Company

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Asia India

Consumer

Deutsche Bank

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Indian consumer sector

Sturdy earnings, stable multiples

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Pricing to determine 2011 winners - ITC, Asian Paints, Titan, Jubilant, Nestle
In our view cigarettes, paints, watches and jewellery remain the best categories in which to invest in India. Headwinds relate to relatively higher commodity prices and changing taxation (for cigarettes). Within the sector there are no significant undervaluations. Long-term buy stories are driven by pricing power for respective companies resulting from an oligopolistic market structure and growing company market share. ITC, Asian Paints, Titan, Jubilant Foodworks and Nestle are our top picks that we expect to outperform their sectors. We retain Hold on HUL.

Top-line enablers remain strong
Top-line enablers for consumer staples remain strong as the government's social welfare schemes (INR400bn for FY11) and near doubling of agri-commodity prices continue to put money into the hands of rural India. While the relatively higher MSPs have also been driving inflation, overall they have placed purchasing power in the hands of rural India and remain top-line enablers.

Capex outlays reveal confidence in demand
The key change within the sector is the willingness of players across the spectrum (home, personal care, processed foods, gems and jewellery and alcoholic beverages) to ramp up capacity (Nestle, Asian Paints, Dabur, Titan, and Jubilant Foodworks), integrate backwards (United Spirits), acquire brands (Dabur, Reckitt Benckiser, Marico, and Godrej) and launch new products (P&G, ITC and Dabur). While MNCs have rediscovered India in terms of capex, Indian companies acquired brands abroad, completing their product portfolios. However, we believe that some of the capex plans may have been accelerated due to sunset clauses (investment in select geographic areas. until March 2011 allowing companies a five-year excise exemption, aside from the minimum tax rate, until 2015). We examine capex across consumer companies along with their asset turns.

Pricing test in 2011 for HUL (Hold, target price INR266)
2011 will likely be a test of HUL's pricing power as incremental volumes in 2010 have been a result of price decreases, discounts and relatively higher spend on advertising. Pricing, however, remains the key driver of HUL's revenue trajectory. Since 2005 the importance of pricing across the sector as a driver of revenues has increased as volume growth across 55% of HUL's portfolio (soaps, detergents and tea) has slowed. We maintain our Hold recommendation.

Valuations and target price changes
We have raised earnings estimates for ITC (target price INR196), Asian Paints (target price INR3,250), and Titan (target price INR4,200). Our target price increase for Nestle is due to the roll-over to CY12 earnings. We maintain earnings and target prices for Jubilant Foodworks (INR810) and Marico (INR150). We decrease our FY11 earnings for HUL by 7.7% and maintain Hold. The revision in HUL's target price to INR266 is due to the change in Deutsche Bank's India risk-free rate and market risk premium (already incorporated for all other stocks).

This report changes ratings, target prices, and/or estimates for several companies under coverage. For a detailed listing of these changes, see Figure 2 on page 3.

Forecast Change

Top picks	
ITC (ITC.BO),INR173.15	Buy
Asian Paints Ltd (ASPN.BO),INR2,714.40	Buy
Titan Industries Ltd (TITN.BO),INR3,415.80	Buy
Jubilant Foodworks (JUBI.BO),INR595.70	Buy
Nestle India Limited (NEST.BO),INR3,784.50	Buy

Companies featured			
Asian Paints Ltd (ASPN.BO),INR2,714.40			**Buy**
	2010A	2011E	2012E
P/E (x)	16.9	30.4	24.4
EV/EBITDA (x)	11.1	19.9	15.2
Price/book (x)	11.5	11.5	8.8
HUL (HLL.BO),INR302.40			**Hold**
	2010A	2011E	2012E
P/E (x)	26.8	27.7	25.0
EV/EBITDA (x)	21.1	22.1	19.4
Price/book (x)	21.0	22.4	19.1
Nestle India Limited (NEST.BO),INR3,784.50			**Buy**
	2009A	2010E	2011E
P/E (x)	29.3	46.0	33.6
EV/EBITDA (x)	18.2	29.8	21.9
Price/book (x)	42.3	56.9	50.4
Marico Limited (MRCO.BO),INR122.65			**Buy**
	2010A	2011E	2012E
P/E (x)	22.5	23.7	18.7
EV/EBITDA (x)	15.2	16.6	13.3
Price/book (x)	10.1	8.1	5.9
Titan Industries Ltd (TITN.BO),INR3,415.80			**Buy**
	2010A	2011E	2012E
P/E (x)	22.9	36.0	26.9
EV/EBITDA (x)	14.4	22.8	16.3
Price/book (x)	11.3	14.2	9.7
Jubilant Foodworks (JUBI.BO),INR595.70			**Buy**
	2010A	2011E	2012E
P/E (x)	51.1	46.4	35.3
EV/EBITDA (x)	25.6	27.9	18.4
Price/book (x)	21.4	21.4	15.3
ITC (ITC.BO),INR173.15			**Buy**
	2010A	2011E	2012E
P/E (x)	22.1	28.7	22.5
EV/EBITDA (x)	13.6	18.4	14.2
Price/book (x)	7.1	8.0	6.7

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Summary of changes

Our recommendations and target prices

Figure 1 gives our recommendation and target prices for our coverage companies

Figure 1: Financial snapshot

	Ticker	Market cap	Rating	Current price	Target price	% Upside	P/E		Earnings growth	EV/EBITDA	EBITDA growth	FCF yield
		(USDm)		(INR)	(INR)		FY11E	FY12E	(FY10-12E) CAGR	(FY12/CY11)	(FY10-12E)	(FY12/CY11)
Asian Paints	ASPN.BO	5,766	Buy	2714	3250	20%	29.3	22.7	17%	14.7	21%	1.2%
Dabur	DABU.BO	3,899	Hold	101	100	-1%	28.5	24.1	20%	19.6	21%	1.0%
HUL	HLL.BO	14,801	Hold	302	245	-19%	27.7	25.0	12%	19.8	13%	3.6%
ITC	ASPN.BO	29,184	Buy	173	196	13%	28.1	21.3	24%	14.2	24%	1.0%
Marico	MRCO.BO	1,636	Buy	123	150	22%	23.7	18.7	29%	13.9	21%	3.2%
Nestle	NEST.BO	8,094	Buy	3785	4200	11%	46.0	33.6	29%	22.2	26%	1.4%
Titan	TITN.BO	3,492	Buy	3416	4200	23%	35.0	25.2	54%	16.2	57%	-0.1%
United Spirits	UNSP.BO	3,429	Hold	1331	1600	20%	47.7	29.3	26%	13.9	34%	0.9%
Jubilant Foodworks	JUBI.BO	809	Buy	596	810	36%	46.5	35.3	79%	18.2	72%	2.4%

Source: Deutsche Bank

Figure 2 gives the changes in target price

Figure 2: Changes in target price

	Recommendation		Target price		Change in EPS		Remarks
	Old	New	Old	New	FY11/CY10	FY12/CY11	
Asian Paints	Buy	Buy	2950	3250	4%	7%	We are raising our earnings forecast and increasing our target price due to higher-than-expected volume growth.
HUL	Hold	Hold	245	266	-8%	-0.10%	In line with the change in risk free rate from 8.1% to 6.4% and market risk premium from 5.4% to 7.2% for India, we have reduced the cost of equity from 11% to 10.3%. This has resulted in an increase in our target price from INR 245 to INR 266.
ITC	Buy	Buy	180	196	2.50%	5.80%	ITC's earnings estimate increase is driven by an increase in FY11 volume estimates (from YoY flat volumes to a 2.5% increase).
Nestle	Buy	Buy	3160	4200	0	5%	We have increased our earnings by 5% to factor in relatively higher margins in CY11 and rolled over to CY12 numbers resulting in an increase of 33% in our target price.
Titan	Buy	Buy	3825	4200	2.60%	6.50%	The revision in earnings is based on a 26% (CAGR FY10-12) increase in Titan's jewellery revenues (up from 22% assumption earlier) driven by a rise in jewellery prices.

Source: Deutsche Bank

Executive summary

Outlook

In our view cigarettes, paints, watches and jewellery remain the best categories in which to invest within the Indian context. Headwinds relate to relatively higher commodity prices (for HPC, foods, alcoholic beverages and jewellery) and changing taxation (for cigarettes).

Consumer sector earnings multiples are unlikely to de-rate in 2011, driven by a low beta, zero debt and high ROE. Asset turns and margins remain relatively strong with accelerated capex partially driven by sunset clauses in tax exempt zones and margins facing short-term headwinds from relatively higher commodity prices. Though top-line enablers remain in place (rural volumes), pricing continues to be a key driver of top lines.

Our top picks – ITC, Titan, Asian Paints, Nestle and Jubilant Foodworks

ITC (Buy, target price INR196)

ITC increased cigarette prices by 13.5% in FY11 and will likely grow volumes by 2.5%, demonstrating its significant pricing power. We estimate 7% cigarette volume growth in FY12 and a 23.6% earnings CAGR (FY10-12).

Our earnings estimate increase is driven by an increase in FY11 volume estimates (from yoy flat volumes to a 2.5% increase). We also factored in a 10% excise duty increase for the forthcoming budget (February 2011). We believe ITC should be able to pass on this excise duty increase comfortably. Our new DCF-derived target price of INR196 implies a target multiple of 24x FY12.

Titan (Buy, target price INR4,200)

Titan earns 76% of its revenues and 56% of its EBITDA from jewellery. Jewellery is an INR7,500bn unorganized and fragmented market,. This has turned out to be Titan's defining area in terms of its ability to build brands and manage working capital.

We raise our target price to INR4,200 based on a 6% increase in Titan’s FY11E earnings and 5% increase in its FY12E earnings. The revision in earnings is based on a 32% increase in Titan’s FY11 jewellery revenues and a 20% increase in FY12. Titan’s watches division continues to grow revenues by 20% CAGR over FY10-12E. A 54% CAGR in FY10-12E earnings is the driver of our DCF-derived target price.

Asian Paints (Buy, target price INR3,250)

A dominant share within a concentrated domestic paints market, 55% of the tonnage accruing from water-based paints (both driving pricing power), and a distribution network that is a formidable entry barrier, contribute to Asian Paints' near monopoly within urban India.. We forecast a revenue CAGR of approximately 17% in FY10-12.

A higher-than-expected volume growth is the key driver of a 7% increase in earnings and a target price revision. Asian Paints’ new plant expansions remain on track. We maintain Buy with a revised target price of INR3,250.

Nestle (Buy, target price INR4,200)

An urban growth play, Nestle's current consumer base consists of approximately 318m urban Indians who account for 52% of India's net domestic output. We believe urban India should remain in a structural growth phase for processed foods, implying a sustained 12-15% revenue growth for Nestle India over the next half a decade. We expect the company to report a 64% free cash flow CAGR over CY10-12 with approximately 130% sustainable ROE

A dominant market share in milk (43% of revenues and86% market share) gives Nestle significant pricing power that it will likely exercise in 2011. Volume growth in Maggi (25% yoy) and chocolates (17% yoy) should be sustained. A 28% CAGR in earnings CY10-12E makes Nestle one of the best consumer franchisees. We maintain Buy with a revised price target of INR4,200.

Jubilant Foodworks (Buy, target price INR810)
A 65% market share in the under-penetrated Indian Quick Service Restaurant sector and an exclusive franchisee of a globally successful brand and solid execution (in terms of both new store opening and a robust supply chain) drive a 42% revenue CAGR (FY11-13), 70% gross margin, negative working capital (approximately 11% of revenues) and a 60% FCF CAGR over FY11-13E. While near-term valuation factors in aggressive growth, our FY12E earnings (the basis of our DCF-derived target price) are 14.5% higher than consensus. We see material upside potential and therefore recommend a Buy rating.

Valuation

Within the sector there are no significant undervaluations. Long-term buy stories are driven by pricing power for respective companies resulting from an oligopolistic market structure and growing market share for companies within the relatively mature home and personal care markets. ITC, Asian Paints, Titan, Nestle, and Jubilant Foodworks are our top picks that we believe should outperform their sectors. HUL remains a Hold

Risks

Demography is not destiny
Projections for the working age population are that India will likely add about 140m to the 15-64 age group between now and 2020. However, the window of opportunity is not as big as it seems. If the working age population is going to peak in 2045, reforms in education (primary, secondary and undergraduate) and labour would be necessary within the next five years in order to take advantage of this demographic shift.

