

Godfrey Phillips India

Marlboro Magic

Godfrey Phillips India's (GPI) cigarette volumes have been growing at a scorching rate. The main reason behind its success is the performance of the Marlboro brand (40-45% of overall volumes). However, GPI is a contract manufacturer and distributor for the Marlboro range of products, with the majority of the profit surge being captured in the joint venture, IPM India Wholesale Trading Ltd. IPM is a JV between GPI, Philip Morris, and the KK Modi Group, with 24.8%, 50.1%, and 25.1% stakes, respectively. IPM India was established for the wholesale trading of cigarettes and other tobacco products, either manufactured in India or imported into India. IPM has recorded a 39 / 49 / 56% CAGR in revenue, EBITDA, and PAT, respectively, over CY19–23, clearly defying the odds of slow consumption growth. The EBITDA margin has expanded from approximately 26% in CY19 to 34% in CY23, despite gross margins being under significant pressure (down 1,440bps to 57.7% in CY23 as compared to CY19) due to increasing share of Marlboro compact (INR 10/stick). In this note, we decipher the key drivers behind the company's market share gains from its rivals.

Marlboro – brand gaining much ground: Marlboro (a brand from Philip Morris) has a market share of around 2%, with the potential to achieve 5% in the medium term. Incrementally, our checks indicate monthly Marlboro volumes have increased from 405 mn stick per month in 1QFY24 to c680 mn sticks per month by 2QFY25. Several factors have been driving this growth:

- First, solid acceptance of Marlboro Compact (Rs 10 per stick) is on account of its brand imagery as a foreign brand, its ability to provide a superior customer experience, and its high trade margins (20-25%), thereby creating a perfect balance between push and pull marketing.
- Second, significant expansion in the distribution network in Tier 2 and Tier 3 cities beyond metro and Tier 1 cities, and attempting to penetrate South India, a stronghold of incumbents. Notably, channel checks suggest that Godfrey Phillips has undergone another round of salesforce consolidation over the last 9-10 months, bifurcating larger areas into smaller ones for a more focused approach. Moreover, our checks with stakeholders suggest that the company has been able to make decent in-roads into the Bangalore market, which is key market for KSFT business, with all eyes on expanding business into Metro cities of Hyderabad and Chennai. However, it has failed to taste any success in the key market of Kerala.
- Third, expansion of the product portfolio with relevant offerings even at the premium end, such as the launch of Marlboro Black, which aims to take market share from Gudang Garam. Moreover, recently, it has introduced Marlboro Vista vision in slim/sleek cigarette at price point of INR 15/stick, in order to grab market share from Classic Connect, market leader in the respective segment. Slim/Sleek category is the fastest growing sub-segment within the cigarette industry as consumers perceive this to be relatively less harmful (given less nicotine content) and it looks more stylish as well.
- Fourth, after testing the waters in North India, channel checks suggest that the company has decided to extend its DSFT offering (targeting price-conscious customers) with Marlboro Pockets (DSFT brand) available at a price point of INR 6 per stick into newer geographies of Bihar and West Bengal. However, checks indicate this product has not been able to make a meaningful dent to the market share of incumbents.

Not Rated

CMP (as on 17 Dec 2024)	INR 5,893
Target Price	NA
NIFTY	24,336

KEY STOCK DATA

Bloomberg code	GP IN
No. of Shares (mn)	52
MCap (INR bn) / (\$ mn)	306/3,609
6m avg traded value (INR mn)	1,150
52 Week high / low	INR 8,480/2,040

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(23.8)	44.0	182.6
Relative (%)	(21.0)	39.2	169.7

SHAREHOLDING PATTERN (%)

	Jun-24	Sep-24
Promoters	72.58	72.58
FIs & Local MFs	1.90	1.97
FPIs	10.83	10.80
Public & Others	14.24	14.20
Pledged Shares	0.00	0.00

