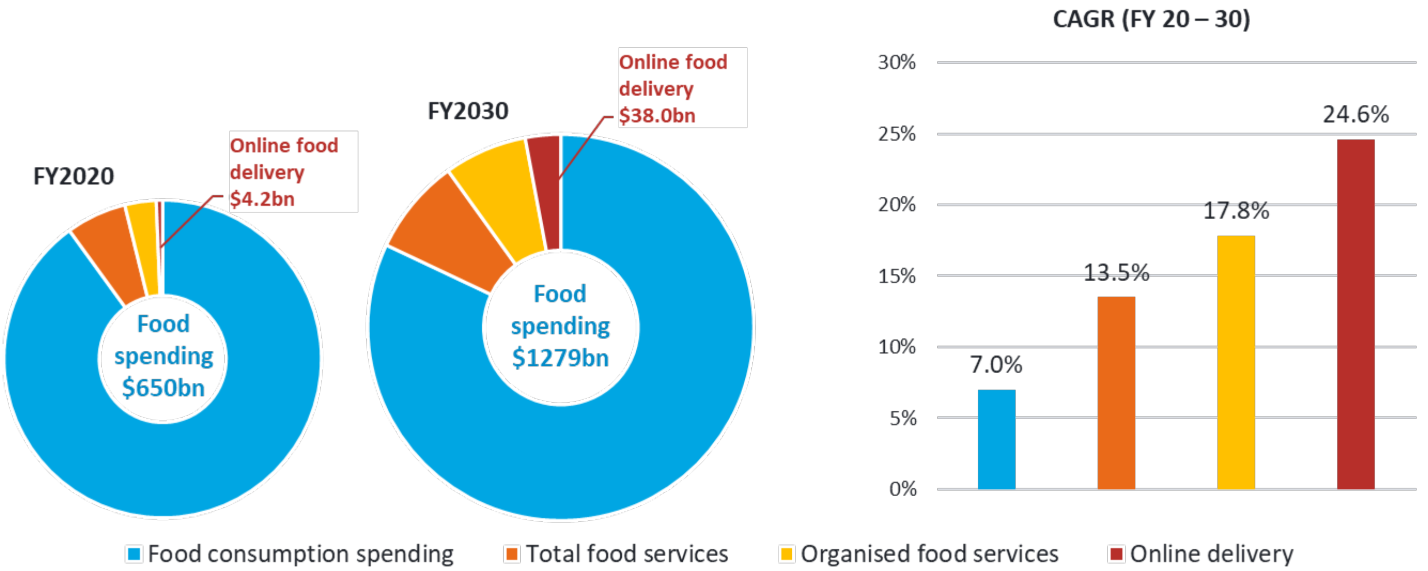
Within this segment we like **Jubilant Foodworks**, the franchise owner for Domino's Pizza in India as well as **Burger King India**, the franchisee of Burger King in India, for their strong growth potential.

5. Online food delivery

This industry has seen strong growth in India over last two to three years but remains underpenetrated at a total gross market value of US$4.2bn, which is just about 6.5% of the overall food services industry and about 16% of the organised restaurants segment, according to data from Zomato. We believe rising internet penetration, young and technology-savvy working population and the convenience offered by food delivery platforms will continue to drive the adoption of online food delivery over the next decade.

While there is no credible independent forecast for online food delivery industry's growth, based on top-down and bottom-up analysis the base case is that the industry can grow at about 24% CAGR over the next decade to reach US$35-38bn. In a bull case scenario, the potential growth for the industry is as high as 40% CAGR.