GST delayed but likely to increase tax base for FMCG companies
The new goods and service tax (GST) is likely to increase the tax charge across FMCG companies, though it should bring in efficiencies over the longer period. While the effective rate for GST (both Centre and State) will be approximately 15% (as per press reports), several categories within the sector operate at relatively lower VAT rates. We provide the rates for hair oil, shampoos, fruit juices and tomato purees in Figure 24.

Top-line enablers are in place

Top-line enablers for consumer staples remain strong as the government's social welfare schemes (INR400bn for FY11) and near doubling of agri-commodity prices continue to put money into the hands of rural India. While the relatively higher MSPs have also been driving inflation, overall they have placed purchasing power in the hands of rural India and remain top-line enablers.

Figure 3: Higher MSP's – the rural Indian growth driver

Sl. number	Commodity	1997-98	2003-04	1998-2004	2004-05	2009-2010	2004-10
1	PADDY	415	550	4.8%	560	950	11.15%
2	JOWAR	360	505	5.8%	515	840	10.28%
3	BAJRA	360	505	5.8%	515	840	10.28%
6	ARHAR(Tur)	900	1360	7.1%	1390	2300	10.60%
8	URAD	900	1370	7.3%	1410	2520	12.31%
11	SUNFLOWER SEED	1000	1250	3.8%	1340	2215	10.57%
12	SOYABEEN	670	840	3.8%	900	1350	8.45%
15	WHEAT	510	630	3.6%	640	1100	11.44%
16	BARLEY	350	525	7.0%	540	750	6.79%
22	COPRA	2700	3320	4.1%	3500	4450	4.92%
24	SUGARCANE@	48.45	73.00	7.5%	74.50	107.76	7.66%

Source: Government of India

The demographics, urbanisation and income and expenditure patterns remain in place for sustained top-line growth across the sector.

Absolute numbers provide another way to understand India's urban present. Even at less than 28% of India's total population of 285m, the urban population is more than the total population of several other countries and is also a little over 10% of the total urban population in the world. There are 5,161 urban centres in the country. Of the total urban population, 68.67% live in 393 class I cities, each with a population of 100,000 or more. There are 35 cities or agglomerations with a population of 1m. These million plus cities together equal a total population of 108m and account for 38% of India's urban population. Contiguous groups of cities, towns and urban centres are another major phenomenon. There are 382 of these in the country, comprising 1,162 urban centres. Some basic facts of India's urbanisation are indicated in Figure 4.

Figure 4: Urbanisation key driver of consumption

Total urban population	285m
	Percentage to total population of India: 27.78%
	Percentage of the world's urban population: 10.02%
	Percentage to Asia's urban population: 21.10%
	Larger than the total population of countries such as France and Germany
	Larger than the total population of countries such as the US and Brazil
	Larger than the total population of parts of continents like eastern Africa, western Asia and western Europe
	Larger than the total population of the continent of Australia
Total population of 35m plus cities	107.88m
	Percentage of total urban population: 37.8%
	These 35 cities belong to the large group of 206m plus cities of Asia
Total population of 393 class I cities including million plus cities	195.95m
	Percentage of total urban population: 68.67%

Source: Deutsche Bank

Urban adults spend significantly and urban youth even more

Urban families spend up to two times as much as rural households. However, spending slows considerably as household's average age increases, so the younger the urban household, the more it will likely spend. The young are also keener and more able to move from a rural to an urban setting. From both perspectives, Indian consumer and retail companies should emerge as winners. At present, India remains one of the most youthful countries of the world. Approximately 53% of the Indian population is less than 25 years old. This compares favourably even with China, where the comparable number is 42%.

Figure 5: A high proportion of younger population, an advantage for India

India	53%
China	42%
Indonesia	30%
US	30%
Brazil	29%
Japan	27%
Germany	26%

Source: Deutsche Bank

Consumerist age bracket is growing quickly

More importantly, according to the Asian Demographics Report, the 20-54 year age bracket is growing faster than the rest of the population and represents more than 50% of the population as of 2010. Consumers in this age bracket are the most likely consumers of cigarettes, pizzas, alcoholic beverages, watches and jewellery, provided they fall in the appropriate income bracket and reside in urban areas.

Projected age distribution of the Indian population

Figure 6: Demographics of India

Years/figures (%)	1996	2001	2006	2010	2013
0-4	12.8	10.7	10.4	10.3	10
5-14	25	23.6	20.2	18.5	18.2
15-19	9.7	10.8	11.2	10.1	9.1
20-24	8.8	8.9	9.9	10.4	10
25-34	15.2	15.5	15.6	16.4	17.4
35-44	11.2	12	12.7	13	13.1
45-54	7.8	8.5	9.2	9.7	10.2
55-59	2.8	3.1	3.4	3.6	3.8
60 and above	6.7	7	7.5	8	8.4

Source: Deutsche Bank

The macro trends in urbanisation, demographic shifts and income growth should be positive for India over the next five years. The consensus is that Indian GDP will reach a 7-8% CAGR over the next five years. Assuming inflation of 3-4%, this implies nominal incomes will show a CAGR of 9-11% and India's current per capita income should double from USD1,000 to USD1,600 (the level at which China is now).

All these factors should create a large pool of young urban consumers willing to spend more money on consumer staples, durables and discretionary. Growth rates in staples (soaps and detergents for example) have been nominal due to a greater share of spending on categories such as motorcycles (and now scooters), credit cards, consumer electronic durables, cell phones, mortgage loans, personal products, lifestyle and luxury products.

Figure 7: Share of total consumption (%)

Consumption category	USA	Germany	Brazil	South Korea	China	India (2005)	India (2025)
In line with benchmarks							
Food beverages and tobacco	15	21	19	23	35	42	25
Apparel	4	5	6	4	11	6	5
Personal products and services	14	10	8	13	4	8	11
Less than benchmarks							
Housing and utilities	19	27	22	18	9	12	10
Household products	5	7	9	4	6	3	3
Education and recreation	12	8	13	16	15	5	9
More than benchmarks							
Transportation	11	17	13	12	6	17	20
Communication	1	1	4	2	7	2	6
Healthcare	19	4	6	8	7	7	13

Source: Deutsche Bank

The urban expenditure pool grows larger and faster

It is important to analyse the composition of India's large urban population in terms of spending power. The Indian "middle class", as per the latest definition of the National Council of Applied Economic Research (NCAER), is defined as "anyone whose family income was between INR200,000 and INR1,000,000 per annum in 2005".

While currently estimated at 60.2m households (approximately 300m people), the middle class is expected to be around 128m households (approximately 500m people) by 2015. However, we believe consumption business plans should also include the "Aspirers" group (annual income INR90,000-200,000, see Figure 8) as part of the India's "consuming middle class" since our conversations within the industry suggest that aspiration levels and consumption levels are experiencing rapid shifts among this group.

Figure 8 demonstrates that the wealthy classes in India grew at a significant rate of 20% during 2005-10 and this growth is expected to accelerate in the next four years assuming the real GDP growth maintains its 7-8% trajectory. While growth rates in the "consuming middle class" have been lower, they are also expected to accelerate over the next four years. The "Seekers" and "Strivers" groups should grow at a CAGR of 13% and 18%, respectively. More importantly from our perspective, analysis shows that the urban population has witnessed aggressive growth across the income classes (both the consuming middle class and the wealthy).

Figure 8: Households income and expenditure

	Household income brackets INR (k)	Number of households INR (m)	Aggregate disposable income INR (tr)	Aggregate consumption INR (tr)
2005	Deprived (<INR90)	101.1	5.4	4.1
	Aspirers (90-200)	91.3	11.4	8.5
	Seekers (200-500)	10.9	3.1	2.1
	Strivers (500-1000)	2.4	1.6	1
	Globals (>1000)	1.2	2.0	1.2
2015E	Deprived (<INR90)	74.1	3.8	3.3
	Aspirers (90-200)	106	14.6	12.2
	Seekers (200-500)	55.1	15.2	11.8
	Strivers (500-1000)	5.5	3.8	2.7
	Globals (>1000)	3.3	6.3	4.1
2025E	Deprived (<INR90)	49.9	2.6	2.4
	Aspirers (90-200)	93.1	13.7	11.9
	Seekers (200-500)	94.9	30.6	24.6
	Strivers (500-1000)	33.1	20.9	16.5
	Globals (>1000)	9.5	21.7	14.1

Source: NCAER

Short-term headwinds for margins

Commodity inflation is likely to negatively impact margins as palm oil (Malaysia), copra, barley, cotton, and coffee have grown between 20% and 90% yoy. While gross margins across the sector remain healthy, price increases in 2011 will likely be a trade-off between volumes and market share in the long term against margins in the short term.

Figure 9: Drivers of raw material costs

Raw material to sales (%)	FY10/ CY09	FY11E/ CY10E	FY12E/ CY11E	Key raw materials
Asian Paints	56%	57%	55%	Crude derivatives
Dabur	63%	61%	61%	Vegetable oils, Chemicals and perfumes
HUL	52%	54%	54%	Palm oil, packing materials
ITC	41%	42%	40%	Raw tobacco, vegetable oils
Marico	49%	50%	52%	Copra, Safflower oil
Nestle	49%	51%	49%	Milk, vegetable oil, coffee
Titan	77%	76%	74%	Gold
United Spirits	62%	65%	60%	Molasses, ENA, Packing materials
Jubilant Foodworks	30%	31%	34%	Cheese, Wheat

Source: Deutsche Bank

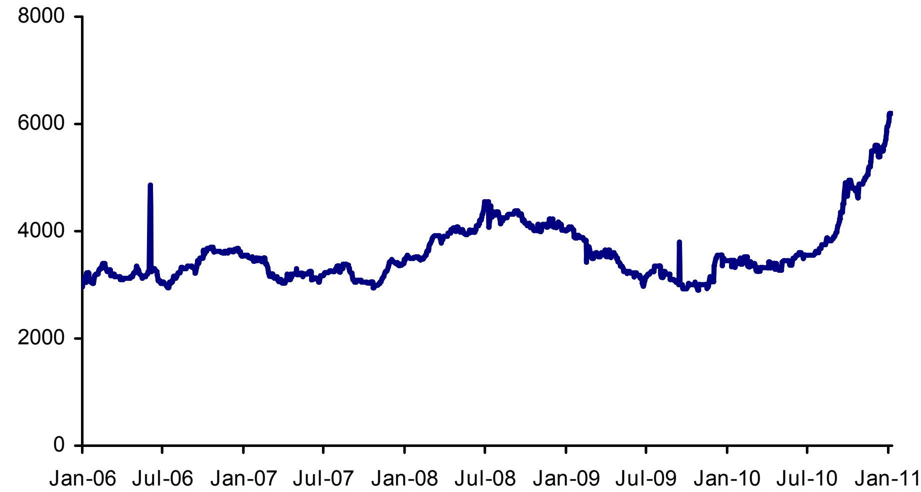
50% increase in palm oil prices is likely to negatively affect HUL's 3QFY11 margins

Figure 10: Palm oil prices

Source: Deutsche Bank

Copra prices have increased by 67% in 3QFY11E. However, as the best produce of copra floods the market in February prices should ease off

Figure 11: Copra price chart



Source: Deutsche Bank

A 40% price increase in barley prices should put pressure on alcohol beverage manufacturers' 3QFY11 margins

Figure 12: Barley price chart

Source: Deutsche Bank

Despite a 6% decline in wheat prices, new crop arrivals in Rabi should benefit processed foods companies Britannia and Nestle

Figure 13: Wheat price chart

Source: Deutsche Bank

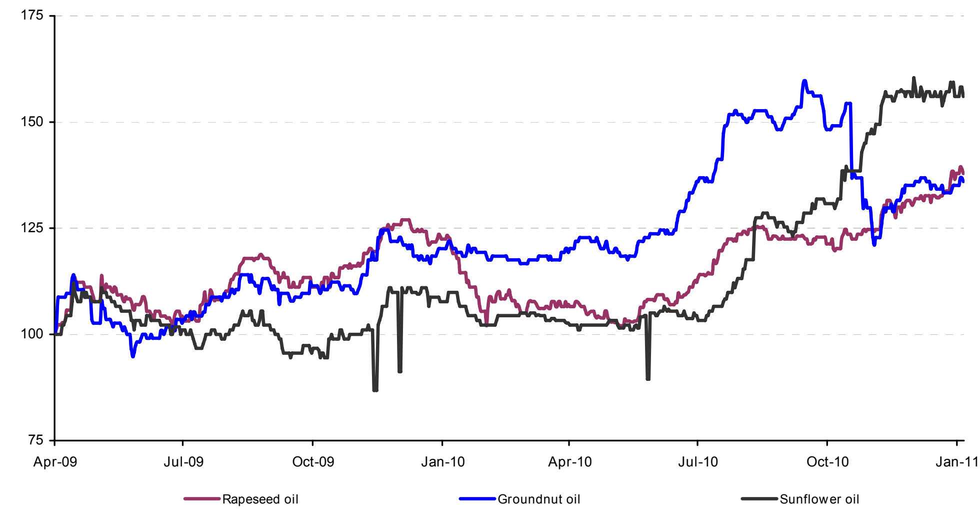
The benefit of a 15% decrease in sugar prices should be reflected in United Spirits 4QFY11E numbers

Figure 14: Sugar price index

Source: Deutsche Bank

The entire edible oil basket remains prohibitive. Increases range from 30% in groundnut oil to 55% in sunflower oil

Figure 15: Edible oil prices



Source: Deutsche Bank

Capital expenditure is back...