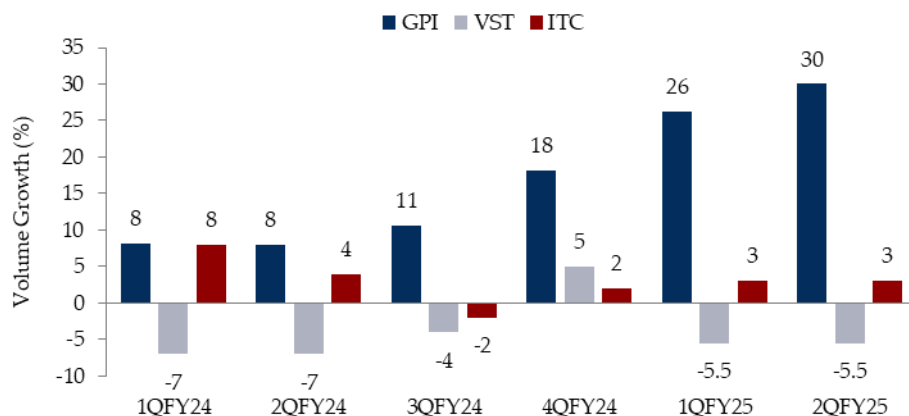
Source : BSE

Pledged shares as % of total shares

Vishal Gutka
vishal.gutka@hdfcsec.com
+91-22-6171-7324

Cigarette volume growth amongst other players

Exhibit 1: Godfrey Phillips (GPI) gaining market share



Source: Company, HSIE Research

- What are incumbents doing to combat the challenge of the Marlboro Compact?** Incumbents have launched products to compete but our ground checks suggest that it was not able to satiate the taste buds of its patrons, given Phillip Morris’s global expertise in clove-based cigarettes. Even if incumbents were able to match taste and experience vs Marlboro Compact via taking various initiatives through its R&D, in our view, it would be very difficult to change brand perception, as legacy brands face generational brand fatigue.
- GPI piggy backing on distribution moat of Marlboro/Phillip Morris:** GPI is even making its presence in one of the fastest-growing sub-segments on the back of disruptive pricing: It has been able to position the Stellar brand as a product meant for Slim cigarettes since 2013; however, this product started gaining meaningful traction since 2019 following the launch of the sub-variant “Stellar Shift.” This variant has found relevance among new-age smokers looking for lighter and flavoured cigarettes. Moreover, its attractive pricing of INR 10 per stick has attracted budget-constrained youth customers, as competitor products are priced at a 20-50% premium (ITC sells Classic Connect/Gold Flake Sleek at INR 15/12 per stick, respectively). However, recently, ITC has introduced sleek cigarette brand under the name of “American Club” at a similar price point.
- Ground checks suggest that Stellar Shift has gained significant market share primarily due to two factors: a) counterfeit issues affecting the Esse brand from Korea, which has the highest consumer brand recall, and b) attractive trade margins (20%). Trade partners further hinted that this brand is currently strong in North India, and the game plan is to make it quite relevant in GPI's strongholds. Additionally, the recent launch of Stellar Shift Duoz at INR 12 per stick is testing the waters in flavoured slim cigarette market and time will tell as to whether they have been able to make inroads into this market or not.

Exhibit 2: Slim cigarette price comparison

Brand	Length	Company	Landing price to Retailer/Stick	Retailer realization/stick	Trade Margin/stick	Trade margin (%)
Stellar Shift	97mm	GPI	8	10	2	20%
Classic Connect	97mm	ITC	13.5	15	1.5	10%
American Club	NA	ITC	8	10	2	20%
Editions	95mm	VST	8	10	2	20%
Esse Gold	97mm	KTGC	8	10	2	20%
Esse Lights	97mm	KTGC	8	10	2	20%

Source: Company, HSIE Research

Two notable observations from the above table

- 1) Market leader offers the lowest trade margin vs other competing brands
- 2) Esse's trade margin of 20% is not worth taking the risk for despite it being at a similar price point (INR 10/ stick), given most of the cigarettes sold in India are smuggled. Retailers are better off selling GPI products if the margin structure is similar

How is Marlboro trying to tackle its historical challenges?