Chart 7: Online food delivery services to grow faster than the growth in overall food services industry



Source: Fidelity International, Zomato Red Herring Prospectus, July 2021

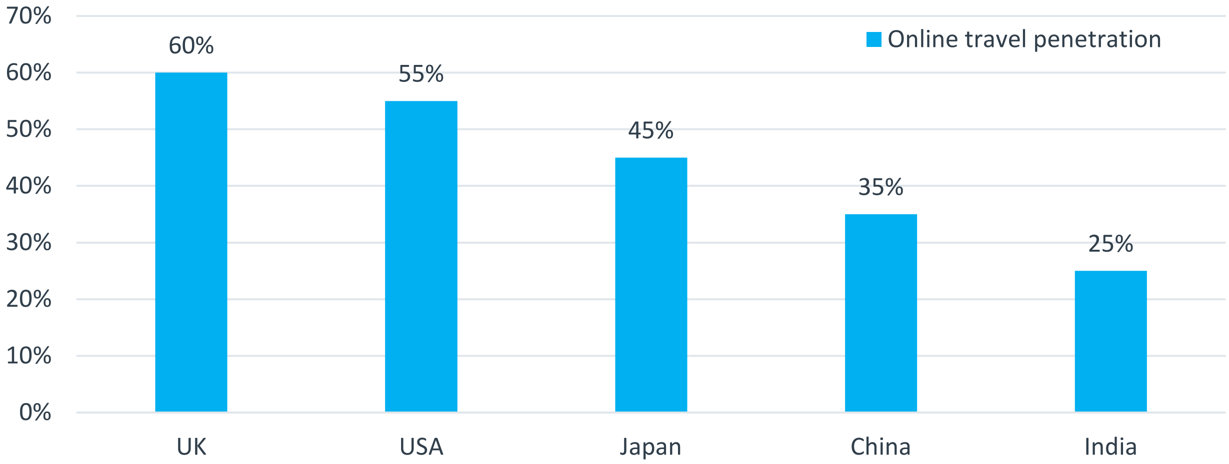
One of the two dominant players in this segment, **Zomato,** which has about 50% share in the third-party food aggregators market, has just made its debut in the Indian equity markets. We believe, Zomato is well positioned to benefit from the growth in online food delivery, given its strategy of having a wider ecosystem across delivery, dine-out and other services that creates better stickiness for restaurants as well as customers, providing multiple monetisation opportunities over the longer term. Zomato's above industry average growth in gross order value and access to cohort data are a testimony to the strength of its platform and execution skills.

6. Online travel services

India's total travel spending is estimated to be about US$50bn (as per a joint study by Bain and Google). Out of this, air travel (US$18bn) and lodging (US$14bn) - equally split between domestic and international - are the largest categories. India's domestic air passenger traffic has been growing at mid-teen CAGR over the last decade. Although Covid has created a short-term disruption in the sector, structural growth drivers remain intact given massive under penetration compared to global peers, rising income levels and investment in travel infrastructure by the government as well as the private sector.

We believe online travel agents (OTAs) are the best way to play this structural growth opportunity, given the low online penetration of air ticketing (about 50%) and hotel booking (about 15-20%), high fragmentation in hotels sector and lower cyclicality.

Chart 8: India far behind China and developed markets on penetration of online travel services



Source: PhoCusWright, Ambit Capital

Within OTAs, we prefer **Makemytrip.com** due to its strong brand recall and leadership position across various categories including air ticketing (50% OTA share and 25% of total tickets booked in India), hotel booking (over 60% share among pure play OTAs) and bus ticketing (dominant share).

Conclusion:

The broader trend of rising consumer demand is leading to the emergence of a host of new domestic companies across different segments. Some of these will become long term winners with strong franchises, but many others will fizzle out due to their weak business models and incompetent management teams by getting into debt traps as they scale-up their operations in pursuit for growth.

Hence, the key to making money from this trend is to back the best quality companies with strong business models and competent management teams. We must also buy them at the right price to be able to gain from their successes. This requires careful fundamental analysis to understand business quality and the appropriate price to pay for such quality and growth. Our strong on-the-ground team of research analysts in India which constantly interacts with these companies and their stakeholders helps us pick businesses that can be long term winners and helps us generate superior returns for our clients.

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