The key change within the sector is the willingness of players across the spectrum (home, personal care, processed foods, gems and jewellery and alcoholic beverages) to ramp up capacity (Nestle, Asian Paints, Dabur, Titan, and Jubilant Foodworks), integrate backwards (United Spirits), acquire brands (Dabur, Reckitt Benckiser, Marico, and Godrej) and launch new products (P&G, ITC and Dabur). While MNCs have rediscovered India in terms of capex, Indian companies acquired brands abroad, completing their product portfolios. We examine capex across consumer companies along with their asset turns. However, some of the capex plans may have been accelerated by sunset clauses (investment in select geographic areas until March 2011 allowing companies a five-year excise exemption, aside from the minimum tax rate, until 2015).

Figure 16: Capital expenditure denotes confidence in demand

INR (m)	FY11E/CY10E	FY12E/CY11E
Asian Paints	3,000	2,500
Dabur	2,500	2,500
HUL	3,000	2,000
ITC	15,000	15,500
Marico	500	500
Nestle	2,500	2,500
Titan	1,000	2,000
United Spirits	3,000	3,500
Jubilant Foodworks	600	600

Source: Deutsche Bank

Figure 17: Asset turns remain healthy

Asset turn ratio	FY11E/CY10E	FY12E/CY11E
Asian Paints	5.1	5.5
Dabur	5.11	5.23
HUL	8.45	9.63
ITC	2.11	2.39
Marico	8.17	9.82
Nestle	5.68	6.29
Titan	19.83	17.58
United Spirits	6.38	5.52
Jubilant Foodworks	3.54	4.41

Source: Deutsche Bank

Financials and valuations

We prefer DCF-based valuation for consumer companies given their relatively stable earnings growth. We have used a risk-free rate of 6.4% and a market risk premium of 7.2%. We have also examined the PE multiples over the last five years (during which we capture both a bull and bear market) and juxtaposed these with earnings growth. We compared EV/EBITDA parameters to a FY10-12E EBITDA CAGR.

Cigarettes, paints, watches and jewellery remain the best categories in which to invest within the Indian context. Within the sector there are no significant undervaluations. Long-term buy stories are driven by pricing power for respective companies resulting from an oligopolistic market structure and a growing market share for companies within the relatively mature home and personal care markets. ITC, Asian Paints, Titan, Jubilant Foodworks and Nestle are our top picks which we believe should outperform the sector. HUL remains a Hold.

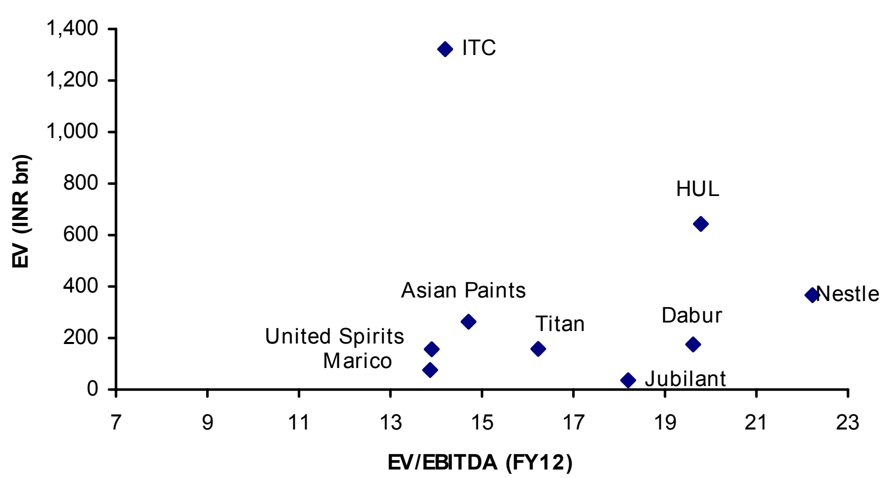
Figure 18: Financial snapshot

	Ticker	Market cap	Rating	Current price	Target price	% Upside	P/E		Earnings growth	EV/EBITDA	EBITDA growth	FCF yield
		(USDm)		(INR)	(INR)		FY11E	FY12E	(FY10-12E) CAGR	(FY12/CY11)	(FY10-12E)	(FY12/CY1 1)
Asian Paints	ASPN.BO	5,766	Buy	2714	3250	20%	29.3	22.7	17%	14.7	21%	1.2%
Dabur	DABU.BO	3,899	Hold	101	100	-1%	28.5	24.1	20%	19.6	21%	1.0%
HUL	HLL.BO	14,801	Hold	302	245	-19%	27.7	25.0	12%	19.8	13%	3.6%
ITC	ASPN.BO	29,184	Buy	173	196	13%	28.1	21.3	24%	14.2	24%	1.0%
Marico	MRCO.BO	1,636	Buy	123	150	22%	23.7	18.7	29%	13.9	21%	3.2%
Nestle	NEST.BO	8,094	Buy	3785	4200	11%	46.0	33.6	29%	22.2	26%	1.4%
Titan	TITN.BO	3,492	Buy	3416	4200	23%	35.0	25.2	54%	16.2	57%	-0.1%
United Spirits	UNSP.BO	3,429	Hold	1331	1600	20%	47.7	29.3	26%	13.9	34%	0.9%
Jubilant Foodworks	JUBI.BO	809	Buy	596	810	36%	46.5	35.3	79%	18.2	72%	2.4%

Source: Deutsche Bank

ITC graduated to become a USD30bn EV. At 14x EV/EBITDA, it remains our top pick

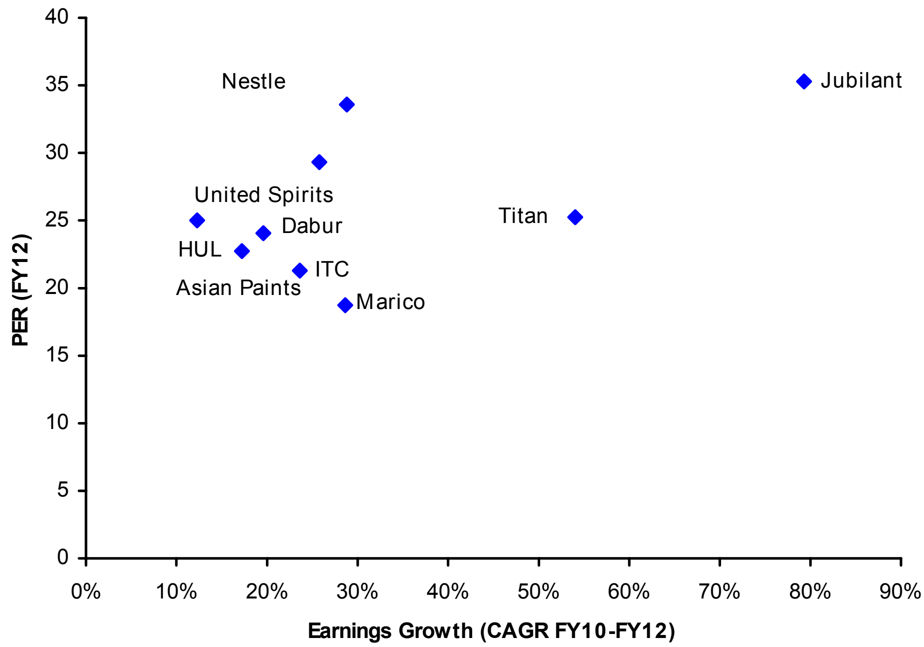
Figure 19: EV vs. EV/EBITDA demonstrates no significant undervaluation



Source: Deutsche Bank

Titan, Jubilant Foodworks and Nestle continue to trade to their underling earnings growth

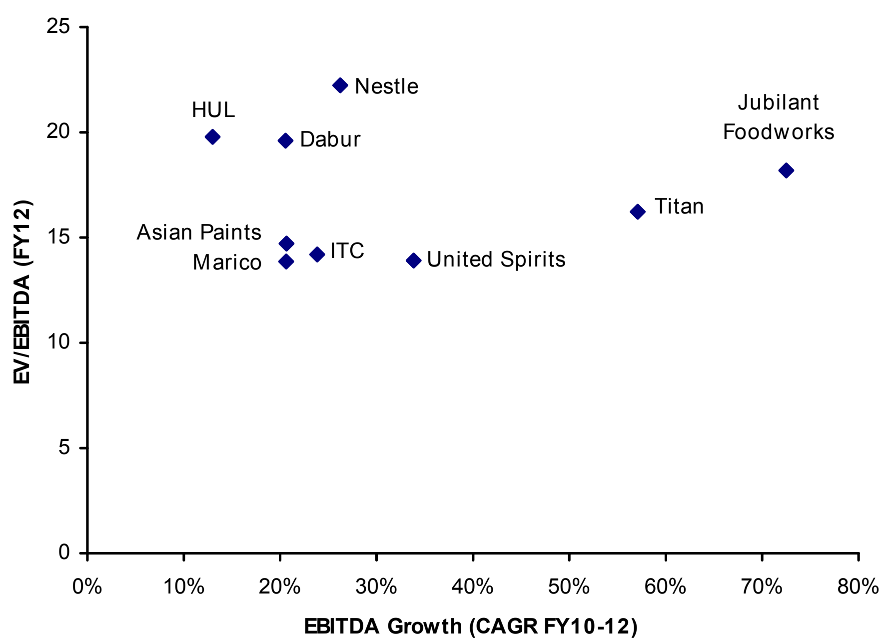
Figure 20: PE vs. earnings growth



Source: Deutsche Bank

Asian paints, Marico, and ITC rank the best in terms of EV/EBITDA

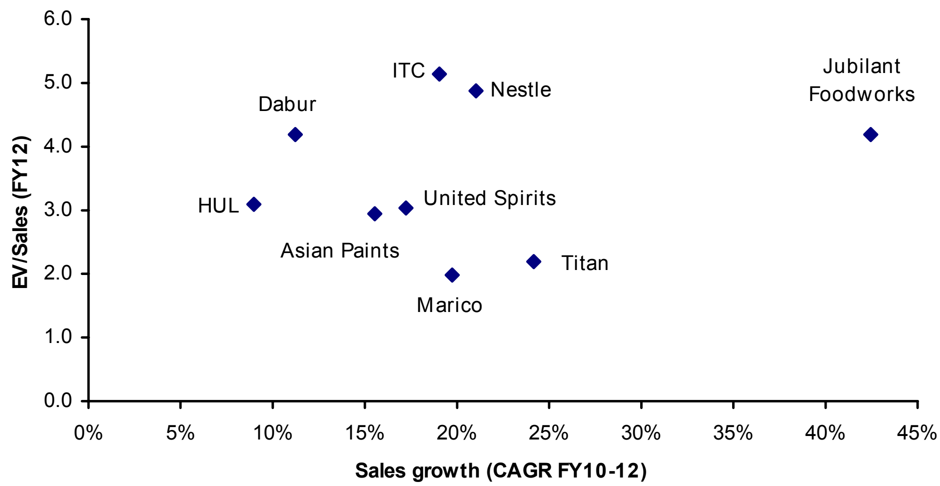
Figure 21: EV/EBITDA vs. earnings growth



Source: Deutsche Bank

At 5x EV/sales, ITC's stock factors in a positive cigarette volume outlook

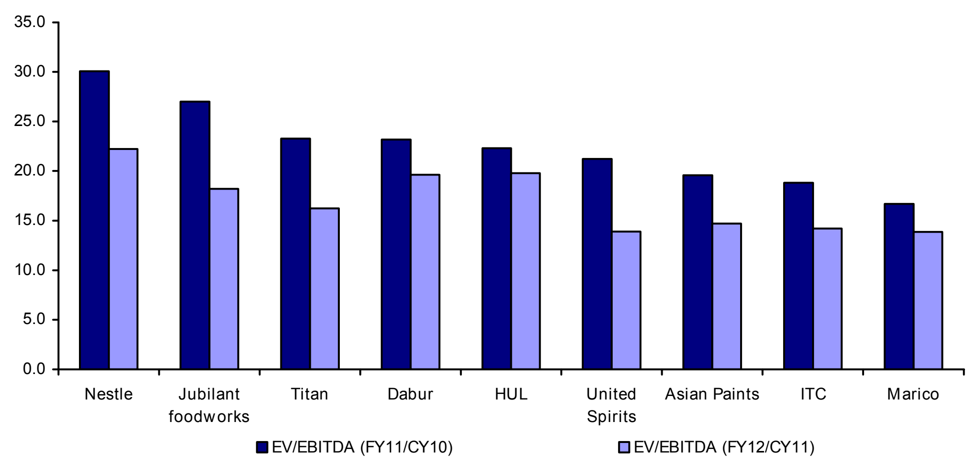
Figure 22: EV/sales vs. sales growth



Source: Deutsche Bank

Jubilant Foodworks and Titan have the sharpest EV/EBITDA delta in FY12E; jewellery for Titan and volume growth for Jubilant Foodworks drive earnings

Figure 23: EV/EBITDA FY11/FY12



Source: Deutsche Bank

Risks

Demography is not destiny

India is likely to have an increasing working age population (ages 15-64) at least for the next 35 years. India is roughly 150m behind China in terms of working age population. The US Census Bureau estimates that India will overtake China by approximately 2025, with a population of 1.4b.