Our ground checks suggested that before the recent blitzkrieg, Marlboro faced twin challenges: (a) finding appropriate retail shelf space for placing its products and (b) dealing with contraband cigarettes from neighbouring countries, which dented its performance. We believe Marlboro, to some extent, supported by macro tailwinds, has been able to address these issues.

Firstly, COVID-19 acted as a blessing in disguise as, during this phase, contraband cigarettes from neighbouring countries could not percolate into India due to logistical challenges. This situation provided a lot of headroom for Godfrey Phillips to expand its distribution network. Secondly, Marlboro has been providing extensive assistance to mom-and-pop store owners to set up exclusive Marlboro stores, which enables more shelf space where incumbents sell their premium range.

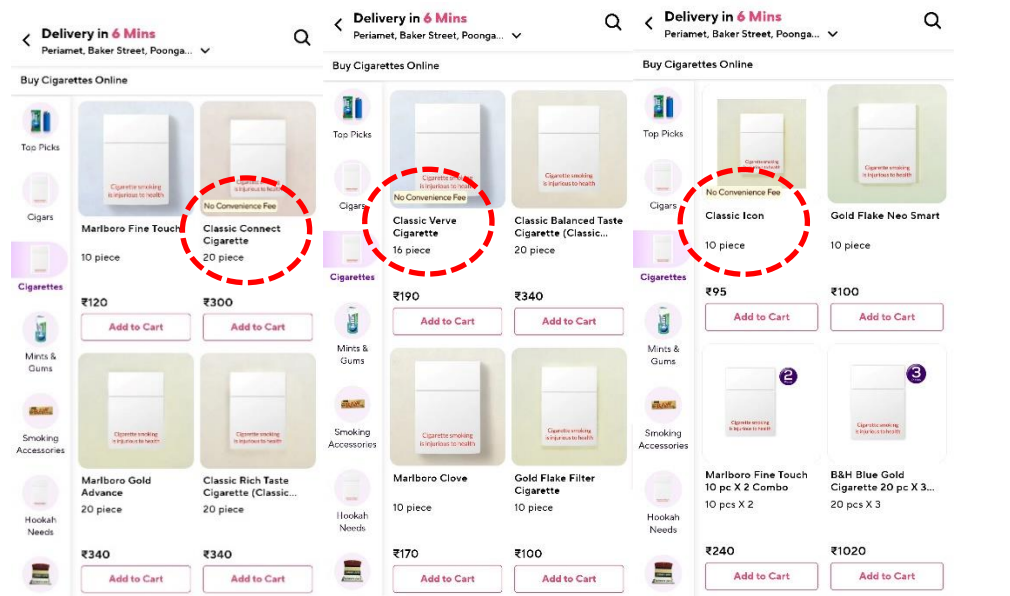
Quick commerce challenging moat of companies with strong distribution networks

Although Quick commerce channel contributes only 1-2% of overall cigarette industry volumes, it has been growing at a scorching pace (in our view, at-least at run rate of 40-50%) owing to the convenience that this platform offers. However, most of the quick commerce players have a separate app/website for ordering tobacco related items (Zepto Lite, Instamart lite, Blinkit Lite) as a) government agencies might be wary of these websites promoting these items aggressively and b) secondly, these apps need to take consent that the customer is above 18 years of age.

Our checks indicate that GPI/Marlboro has 40% market share in quick commerce vs national level market share of only 14-15% and strength of the brand gets further vindicated by the fact that it does not offer any waiver on convenience fees whereas incumbents are offering waiver on selected brands with respect to convenience fees. Quick commerce is a boon for players like Marlboro, otherwise it might be very difficult to gain shelf space in key metro cities, given the small-sized shops.

One more interesting observation that VST industries so far is not offering its product on these platforms.

Exhibit 3: Marlboro is not offering any discount on sales made through Q-comm; whereas competitors continue to offer waiver on convenience fee



Source: Zepto Lite, HSIE Research

Change in CEO has led to aggression on driving numbers

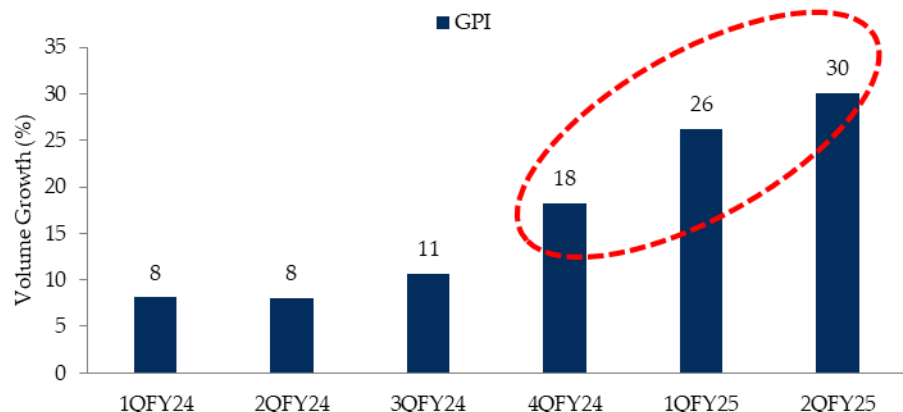
Post induction of Navaneel Kar as CEO of Phillip Morris India in Jan, 2024, volume growth has significantly accelerated over the past three quarters -a) as he has solid experience understanding nuancing of cigarette distribution, given he has spent more than 16 years with ITC; b) he himself, being a go-getter, has exerted significant focus on driving execution in distribution expansion and marketing excellence.

Exhibit 4: Navaneel Kar has spent c16 years of his career at ITC

Company	Position	Tenure
ITC	Assistant Manager	2003-2005
	Branch Head - FMCG (Madhya Pradesh)	2005-2007
	Brand Manager - Sunfeast	2007-2008
	Regional Sales Manager (West)	2008-2010
	Category Development Manager	2010-2013
	District Manager (Head of FMCG inc. Cigg)	2013-2019
TCPL	National Sales Head	2019-2020
	President and Head (India Sales)	2020-2023
Philip Morris International	Managing Director – India	2023-2024

Source: Company, HSIE Research

Exhibit 5: Godfrey Phillips volume growth has accelerated post induction of Navaneel Kar as MD in December 2023



Source: Company, HSIE Research

Exhibit 6: GPI offering highest margin for Marlboro Compact (top selling SKU) and Stellar brand

Brand	Length	Category	Landing price to Retailer/Stick	MRP/Stick	Convenience fees/stick	Retailer realization/stick	Trade Margin/stick	Trade margin (%)
Marlboro Gold Advance	84mm	KSFT	15.65	17	1	18	2.35	13%
Marlboro Fuse	84mm	KSFT	15.65	17	1	18	2.35	13%
Marlboro red	84mm	KSFT	15.65	17	1	18	2.35	13%
Marlboro Gold Light	84mm	KSFT	15.65	17	1	18	2.35	13%
Marlboro Clove	84mm	KSFT	15.65	17	1	18	2.35	13%
Marlboro Advance Compact	69mm	RSFT	7.5	9.5	0.5	10	2.5	25%
Marlboro Fine Touch	84mm	Slim	10	12	0	12	2	17%
Marlboro Black Filter	90mm	Slim	10.83	12.5	2.5	15	4.17	28%
Stellar Shift duos	97mm	Slim	9.5	12	0	12	2.5	21%
Stellar Define paan	97mm	Slim	8	10	0	10	2	20%
Stellar Define	97mm	Slim	8	10	0	10	2	20%
Stellar Cool blast	97mm	RSFT	7.85	10	0	10	2.15	22%
Stellar Shift	97mm	Slim	8	10	0	10	2	20%