Projections for the working age population are that India will likely add about 140m to the 15-64 age group between now and 2020. However, the window of opportunity is not as big as it seems. If the working age population is going to peak in 2045, a reform of education (primary, secondary and undergraduate) would be necessary within the next five years in order to take advantage of this demographic shift.

This education reform would ensure a well-educated population in 2025-30. That should provide India with a 15-year demographic advantage vs. China until 2045. With every year of delay in improving the Indian education system, an opportunity for encashing the demographic dividend is lost. In our view, the second area within the country that could use some improvement is its labour markets. Currently, India has a highly fossilised labour market, where organised labour is strong and unorganised labour is left to fend for itself. A more flexible hire-fire policy, backed appropriately by social safety nets, would be beneficial. This can easily be financed by higher taxes on employment and/or unemployment insurance, but there has been no movement in this direction as of yet. Without labour flexibility, industry will likely continue to prefer automation to the hire of new employees.

GST delayed but likely to increase tax base for FMCG companies

The new goods and service tax (GST) is likely to increase the tax charge across FMCG companies, though it should bring in efficiencies over the longer period. While the effective rate for GST (both Centre and State) will be approximately 15% (as per press reports), several categories within the sector operate at relatively lower VAT rates. We provide the rates for a hair oil, shampoos, fruit juices and tomato purees in Figure 24.

Figure 24: VAT rates for different states

Category	Cigarette	Hair oil	Shampoo	Juices	Tomato puree
State name					
Andhra Pradesh	12.5	12.5	12.5	12.5	12.5
Assam	12.5	12.5	12.5	12.5	4.5
Bihar	12.5	12.5	12.5	12.5	4
Chandigarh	12.5	13.2	13.2	13.2	13.2
Chatisgarh	12.5	17.3	17.3	13.8	13.8
Delhi	20	12.5	12.5	4	4
Gujarat	12.5	15	15	15	12
Haryana	12.5	12.5	12.5	12.5	12.5
Himachal Pradesh	12.5	12.5	12.5	4	4
J & K	12.5	12.5	12.5	4	4
Jharkhand	12.5	12	12	12	8
Karnataka	12.5	12.5	12.5	12.5	12.5
Kerala	12.5	12.5	12.5	12.5	12.5
Madhya Pradesh	12.5	13.8	13.8	13.8	13.8
Maharashtra	20	12.5	12.5	4	4
Orissa	12.5	12.5	12.5	4	4
Punjab	12.5	12.5	12.5	4	4
Rajasthan	20	14	14	12	12
Tamil Nadu	12.5	21	21	12.6	12.6
UP	12.5	17	17	12	12
Uttaranchal	12.5	12.5	12.5	4	4
West Bengal	12.5	12.5	12.5	4	4
Arunachal Pradesh	12.5	12.5	12.5	4	4
Bhutan	12.5	20	20	15	15
Goa	12.5	12.5	12.5	4	4
Manipur	12.5	12	12	12	12
Meghalaya	12.5	12.5	12.5	4	4
Mizoram	12.5	12.5	12.5	12.5	12.5
Nagaland	12.5	12	8	8	12
Pondicherryy	12.5	12	12	3	3
Port Blair	12.5				
Sikkim	12.5	15.5	15.5	15.56	7
Tripura	12.5	12.5	12.5	12.5	4

Source: Deutsche Bank

Company section

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Asia India
Consumer

14 January 2011

ITC

Reuters: **ITC.BO** Bloomberg: **ITC IN**

Strong cigarette volumes; raising target price to INR196

Increase in volume estimates; revising our target price to INR196
ITC's earnings estimate increase is driven by an increase in FY11 volume estimates (from YoY flat volumes to a 2.5% increase). We also factored in a 10% excise duty hike during the forthcoming budget (February 2011). We believe ITC will be able to comfortably pass on this excise duty increase. Our new DCF-derived target price of INR196 implies a target multiple of 24x FY12. Maintain Buy.

Recession drives cigarette duty hikes
Cigarette duties get increased during times of recession, irrespective of the particular Finance Minister. Other than in 1983-84, when the then finance minister (Mr. Pranab Mukherjee, who incidentally is the FM once more) changed the duty regime from ad valorem to specific, cigarette duties have risen in a fairly linear fashion.

Up to 10% excise charge is bearable
We expect cigarette duties to be raised by 10% in the current budget (expected 28 February 2011). Cigarette volumes should be positive if the duty increase is up to 10%. If the duty hike is more than 10%, then ITC volumes will likely suffer, as they did in 2007, when ITC faced the most punitive tax hits (first a state-imposed VAT imposition and then a relatively higher duty on non-filter cigarettes, which effectively killed the lower segment of cigarettes).

DCF-derived target price of INR196; maintain Buy rating
Our DCF-derived target price of INR196 rests on a 12% cost of equity, 4.5% terminal growth and a 23.6% earnings CAGR (FY10-FY12). Key risks include increased competition from international players interested in India

Forecasts and ratios

Year End Mar 31	2009A	2010A	2011E	2012E	2013E
Sales (INRm)	153,881.1	181,531.9	**210,260.1**	257,253.4	308,450.8
EBITDA (INRm)	48,818.0	60,734.6	**70,319.2**	93,132.7	108,337.9
Reported NPAT (INRm)	32,635.9	40,604.6	**47,150.4**	62,048.3	71,771.7
Reported EPS FD (INR)	4.32	5.32	**6.17**	8.13	9.40
DB EPS FD (INR)	4.35	5.32	**6.17**	8.13	9.40
OLD DB EPS FD (INR)	4.35	5.32	**6.02**	7.68	9.03
% Change	0.0%	0.0%	**2.5%**	5.8%	4.1%
DB EPS growth (%)	5.2	22.1	**16.1**	31.6	15.7
PER (x)	21.4	22.1	**28.0**	21.3	18.4
EV/EBITDA (x)	13.6	13.6	**18.0**	13.4	11.2
DPS (net) (INR)	1.85	5.00	**2.50**	3.00	3.50
Yield (net) (%)	2.0	4.3	**1.4**	1.7	2.0

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

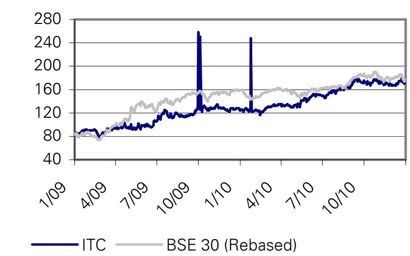
Buy

Price at 13 Jan 2011 (INR)	**173.15**
Price target - 12mth (INR)	**196.00**
52-week range (INR)	**247.95 - 116.02**
BSE 30	**19,534**

Key changes

Price target	180.00 to 196.00	↑	**8.9%**
Sales (FYE)	207,578 to 210,260	↑	**1.3%**
Op prof margin (FYE)	29.8 to 30.2	↑	**1.5%**
Net profit (FYE)	45,992.2 to 47,150.4	↑	**2.5%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*3.6*	*-1.2*	*39.1*
BSE 30	*-0.8*	*-5.6*	*11.6*

Stock data

Market cap (INRm)	**1,322,243**
Market cap (USDm)	**29,227**
Shares outstanding (m)	**7,636.4**
Major shareholders	**BAT plc (32%)**
Free float (%)	**44**
Avg daily value traded (USDm)	**27.6**

Key indicators (FY1)

ROE (%)	**30.8**
Net debt/equity (%)	**-0.9**
Book value/share (INR)	**21.70**
Price/book (x)	**8.0**
Net interest cover (x)	**–**
Operating profit margin (%)	**30.2**

Model updated:13 January 2011

Running the numbers

Asia

India

Consumer

ITC

Reuters: ITC.BO Bloomberg: ITC IN

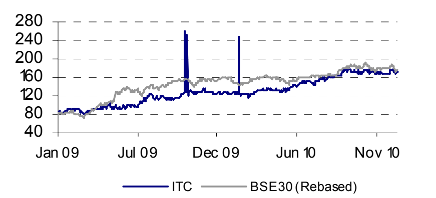
Buy

Price (13 Jan 11)	INR 173.15
Target price	INR 196.00
52-week Range	INR 116.03 - 247.95
Market Cap (m)	INRm 1,322,243 USDm 29,227

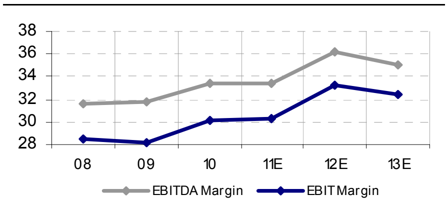
Company Profile

ITC Limited is a holding company, which has operations in the following business areas: Cigarettes & Tobacco, Agri Products, Hotels, Paper, Printing & Packaging, Real Estate and Travel Services. The Company manufactures and markets cigarettes under the India Kings Classic" and "Wills" brand names. ITC operates its chain of upscale hotels under the "Welcomgroup" brand name.

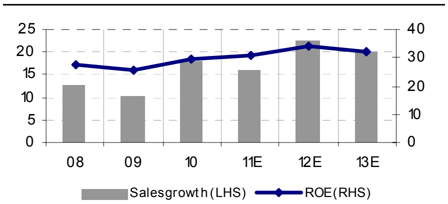
Price Performance



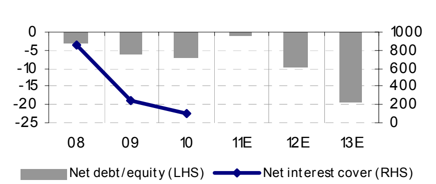
Margin Trends



Growth & Profitability



Solvency



Harrish Zaveri
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Fiscal year end 31-Mar	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (INR)	4.14	4.35	5.32	6.17	8.13	9.40
Reported EPS (INR)	4.14	4.32	5.32	6.17	8.13	9.40
DPS (INR)	1.75	1.85	5.00	2.50	3.00	3.50
BVPS (INR)	16.0	18.2	18.4	21.7	26.4	31.7
Weighted average shares (m)	7,537	7,548	7,636	7,636	7,636	7,636
Average market cap (INRm)	672,994	702,235	895,450	1,322,243	1,322,243	1,322,243
Enterprise value (INRm)	640,090	665,309	827,995	1,263,527	1,245,569	1,217,552
Valuation Metrics						
P/E (DB) (x)	21.6	21.4	22.1	28.0	21.3	18.4
P/E (Reported) (x)	21.6	21.5	22.1	28.0	21.3	18.4
P/BV (x)	6.45	5.08	7.14	7.98	6.57	5.46
FCF Yield (%)	1.6	2.9	7.6	1.0	3.4	4.5
Dividend Yield (%)	2.0	2.0	4.3	1.4	1.7	2.0
EV/Sales (x)	4.6	4.3	4.6	6.0	4.8	3.9
EV/EBITDA (x)	14.5	13.6	13.6	18.0	13.4	11.2
EV/EBIT (x)	16.1	15.4	15.2	19.9	14.5	12.2
Income Statement (INRm)						
Sales revenue	**139,475**	**153,881**	**181,532**	**210,260**	**257,253**	**308,451**
Gross profit	**77,569**	**87,521**	**106,697**	**121,916**	**153,588**	**180,444**
EBITDA	**44,039**	**48,818**	**60,735**	**70,319**	**93,133**	**108,338**
Depreciation	4,385	5,494	6,087	6,734	7,509	8,309
Amortisation	0	0	0	0	0	0
EBIT	**39,655**	**43,324**	**54,648**	**63,585**	**85,624**	**100,029**
Net interest income(expense)	-46	-183	-534	-32	0	0
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	-233	0	0	0	0
Other pre-tax income/(expense)	6,109	5,349	6,034	6,300	6,300	6,300
Profit before tax	**45,718**	**48,257**	**60,148**	**69,852**	**91,923**	**106,328**
Income tax expense	14,517	15,622	19,543	22,702	29,875	34,557
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**31,201**	**32,636**	**40,605**	**47,150**	**62,048**	**71,772**
DB adjustments (including dilution)	0	233	0	0	0	0
DB Net profit	**31,201**	**32,869**	**40,605**	**47,150**	**62,048**	**71,772**
Cash Flow (INRm)						
Cash flow from operations	**31,783**	**37,768**	**81,045**	**28,311**	**59,919**	**74,887**
Net Capex	-21,232	-17,397	-12,741	-15,000	-15,500	-16,000
Free cash flow	**10,551**	**20,371**	**68,304**	**13,311**	**44,419**	**58,887**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-15,235	-16,130	-44,100	-22,050	-26,460	-30,870
Net inc/(dec) in borrowings	136	-369	-698	-1,077	0	0
Other investing/financing cash flows	-506	0	6,106	0	0	0
Net cash flow	**-5,054**	**3,872**	**29,611**	**-9,816**	**17,959**	**28,017**
Change in working capital	*-3,802*	*-827*	*34,353*	*-25,573*	*-9,638*	*-5,194*
Balance Sheet (INRm)						
Cash and other liquid assets	5,703	10,324	11,263	1,447	19,405	47,422
Tangible fixed assets	72,957	84,860	91,514	99,780	107,771	115,462
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	29,346	28,378	57,269	57,269	57,269	57,269
Other assets	67,367	74,186	73,370	80,125	100,866	119,697
Total assets	**175,372**	**197,747**	**233,416**	**238,621**	**285,311**	**339,850**
Interest bearing debt	2,144	1,776	1,077	0	0	0
Other liabilities	52,651	58,621	91,695	72,876	83,979	97,616
Total liabilities	**54,795**	**60,396**	**92,772**	**72,876**	**83,979**	**97,616**
Shareholders' equity	120,577	137,351	140,644	165,744	201,332	242,234
Minorities	0	0	0	0	0	0
Total shareholders' equity	**120,577**	**137,351**	**140,644**	**165,744**	**201,332**	**242,234**
Net debt	*-3,558*	*-8,548*	*-10,186*	*-1,447*	*-19,405*	*-47,422*
Key Company Metrics						
Sales growth (%)	12.8	10.3	18.0	15.8	22.4	19.9
DB EPS growth (%)	15.4	5.2	22.1	16.1	31.6	15.7
EBITDA Margin (%)	31.6	31.7	33.5	33.4	36.2	35.1
EBIT Margin (%)	28.4	28.2	30.1	30.2	33.3	32.4
Payout ratio (%)	42.3	42.8	94.0	40.5	36.9	37.2
ROE (%)	27.7	25.3	29.2	30.8	33.8	32.4
Capex/sales (%)	15.2	11.3	7.0	7.1	6.0	5.2
Capex/depreciation (x)	4.8	3.2	2.1	2.2	2.1	1.9
Net debt/equity (%)	-3.0	-6.2	-7.2	-0.9	-9.6	-19.6
Net interest cover (x)	860.2	236.5	102.4	nm	nm	nm

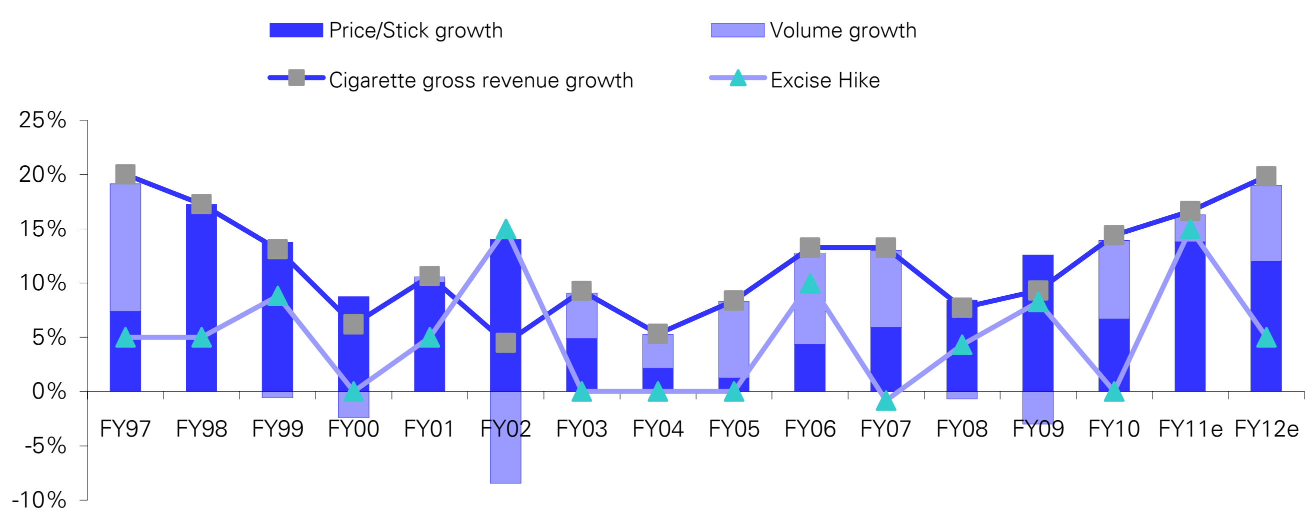
Source: Company data, Deutsche Bank estimates

The more things change…

Up to 10% excise charge is bearable

We expect cigarette duties to be raised by 10% in the current budget (which is expected in the last week of February). Cigarette volumes should be positive if the duty increase is up to 10%. If the duty hike is higher, then ITC volumes will suffer, as they have over the last two years, when ITC faced the most punitive tax hits (first a state-imposed VAT imposition and then a relatively higher duty on non-filter cigarettes, which effectively killed the lower segment of cigarettes).

Figure 25: Sensitivity of cigarette volume growth to excise duty hike



Source: Company data, Deutsche Bank

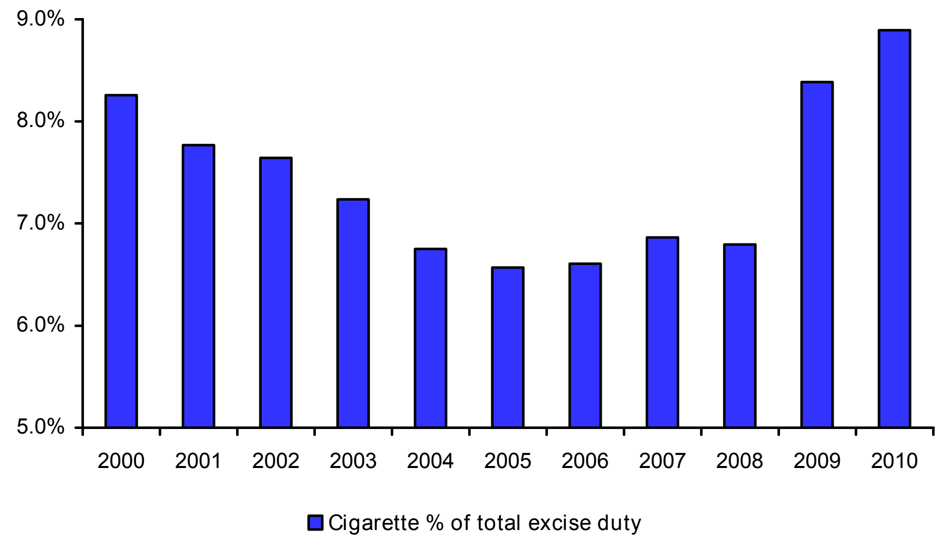
Figure 26: Despite excise duties being cut in 2009 and 2010…

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Government excise duty collections	619,020	685,260	725,550	823,100	907,740	991,250	1,112,260	1,176,130	1,236,110	1,083,590	1,064,770
Growth		10.7%	5.9%	13.4%	10.3%	9.2%	12.2%	5.7%	5.1%	-12.3%	-1.7%
ITC cigarettes excise duty paid	41,080	44,478	46,740	50,494	52,274	55,252	61,984	68,480	70,441	73,254	75,939
Growth %		8.3%	5.1%	8.0%	3.5%	5.7%	12.2%	10.5%	2.9%	4.0%	3.7%
Overall cigarette excise duty paid	51,115	53,228	55,463	59,562	61,293	65,111	73,502	80,723	83,992	90,860	94,709
Growth %		4.1%	4.2%	7.4%	2.9%	6.2%	12.9%	9.8%	4.1%	8.2%	4.2%

Source: Deutsche Bank

The last decade has witnessed a reduced dependence on cigarette excise duties within the total excise collections. Cigarette excise collections as a percentage of total excise dropped from 8.2% in 2000 to 6.5% in 2008. However, the stimulus in 2008 (when the government cut excise duties by 4% across all sectors except for cigarettes) resulted in cigarette excise contribution increasing to ~9% in 2010.

Figure 27: Cigarette excise duty as a % of total central excise duty collections



Source: Deutsche Bank

We expect the states of Bihar, MP, Uttar Pradesh, Kerala, Jharkhand, Orissa and Tamilnadu to hike VAT rates for cigarettes in the coming budgets.

Figure 28: State VAT increases over the last three budgets

State	2009-2010
Maharashtra	7.5% hike
Delhi	7.5% hike
Rajasthan	7.5% hike
State	**2010-2011**
Chhattisgarh	7.5% hike
Gujarat	7.5% hike
Haryana	7.5% hike
Karnataka	2.5% Hike
Andhra Pradesh	2% Hike
State	**2010-2011**
Bihar	No Hike
Madhya Pradesh	No Hike
Uttar Pradesh	No Hike
Kerala	No Hike
Jharkhand	No Hike
Orissa	No Hike
Tamil Nadu	No Hike
Uttarakhand	No Hike
West Bengal	No Hike
Himachal Pradesh	No Hike
Punjab	No Hike

Source: Deutsche Bank

Drivers of cigarette duty hikes

What began as an exercise to determine the new FM's past views on cigarette duties was extended to examine the approach of various finance ministers' approach to cigarette duties during times of recession. We found that:

1) Cigarette duties get increased during times of recession.

2) Other than in 1983-84, when the then finance minister (Mr. Pranab Mukherjee) changed the duty regime from ad valorem to specific, cigarette duties have risen in a fairly linear fashion.