Source: Company, HSIE Research

**** Kindly note that we have taken these numbers from a distributor based in Lucknow; these could vary depending upon the strength of the respective brand in the respective geography

Exhibit 7: Red & White, Four Square on declining trend despite offering higher margin to trade

Brand	Length	Category	Landing price to Retailer/Stick	MRP/Stick	Convenience fees/stick	Retailer realization/stick	Trade Margin/stick	Trade margin (%)
Red & White Prince	69mm	RSFT	3.8	6	0	6	2.2	37%
Red & White Original	69mm	RSFT	4.9	5.5	0.5	6	1.1	18%
Four Square Clove	69mm	RSFT	7.3	9	1	10	2.7	27%
Four Square Tropical	69mm	RSFT	6.8	9	1	10	3.2	32%

Source: Company, HSIE Research

**** Kindly note that we have taken these numbers from a distributor based in Lucknow; these could vary depending upon the strength of the respective brand in the respective geography

Two notable observations from the above table

- 1) GPI is offering solid trade margins (vs competition, who generally offers around 10%) for its two top-selling brands - Stellar Shift and Marlboro
- 2) Red & White and Four Square – although margins offered are on the higher side, sales are on a declining trend for these two brands. Our checks suggest that Gujarat is the only state, where Four Square is seeing strong growth.

IPM India Wholesale Trading Pvt. Ltd.: Financial snapshot

(INR mn)	CY19	CY20	CY21	CY22	CY23	CAGR (%) (CY19-CY23)
Net sales	5,866	7,057	9,874	15,223	22,011	39
Gross profit	4,232	4,504	6,360	9,405	12,706	32
Employee expenses	583	709	722	799	751	7
Advertising expenses	1,518	1,283	2,120	2,826	3,124	20
Legal & professional charges	435	513	644	812	1,032	24
Royalty expense	57	65	73	130	185	35
Other expenses	141	87	204	228	169	5
EBITDA	1,499	1,848	2,597	4,610	7,445	49
Net Profit	959	1,526	2,750	3,425	5,652	56

Source: MCA, HSIE Research

IPM India Wholesale Trading Pvt. Ltd.: Common-size snapshot

(%)	CY19	CY20	CY21	CY22	CY23	bps change
Net sales	100.0	100.0	100.0	100.0	100.0	
Gross profit	72.1	63.8	64.4	61.8	57.7	(1,442)
Employee expenses	9.9	10.0	7.3	5.3	3.4	
Advertising expenses	25.9	18.2	21.5	18.6	14.2	
Legal & professional charges	7.4	7.3	6.5	5.3	4.7	
Royalty expense	1.0	0.9	0.7	0.9	0.8	
Other expenses	2.4	1.2	2.1	1.5	0.8	
EBITDA	25.5	26.2	26.3	30.3	33.8	828

Source: MCA, HSIE Research

Consolidated P&L

(INR mn)	FY20	FY21	FY22	FY23	FY24
Net Revenues	30,418	29,224	31,934	42,278	52,389
Growth (%)	17.9	(3.9)	9.3	32.4	23.9
Material Expenses	14,527	16,592	17,668	24,788	33,300
Employee Expense	2,784	2,666	2,783	3,084	3,364
Other Expenses	7,453	4,942	5,501	6,691	7,460
EBITDA	5,916	5,411	6,334	8,036	8,921
EBITDA Growth (%)	46.8	(8.5)	17.1	26.9	11.0
EBITDA Margin (%)	19.4	18.5	19.8	19.0	17.0
Depreciation	1,552	1,413	1,452	1,536	1,460
EBIT	4,364	3,998	4,882	6,499	7,462
Other Income	1,069	1,186	1,141	1,681	2,143
Interest	302	308	339	290	261
PBT	5,130	4,876	5,683	7,890	9,343
Tax	1,287	1,108	1,302	1,822	2,110
Profit from minority/associates	5	(5)	(0)	836	1,598
RPAT	3,848	3,762	4,381	6,905	8,830
Adjustment	-	-	-	-	-
Adjusted PAT	3,848	3,762	4,381	6,905	8,830
APAT Growth (%)	47.8	(2.2)	16.4	57.6	27.9
Adjusted EPS	74.0	72.4	84.3	132.8	169.8
EPS Growth (%)	47.8	(2.2)	16.4	57.6	27.9