Figure 29: Cigarettes' excise duty changes during periods of low GDP growth in India

Budget for the Year	Finance minister	Situation before the budget	Cigarette duty
1982-83	Pranab Mukharjee	Severe draught, low agricultural productivity and inflation	No mention
1983-84	Pranab Mukharjee	Poor economic condition	The concessional rates of duty on cigarettes were withdrawn and the rates of duty were linked to the retail price printed on the cigarette packs
1984-85	Pranab Mukharjee	Economy beginning to recover	The effective excise duty on cigarettes was kept the same while changing the proportion between basic excise duty and additional excise duty.
1989-90	SB Chavan	Rising budget deficit	Increase in excise duty for both filter and non-filter cigarettes
1990-91	Prof Madhu Dandavate	Huge budget deficit, balance of payment under strain	Hike of 15 paise for the cheaper cigarettes and 75 paise for costlier cigarettes per packet of ten. There was no change in the duty rate on non-filter cigarettes of a length up to 60mm
1991-92	Manmohan Singh	Foreign exchange crisis, double-digit inflation, political instability, sharp decline in capital inflows	Hike in duties by INR10 to INR25 per thousand cigarettes depending upon length. In respect to filter cigarettes, the increase was between INR35 and INR125 per thousand cigarettes. However, filter cigarettes exceeding 85mm were set at the ceiling rate prescribed in the excise tariff.
1992-93	Manmohan Singh	Economy on the verge of collapse. Inflation was accelerating rapidly. The balance of payments was in serious trouble. The foreign exchange reserves were barely enough for two weeks of imports. Foreign commercial banks had stopped lending to India.	No hike in non-filter cigarettes; hike of INR30-INR100 on filter cigarettes depending on the length
1993-94	Manmohan Singh	Slight recovery seen in the economy	No mention
1999-00	Yashwant Sinha	Sanctions after nuclear tests	No mention
2000-01	Yashwant Sinha	Budget after Gargil War, Orrisa cyclone	5% hike on all cigarettes
2001-02	Yashwant Sinha	Gujarat earthquake, irregular monsoon, low agricultural productivity but low inflation, record foreign exchange reserves and food stocks	Surcharge of 15% on cigarettes
2002-03	Yashwant Sinha	Attack on World Trade Tower; agricultural recovery, inflation down to 1.1%, rising foreign exchange reserves and food stock	16% CENVAT on cigars
2003-04	Jaswant Singh	Current account surplus, industry and services sectors show good growth despite a decline in agricultural GDP	No mention
2007-08 (Feb 2007)	P. Chidambaram	Strong GDP growth of 9%; strong manufacturing growth of 11.2%	5% increase in excise duty in cigarettes, 50% increase in tax on bidis
2008-09 (Feb 2008)	P. Chidambaram	The start of the credit crisis; poor agriculture growth; very high commodity prices	Excise duty on non-filter cigarettes increased to the same level as filter cigarettes
2009-10 (July 2009)	Pranab Mukharjee	Congress government voted back to power, credit crisis at its peak, weak business sentiment, GDP growth slower at 6.7%, focus on putting economy back on track	No mention
2010-11 (Feb 2010)	Pranab Mukharjee	Business confidence still low, delayed and sub-normal monsoon	9-18% increase in excise duty

Source: Deutsche Bank, Finance Ministry

ITC's stock performance during the budget period

1 month ahead of the budget….

ITC's stock price has a reasonably good indicator of the FM's actions going forward with the five-year period 1999-03 reflecting a tough budget in 2001 (15% hike in excise) and benign budgets in other years (with no duties in 1999, 2000, 2002 and 2003). The exceptions were 1991 and 1992, when the markets were in a bull market.

Figure 30: ITC's stock performance during the budget period

1 month before the budget		1 day before the budget		Change %	Change on the budget day
2/3/1992	4.38	2/27/1992	6.41	46.3%	33.0%
2/1/1993	6.33	2/27/1993	6.86	8.4%	-0.4%
2/1/1999	21.61	2/27/1999	22.44	3.8%	7.0%
2/1/2000	19.11	2/28/2000	21.91	14.7%	-8.0%
2/1/2001	24.34	2/27/2001	22.59	-7.2%	-6.2%
2/1/2002	19.31	2/27/2002	20.16	4.4%	2.2%
2/3/2003	18.36	2/27/2003	18.07	-1.6%	1.1%
1-Feb-07	79.36	27-Feb-07	74.98	-5.5%	3.9%
1-Feb-08	95.01	28-Feb-08	93.66	-1.4%	0%
8-Jun-09	86.92	5-Jul-09	90.76	4.4%	3.13%
1-Feb-10	118.79	27-Feb-10	111.92	-5.8%	4.17%

Source: Bloomberg Finance LP

Prices following the budget

Stock prices following the budget were a continuation of the trend started one month before, reflecting a tough budget in 2001 (15% hike in excise) and benign budgets in other years (with no duties in 1999, 2000, 2002 and 2003). The exceptions were 1991 and 1992, when the markets were in a bull market.

Valuation and risks

Increase target price to INR196

A 23.6% CAGR in earnings (FY10-12) is the driver of our DCF-based valuation. We compare ITC to its international peers vis-à-vis its earnings growth, EV/EBITDA valuation and EV/FCF as well as earnings multiple valuation. Earnings growth remains the key driver of tobacco companies' multiples. EV/FCF is a function of FCF growth over two years.

Figure 31: International peers

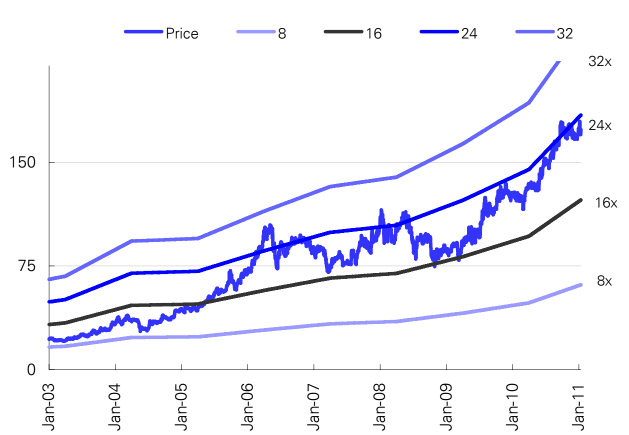
			-----------------FY12/CY11----------------				-----------------FY13/CY12----------------			
	Ticker	**Current price**	**P/E**	**EPS Growth**	**EV/EBITDA**	**EV/FCF**	**P/E**	**EPS Growth**	**EV/EBITDA**	**EV/FCF**
Imperial	IMT.L	1940 (GBp)	10.1	7.5	8.5	15.5	9.2	9.5	8.0	14.2
BAT	BATS.L	2411 (GBp)	12.6	9.7	8.9	15.3	11.6	8.6	8.2	14.1
Philip Morris International	PM.N	56.59 (USD)	12.7	12.1	8.9	15.4	11.5	10.1	8.2	13.9
KT&G	033780.KS	64600 (KRW)	12.9	-1.9	6.2	11.0	12.0	7.1	5.7	10.0
BAT Malaysia	BATO.KL	47.18 (MYR)	18.0	1.6	12.5	18.5	17.0	6.2	11.9	NM
Gudan Garam	GGRM.JK	40300 (IDR)	13.7	21.1	8.7	13.0	0.0	NA	NM	NM
ITC	ITC.BO	173.35 (INR)	22.6	27.5	14.2	29.8	19.2	17.5	11.8	21.8

Source: Deutsche Bank

Target price does not imply a re-rating

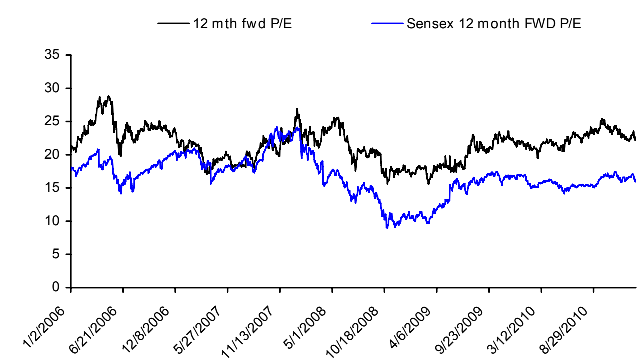
Our target price for ITC does not imply a re-rating for the stock beyond its historical band. ITC's stock has historically traded in an earnings band of 18-24x one-year forward and remains within the band.

Figure 32: Rolling one-year forward PE bands



Source: Bloomberg Finance LP data

Figure 33: One-year forward ITC PE vs. Sensex



Source: Bloomberg Finance LP data

Discounted free-cash-flow-to-equity model implies a target price of INR196 per share

The key assumptions for our two-stage FCFE methodology are:

a) A Risk-free rate of 6.4%, market risk premium of 7.2% and beta of 0.78, implying a cost of equity of 12%

b) Growth in the stable phase of 4.5%

Our value for ITC works out to INR196 per share. This implies an earnings multiple of 24x FY12E.

Refer to Figure 34 for further details of our DCF model.

Risks

Our chief concern lies in increased competition. International players, such as Japan Tobacco in particular, are interested in India. The change in competitive landscape in ITC's key cash cow business should be watched out for. However, the current political disposition is in favour of banning FDI in cigarettes altogether, which implies continued near-monopoly status for ITC.

Hotels and paper suffer from cyclical risks while the scale-up in the non-cigarette FMCG business faces execution risk.

Figure 34: DCF valuation for ITC

Cost of Equity =	12.01%

Proportion of Debt: Capital Spending (DR)=	0.00%
Proportion of Debt: Working Capital (DR)=	0.00%

Current Earnings per share=	8.1
(Capital Spending - Depreciation)*(1-DR)	1.0
Change in Working Capital * (1-DR)	3.6
Current FCFE	3.5

Growth Rate in Earnings per share

	Growth Rate	*Weight*
Historical Growth =	18.11%	0.00%
Outside Estimates =	17.00%	0.00%
Fundamental Growth =	19.44%	100.00%
Weighted Average	*19.44%*	

Growth Rate in capital spending, depreciation and working capital

	High Growth	*Stable Growth*
Growth rate in capital spending =	10.00%	Do not enter
Growth rate in depreciation =	10.00%	Do not enter
Growth rate in revenues =	18.00%	0.00%

Working Capital as percent of revenues =	15%	(in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	**1.00**	**2.00**	**3.00**	**4.00**	**5.00**
Earnings	9.7	11.6	13.8	16.5	19.8
- (CapEx-Depreciation)*(1-DR)	1.2	1.3	1.4	1.5	1.7
-Chg. Working Capital*(1-DR)	0.9	1.1	1.3	1.5	1.8
Free Cashflow to Equity	7.6	9.2	11.2	13.5	16.3
Present Value	**6.8**	**7.4**	**7.9**	**8.6**	**9.2**

Growth Rate in Stable Phase =	4.50%
FCFE in Stable Phase =	20.64
Cost of Equity in Stable Phase =	12.01%
Price at the end of growth phase (INR/share) =	**275**

Present Value of FCFE in high growth phase (INR/share)=	**40**
Present Value of Terminal Price (INR/share) =	**156**
Value of the stock (INR/share)=	**196**

Estimating the value of growth (INR/share)

Value of assets in place =	29
Value of stable growth =	19
Value of extraordinary growth =	148
Value of the stock =	196

Source: Deutsche Bank

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Asia India
Consumer Retail/Wholesale Trade

14 January 2011

Asian Paints Ltd

Reuters: **ASPN.BO** Bloomberg: **APNT IN**

Strong volume growth, raising target price to INR3,250/share

Higher volume growth estimate drives our earnings upgrade

We are raising our earnings forecast 7% and upgrading our target price due to higher-than-expected volume growth. Sustainable market share gains continue to be driven by ongoing conversion to water-based paints. Asian Paints' new plant expansions remain on track. We maintain Buy with a revised target price of INR3,250.

Deferred demand reflected in Asian Paints' inventory

A 72% hike in September 2010 inventories versus September 2009 is indicative of a build-up for servicing dealers in the festive season. This was similar to the increase in inventories reflected in ICI's books. Management mentioned that while in September 2009 demand was chasing production, in 2010 production was chasing demand until July before the situation reversed with the floods in North India.

Prices up 9% during the past eight months

The company has raised prices four times in the past eight months (total 9%) to counter a 16% increase in raw material prices. We believe the price hikes are sufficient to pass through the increase in raw material prices.