Source: Company, HSIE Research

Consolidated Balance Sheet

(INR mn)	FY20	FY21	FY22	FY23	FY24
SOURCES OF FUNDS					
Share Capital - Equity	104	104	104	104	104
Reserves	21,769	25,717	29,172	35,375	42,217
Total Shareholders Funds	21,873	25,821	29,276	35,479	42,321
Minority Interest	286	54	54	53	62
Long Term Debt	9	10	11	12	13
Short Term Debt	111	749	298	347	440
Total Debt	120	759	309	359	453
Net Deferred Taxes	282	411	498	691	1,057
Other Non-current Liabilities & Provns	3,370	3,115	2,955	3,049	2,839
TOTAL SOURCES OF FUNDS	25,932	30,160	33,091	39,631	46,733
APPLICATION OF FUNDS					
Net Block	10,111	10,245	9,690	9,114	8,763
CWIP	167	264	365	221	102
Other Non Current Assets	12,107	11,571	14,474	26,153	29,452
Total Non-current Assets	22,384	22,080	24,530	35,488	38,316
Inventories	6,879	7,431	8,287	9,281	14,416
Debtors	689	1,230	1,546	1,495	1,729
Other Current Assets	1,232	1,495	1,454	1,630	2,145
Cash & Equivalents	1,768	5,082	5,199	1,787	1,827
Total Current Assets	10,567	15,238	16,486	14,194	20,116
Creditors	2,540	2,332	2,529	3,655	4,668
Other Current Liabilities & Provns	4,480	4,825	5,396	6,396	7,032
Total Current Liabilities	7,020	7,157	7,925	10,051	11,700
Net Current Assets	3,547	8,080	8,561	4,143	8,416
TOTAL APPLICATION OF FUNDS	25,932	30,160	33,091	39,631	46,733

Source: Company, HSIE Research

Consolidated Cash Flow

(INR mn)	FY20	FY21	FY22	FY23	FY24
Reported PBT	5,135	4,873	5,683	7,890	9,343
Non-operating & EO Items	(789)	(1,140)	(957)	(1,305)	(1,825)
Interest Expenses	258	260	212	198	128
Depreciation	1,552	1,413	1,452	1,536	1,460
Working Capital Change	(1,168)	(1,328)	(205)	930	(4,230)
Tax Paid	(1,239)	(979)	(1,399)	(1,890)	(1,972)
OPERATING CASH FLOW (a)	3,750	3,098	4,786	7,359	2,902
Capex	(1,206)	(1,303)	(764)	(800)	(982)
Free Cash Flow (FCF)	2,545	1,796	4,022	6,560	1,921
Investments	(53,286)	(39,082)	(57,599)	(70,344)	(70,365)
Non-operating Income	53,775	37,409	56,020	65,736	71,901
INVESTING CASH FLOW (b)	(716)	(2,976)	(2,343)	(5,408)	554
Debt Issuance/(Repaid)	(300)	638	(451)	49	(531)
Interest Expenses	(299)	(288)	(380)	(259)	(282)
FCFE	3,634	(227)	3,274	2,162	4,270
Share Capital Issuance	-	-	-	-	-
Dividend	(2,087)	(25)	(1,239)	(1,449)	(2,284)
Others	(347)	(484)	(310)	(403)	(398)
FINANCING CASH FLOW (c)	(3,033)	(159)	(2,380)	(2,063)	(3,495)
NET CASH FLOW (a+b+c)	1	(37)	63	(111)	(38)
EO Items, Others	0	0	-	-	-
Closing Cash & Equivalents	315	279	342	230	192

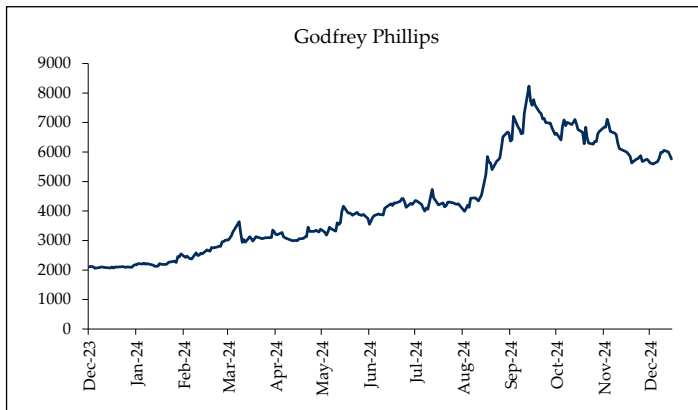
Source: Company, HSIE Research

Ratios

KEY RATIOS	FY20	FY21	FY22	FY23	FY24
PROFITABILITY (%)					
GPM	52.2	43.2	44.7	41.4	36.4
EBITDA Margin	19.4	18.5	19.8	19.0	17.0
EBIT Margin	14.3	13.7	15.3	15.4	14.2
APAT Margin	12.6	12.9	13.7	16.3	16.9
RoE	18.2	15.8	15.9	21.3	22.7
RoIC (or Core RoCE)	15.8	12.8	14.5	15.5	14.3
RoCE	17.7	14.5	14.9	20.0	21.4
EFFICIENCY					
Tax Rate (%)	25.1	22.7	22.9	23.1	22.6
Fixed Asset Turnover (x)	2.0	1.7	1.9	2.5	2.9
Inventory (days)	82.6	92.8	94.7	80.1	100.4
Debtors (days)	8.3	15.4	17.7	12.9	12.0
Other Current Assets (days)	14.8	18.7	16.6	14.1	14.9
Payables (days)	30.5	29.1	28.9	31.6	32.5
Other Current Liab & Provns (days)	53.8	60.3	61.7	55.2	49.0
Cash Conversion Cycle (days)	21.4	37.5	38.4	20.3	45.9
Net D/E (x)	(0.1)	(0.2)	(0.2)	(0.0)	(0.0)
Interest Coverage (x)	14.4	13.0	14.4	22.4	28.5
PER SHARE DATA (Rs)					
EPS	74.0	72.4	84.3	132.8	169.8
CEPS	103.9	99.5	112.2	162.3	197.9
Dividend	24.0	24.0	28.0	44.0	56.0
Book Value	420.7	496.6	563.1	682.4	814.0
VALUATION					
P/E (x)	78.37	80.16	68.84	43.68	34.15
P/BV (x)	13.8	11.7	10.3	8.5	7.1
EV/EBITDA (x)	50.7	54.9	46.8	37.4	33.6
EV/Revenues (x)	9.9	10.2	9.3	7.1	5.7
OCF/EV (%)	1.3	1.0	1.6	2.5	1.0
FCF/EV (%)	0.8	0.6	1.4	2.2	0.6
FCFE/Mkt Cap (%)	1.2	(0.1)	1.1	0.7	1.4
Dividend Yield (%)	0.4	0.4	0.5	0.8	1.0

Source: Company, HSIE Research

Price movement



Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: >10% Downside return potential

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Murli V Karkera Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

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HDFC Securities

Institutional Equities

Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,

Senapati Bapat Marg, Lower Parel, Mumbai - 400 013

Board: +91-22-6171-7330 www.hdfcsec.com