Maintaining Buy with revised target price of INR3,250

Our DCF-based target price of INR3,250 rests on a cost of equity of 11.2% and 4.5% growth. Downside risks include higher solvent prices, which affect 30% of Asian Paints' revenues from solvent-based paints, and slower demand during the peak December quarter

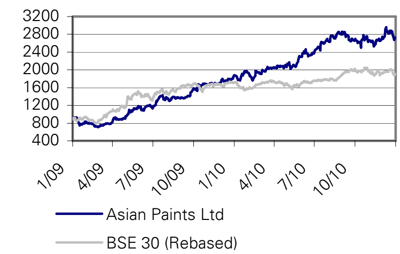
Buy

Price at 13 Jan 2011 (INR)	**2,714.40**
Price target - 12mth (INR)	**3,250.00**
52-week range (INR)	**2,963.15 - 1,761.35**
BSE 30	**19,534**

Key changes

Price target	2,950.00 to 3,250.00 ↑	**10.2%**
Sales (FYE)	74,949 to 75,582 ↑	**0.8%**
Op prof margin (FYE)	15.9 to 16.5 ↑	**3.4%**
Net profit (FYE)	8,560.0 to 8,901.6 ↑	**4.0%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*1.0*	*2.0*	*45.6*
BSE 30	*-0.8*	*-5.6*	*11.6*

Stock data

Market cap (INRm)	**260,365**
Market cap (USDm)	**5,769**
Shares outstanding (m)	**95.9**
Major shareholders	**Promoter's family (49.98%)**
Free float (%)	**34**
Avg daily value traded (USDm)	**4.916**

Key indicators (FY1)

ROE (%)	**44.6**
Net debt/equity (%)	**5.2**
Book value/share (INR)	**237.74**
Price/book (x)	**11.4**
Net interest cover (x)	**43.7**
Operating profit margin (%)	**16.5**

Forecasts and ratios

Year End Mar 31	2009A	2010A	**2011E**	2012E	2013E
Sales (INRm)	54,632.3	66,809.4	**75,581.8**	89,186.5	103,456.4
EBITDA (INRm)	6,916.4	12,276.2	**13,431.0**	17,872.2	21,706.8
Reported NPAT (INRm)	3,978.4	8,329.6	**8,901.6**	11,449.1	13,755.0
Reported EPS FD(INR)	41.48	86.84	**92.80**	119.36	143.40
DB EPS FD(INR)	41.48	86.84	**92.80**	119.36	143.40
OLD DB EPS FD(INR)	41.48	86.84	**89.24**	111.20	134.07
% Change	0.0%	0.0%	**4.0%**	7.3%	7.0%
DB EPS growth (%)	-2.8	109.4	**6.9**	28.6	20.1
PER (x)	25.0	16.9	**29.2**	22.7	18.9
EV/EBITDA (x)	14.5	11.1	**19.1**	14.1	11.4
DPS (net) (INR)	17.39	27.00	**28.86**	37.12	44.60
Yield (net) (%)	1.7	1.8	**1.1**	1.4	1.6

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Model updated:12 January 2011

Running the numbers

Asia

India

Retail/Wholesale Trade

Asian Paints Ltd

Reuters: ASPN.BO Bloomberg: APNT IN

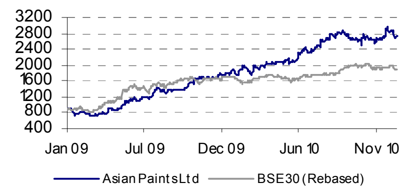
Buy

Price (13 Jan 11)	INR 2,714.40
Target price	INR 3,250.00
52-week Range	INR 1,761.35 - 2,963.15
Market Cap (m)	INRm 260,365 USDm 5,769

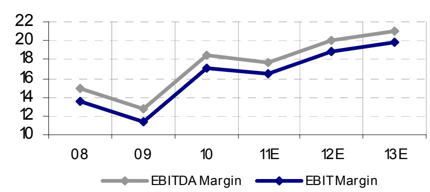
Company Profile

Asian Paints is India's largest paint company operating in 22 countries with 30 paint manufacturing facilities in the world.

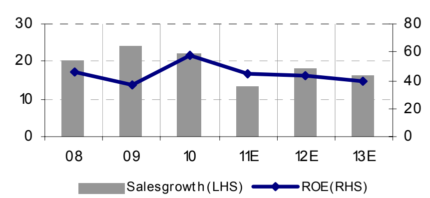
Price Performance



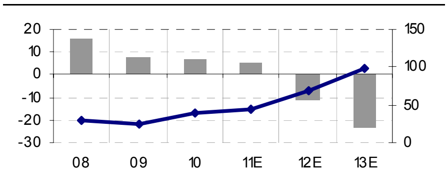
Margin Trends



Growth & Profitability



Solvency



Harrish Zaveri
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Fiscal year end 31-Mar	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (INR)	42.66	41.48	86.84	92.80	119.36	143.40
Reported EPS (INR)	42.66	41.48	86.84	92.80	119.36	143.40
DPS (INR)	33.01	17.39	27.00	28.86	37.12	44.60
BVPS (INR)	102.4	125.4	178.3	237.7	314.2	406.1
Weighted average shares (m)	96	96	96	96	96	96
Average market cap (INRm)	92,804	99,583	140,811	260,365	260,365	260,365
Enterprise value (INRm)	92,256	100,537	136,748	256,811	252,707	247,080
Valuation Metrics						
P/E (DB) (x)	22.7	25.0	16.9	29.2	22.7	18.9
P/E (Reported) (x)	22.7	25.0	16.9	29.2	22.7	18.9
P/BV (x)	11.72	6.27	11.46	11.42	8.64	6.68
FCF Yield (%)	4.4	0.6	6.1	1.2	3.4	4.3
Dividend Yield (%)	3.4	1.7	1.8	1.1	1.4	1.6
EV/Sales (x)	2.1	1.8	2.0	3.4	2.8	2.4
EV/EBITDA (x)	14.0	14.5	11.1	19.1	14.1	11.4
EV/EBIT (x)	15.4	16.3	12.0	20.6	15.1	12.1
Income Statement (INRm)						
Sales revenue	**44,043**	**54,632**	**66,809**	**75,582**	**89,187**	**103,456**
Gross profit	**18,267**	**20,926**	**29,230**	**32,169**	**40,011**	**47,042**
EBITDA	**6,582**	**6,916**	**12,276**	**13,431**	**17,872**	**21,707**
Depreciation	592	744	836	990	1,128	1,265
Amortisation	0	0	0	0	0	0
EBIT	**5,991**	**6,173**	**11,441**	**12,441**	**16,744**	**20,442**
Net interest income(expense)	-212	-263	-285	-285	-245	-206
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	-16	-23	-56	0	0	0
Other pre-tax income/(expense)	551	282	1,414	1,248	1,248	1,404
Profit before tax	**6,314**	**6,169**	**12,514**	**13,404**	**17,748**	**21,640**
Income tax expense	2,034	1,974	3,731	4,021	5,679	7,141
Minorities	189	216	454	481	619	744
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**4,092**	**3,978**	**8,330**	**8,902**	**11,449**	**13,755**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**4,092**	**3,978**	**8,330**	**8,902**	**11,449**	**13,755**
Cash Flow (INRm)						
Cash flow from operations	**6,620**	**3,447**	**13,236**	**6,170**	**11,335**	**13,813**
Net Capex	-2,577	-2,878	-4,586	-3,000	-2,500	-2,500
Free cash flow	**4,043**	**570**	**8,650**	**3,170**	**8,835**	**11,313**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-3,657	-1,927	-2,991	-3,197	-4,113	-4,941
Net inc/(dec) in borrowings	-310	334	-794	0	-637	0
Other investing/financing cash flows	-23	3,769	-7,659	0	0	0
Net cash flow	**53**	**2,746**	**-2,794**	**-27**	**4,086**	**6,372**
Change in working capital	*1,664*	*-1,749*	*3,571*	*-4,203*	*-1,861*	*-1,952*
Balance Sheet (INRm)						
Cash and other liquid assets	1,107	2,104	1,058	1,031	5,117	11,489
Tangible fixed assets	6,917	9,051	12,802	14,812	16,184	17,419
Goodwill/intangible assets	444	506	367	367	367	367
Associates/investments	2,767	784	6,241	6,241	6,241	6,241
Other assets	14,008	15,883	17,377	19,109	22,433	25,919
Total assets	**25,242**	**28,328**	**37,845**	**41,561**	**50,343**	**61,435**
Interest bearing debt	2,752	3,086	2,292	2,292	1,655	1,655
Other liabilities	12,093	12,454	17,509	15,039	16,502	18,036
Total liabilities	**14,845**	**15,541**	**19,802**	**17,332**	**18,157**	**19,692**
Shareholders' equity	9,824	12,032	17,100	22,804	30,140	38,955
Minorities	574	756	945	1,426	2,045	2,789
Total shareholders' equity	**10,397**	**12,787**	**18,044**	**24,230**	**32,186**	**41,744**
Net debt	*1,645*	*983*	*1,234*	*1,261*	*-3,462*	*-9,834*
Key Company Metrics						
Sales growth (%)	20.0	24.0	22.3	13.1	18.0	16.0
DB EPS growth (%)	45.6	-2.8	109.4	6.9	28.6	20.1
EBITDA Margin (%)	14.9	12.7	18.4	17.8	20.0	21.0
EBIT Margin (%)	13.6	11.3	17.1	16.5	18.8	19.8
Payout ratio (%)	77.4	41.9	31.1	31.1	31.1	31.1
ROE (%)	46.5	36.4	57.2	44.6	43.2	39.8
Capex/sales (%)	5.9	5.3	6.9	4.0	2.8	2.4
Capex/depreciation (x)	4.4	3.9	5.5	3.0	2.2	2.0
Net debt/equity (%)	15.8	7.7	6.8	5.2	-10.8	-23.6
Net interest cover (x)	28.3	23.5	40.2	43.7	68.3	99.4

Source: Company data, Deutsche Bank estimates

Higher volume growth drives earnings upgrade

Deferred festive demand to be reflected in Q3FY11 results

Asian Paints reported 5% top-line growth and a 20% decline in PAT for 2QFY11. The key reasons for its weak numbers was a shift in festive sales to the third quarter due to the Diwali festival in November compared with October the previous year and weak demand in North India due to extended monsoons.

A 72% y-o-y increase in September inventories was indicative of a build-up for servicing dealers during the festive season. This was similar to the rise in inventories reflected in ICI's books. The management mentioned that while in September 2009 demand was chasing production, in 2010 production was chasing demand until July, before the situation reversed with the floods in North India.

Figure 35: 2QFY11 results comparison: Asian Paints vs ICI Paints

	Asian Paints	ICI Paints
Sales growth	6%	4%
Volume growth	-1%	2%
Price hike	5%	2%
EBITDA growth	3%	-3%
PBT increase	1%	-3.20%
PAT Increase	-20%	-12.70%
Gross margin increase	50 bps	-279 bps
EBITDA margin increase	-42 bps	-61 bps
Increase in inventory	73.8%	44%

Source: Company data, Deutsche Bank

Prices up 9% during the past eight months

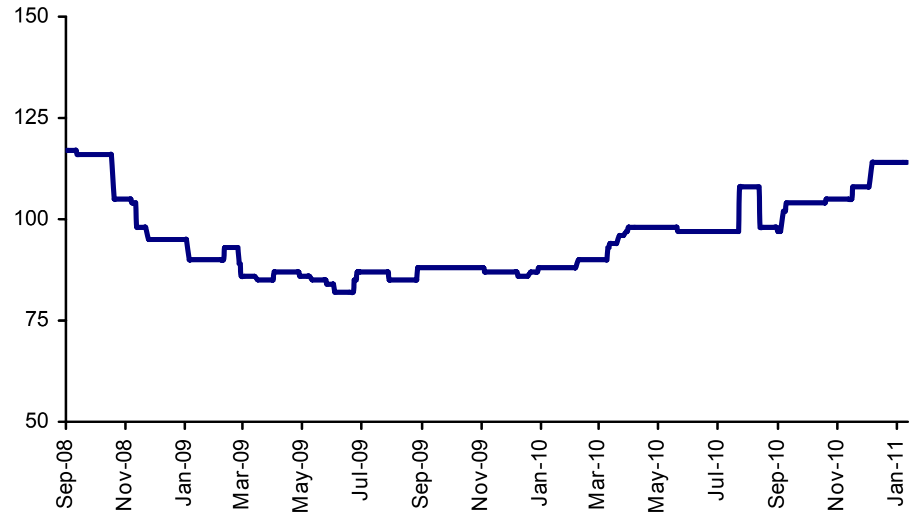
The company raised prices four times in the last eight months (total 9%) to counter a 16% increase in raw material prices. We believe the price hikes are sufficient to pass through the increase in raw material prices.

Figure 36: Recent price hikes

	Price increases
May-10	4.15%
July-10	2.60%
August-10	1.20%
December-10	1.20%
	9.15%

Source: Deutsche Bank

Figure 37: Titanium dioxide chart (INR/kg)



Source: Bloomberg Finance LP

Clearances obtained for a 300,000 KL plant (67% of existing capacity)

The company has obtained clearances to commission a 300,000 KL plant at Khandala. The plant is scheduled to be commissioned in FY12-13. In April 2010, the company commissioned a 150,000 KL capacity plant in Rohtak, which was 30% of its capacity at that time. We believe the additional 67% capacity indicates the robustness of domestic demand. The capex for the new plant would be INR10bn

We expect 27% PAT growth in 3Q

We expect strong sales growth in 3Q with deferred demand in the last quarter reflected in 3Q results. We believe 17% volume growth and about an 8% effective price rise should be the key highlights of the quarter.

Figure 38: 3QFY11 results preview

INR mn	3QFY11 (DB est)	3QFY10	YoY	FY11E	FY12E
Net Sales	20,454	16,200	26%	75,582	89,187
Gross Profit	8,607	7,073	22%	32,169	40,011
EBITDA	4,157	3,181	31%	13,431	17,872
Net profit	2,523	1,984	27%	8,902	11,449
Margins			**Bps**		
Gross Margin	42.1%	43.7%	-158	42.6%	44.9%
EBITDA Margin	20.3%	19.6%	69	17.8%	20.0%
Net Profit Margin	12.3%	12.2%	9	11.8%	12.8%

Source: Deutsche Bank, company data

Valuation and risks

Our DCF-derived target price of INR3,250 rests on the following assumptions.

- Risk-free rate of 6.4% (Deutsche Bank estimates), market-risk premium of 7.2% (Deutsche Bank estimates) and Beta of 0.67 (Bloomberg data), implying a cost of equity of 11.22%
- Growth in the stable phase of 4.5% (the long-term growth rate in the number of households in India). Our value for Asian Paints works out to INR3,250 per share.

(*Refer to Figure 5 on the next page)*

Increase in earnings estimates reflects higher volume growth

Our channel checks suggest that domestic volume growth has been higher than expected. Consequently, we have raised our consolidated sales growth forecasts from 18.5% to 19.5% in FY11 and from 17% to 18% in FY12.

Management's decision to increase capacity by 67% gives us confidence in our revenue growth assumptions.

Risks

Downside risks include solvent prices, which affect 30% of the company's revenues from solvent-based paints (the key solvents are monomers, resins and pigments, apart from titanium dioxide); and relatively slower demand during the peak December quarter.

Figure 39: DCF valuation for Asian Paints

Cost of Equity =	11.22%	

Proportion of Debt: Capital Spending (DR)=	5.21%
Proportion of Debt: Working Capital (DR)=	5.21%

Current Earnings per share=	119.4
(Capital Spending - Depreciation)*(1-DR)	13.6
Change in Working Capital * (1-DR)	- 18.4
Current FCFE	124.2

Growth Rate in Earnings per share

	Growth Rate	*Weight*
Historical Growth =	32.44%	0.00%
Outside Estimates =	-	0.00%
Fundamental Growth =	26.17%	100.00%
Weighted Average	*26.17%*	

Growth Rate in capital spending, depreciation and working capital

	High Growth	*Stable Growth*
Growth rate in capital spending =	26.17%	4.50%
Growth rate in depreciation =	26.17%	4.50%
Growth rate in revenues =	26.17%	4.50%

Working Capital as percent of revenues =	-8%	(in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	**1.00**	**2.00**	**3.00**
Earnings	150.6	190.0	239.7
- (CapEx-Depreciation)*(1-DR)	17.1	21.6	27.2
-Chg. Working Capital*(1-DR)	- 18.5	- 23.3	- 29.4
Free Cashflow to Equity	151.9	191.7	241.9
Present Value	**136.6**	**155.0**	**175.8**

Growth Rate in Stable Phase =	4.50%
FCFE in Stable Phase =	256.91
Cost of Equity in Stable Phase =	11.22%
Price at the end of growth phase (INR/share) =	**3,821**

Present Value of FCFE in high growth phase (INR/share)=	**467**
Present Value of Terminal Price (INR/share) =	**2,777**
Value of the stock (INR/share)=	**3,244**

Estimating the value of growth (INR/share)

Value of assets in place =	1,106
Value of stable growth =	824
Value of extraordinary growth =	1,314
Value of the stock =	3,244

Source: Deutsche Bank

Asia India
Consumer Food & Beverage

14 January 2011

Jubilant Foodworks

Reuters: **JUBI.BO** Bloomberg: **JUBI IN**

Fresh from the oven; Buy

An FCF machine

A 65% market share in the under-penetrated Indian quick-service restaurant (QSR) sector, an exclusive franchisee of a globally successful brand and solid execution (in terms of new store opening and robust supply chain) drive a 42% revenue CAGR (FY11-13E), 70% gross margin, negative working capital (~11% of revenue) and FY11-13E 60% FCF CAGR. While the near-term valuation factors in aggressive growth, our FY12E EPS is 14.5% higher than consensus. We maintain Buy.

Exclusive franchisee of a globally successful brand

JFL operates its pizza stores pursuant to a master franchise agreement with Domino's International, which provides it with the exclusive right to develop and operate Domino's pizza delivery stores in India, Nepal, Bangladesh and Sri Lanka. Its association with Domino's provides JFL with the technical, marketing and operational expertise to compete successfully with other restaurants in the QSR industry in India. JFL has a dominant 65% market share in the organised pizza home-delivery segment in India.

We expect 55% sales growth and 62% profit growth in 3Q11

We expect JFL to continue its impressive performance in 3Q. We estimate 55% top-line growth, driven by same-store sales growth and new-store sales. Strong operating leverage would result in EBITDA margins expanding by 293bps. For the full year, we have factored in an increase of 60 new stores for the current fiscal year. In 1H, JFL opened 33 stores and looks on course to comfortably achieve our target.

Maintaining Buy; target price of INR810

Our DCF-based target price of INR810 is based on cost of equity of 13.6% and 4.5% terminal growth. Downside risks include increase in royalty charge to Domino's International and execution risk in the opening of new stores

Forecasts and ratios

Year End Mar 31	2009A	2010A	**2011E**	2012E	2013E
Sales (INRm)	2,806.1	4,239.3	**6,097.6**	8,602.6	12,314.2
EBITDA (INRm)	335.8	666.1	**1,335.3**	1,982.0	2,976.1
Reported NPAT (INRm)	81.1	334.1	**815.9**	1,073.6	1,696.7
Reported EPS FD(INR)	1.39	5.25	**12.82**	16.88	26.67
DB EPS FD (INR)	1.39	5.25	**12.82**	16.88	26.67
DB EPS growth (%)	–	276.6	**144.2**	31.6	58.0
PER (x)	–	51.1	**46.4**	35.3	22.3
EV/EBITDA (x)	–	25.6	**27.9**	18.4	11.7
DPS (net) (INR)	0.00	0.00	**3.00**	5.00	10.00
Yield (net) (%)	–	0.0	**0.5**	0.8	1.7

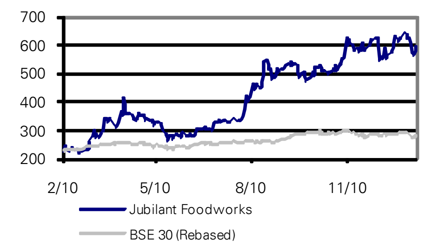
Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Buy

Price at 13 Jan 2011 (INR)	**595.70**
Price target - 12mth (INR)	**810.00**
52-week range (INR)	**643.60 - 220.05**
BSE 30	**19,183**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*7.3*	*13.1*	*–*
BSE 30	*-2.6*	*-7.3*	*9.6*

Stock data

Market cap (INRm)	**37,899**
Market cap (USDm)	**838**
Shares outstanding (m)	**63.6**
Major shareholders	**–**
Free float (%)	**39**
Avg daily value traded (USDm)	**0.0**

Key indicators (FY1)

ROE (%)	**55.4**
Net debt/equity (%)	**-35.7**
Book value/share (INR)	**27.82**
Price/book (x)	**21.4**
Net interest cover (x)	**132.9**
Operating profit margin (%)	**16.9**

Model updated:30 November 2010

Running the numbers

Asia

India

Food & Beverage

Jubilant Foodworks

Reuters: JUBI.BO Bloomberg: JUBI IN

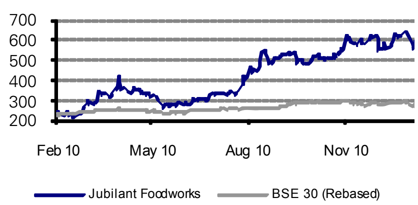
Buy

Price (13 Jan 11)	INR 595.70
Target price	INR 810.00
52-week Range	INR 220.05 - 643.60
Market Cap (m)	INRm 37,899 USDm 838

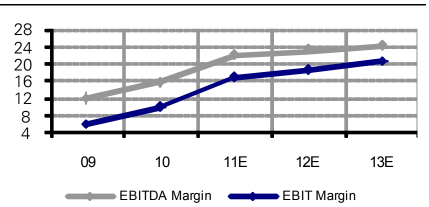
Company Profile

Jubilant Foodworks ltd has the Master Franchisee Rights for Domino's Pizza for India, Nepal, Sri Lanka and Bangladesh. It has a countrywide network of more than 300 stores across 79 cities with a team of over 9,000 people.

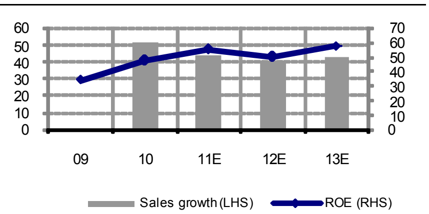
Price Performance



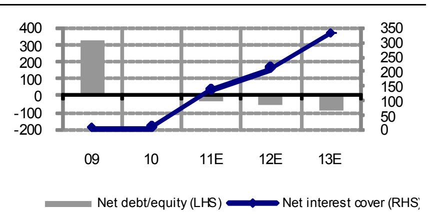
Margin Trends



Growth & Profitability



Solvency



Harrish Zaveri
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Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Financial Summary					
DB EPS (INR)	1.39	5.25	12.82	16.88	26.67
Reported EPS (INR)	1.39	5.25	12.82	16.88	26.67
DPS (INR)	0.00	0.00	3.00	5.00	10.00
BVPS (INR)	4.1	18.5	27.8	38.9	54.0
Weighted average shares (m)	58	64	64	64	64
Average market cap (INRm)	na	17,070	37,899	37,899	37,899
Enterprise value (INRm)	na	17,085	37,267	36,419	34,918
Valuation Metrics					
P/E (DB) (x)	na	51.1	46.4	35.3	22.3
P/E (Reported) (x)	na	51.1	46.4	35.3	22.3
P/BV (x)	0.00	16.99	21.41	15.31	11.02
FCF Yield (%)	na	1.0	2.3	3.2	5.9
Dividend Yield (%)	na	0.0	0.5	0.8	1.7
EV/Sales (x)	nm	4.0	6.1	4.2	2.8
EV/EBITDA (x)	nm	25.6	27.9	18.4	11.7
EV/EBIT (x)	nm	40.4	36.3	22.6	13.7
Income Statement (INRm)					
Sales revenue	**2,806**	**4,239**	**6,098**	**8,603**	**12,314**
Gross profit	**1,942**	**2,969**	**4,192**	**5,661**	**7,867**
EBITDA	**336**	**666**	**1,335**	**1,982**	**2,976**
Depreciation	169	243	308	372	436
Amortisation	0	0	0	0	0
EBIT	**166**	**423**	**1,028**	**1,610**	**2,540**
Net interest income(expense)	-89	-91	-8	-8	-8
Associates/affiliates	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0
Other pre-tax income/(expense)	4	4	0	0	0
Profit before tax	**81**	**335**	**1,020**	**1,602**	**2,532**
Income tax expense	0	1	204	529	836
Minorities	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0
Net profit	**81**	**334**	**816**	**1,074**	**1,697**
DB adjustments (including dilution)	0	0	0	0	0
DB Net profit	**81**	**334**	**816**	**1,074**	**1,697**
Cash Flow (INRm)					
Cash flow from operations	**232**	**696**	**1,468**	**1,816**	**2,836**
Net Capex	-539	-522	-600	-600	-600
Free cash flow	**-307**	**174**	**868**	**1,216**	**2,236**
Equity raised/(bought back)	0	605	0	0	0
Dividends paid	0	0	-220	-367	-735
Net inc/(dec) in borrowings	314	-739	0	0	0
Other investing/financing cash flows	2	0	0	0	0
Net cash flow	**9**	**40**	**648**	**848**	**1,501**
Change in working capital	*-10*	*118*	*344*	*370*	*703*
Balance Sheet (INRm)					
Cash and other liquid assets	30	70	718	1,566	3,067
Tangible fixed assets	1,155	1,429	1,721	1,949	2,113
Goodwill/intangible assets	0	0	0	0	0
Associates/investments	0	0	0	0	0
Other assets	306	462	510	590	685
Total assets	**1,491**	**1,962**	**2,949**	**4,106**	**5,866**
Interest bearing debt	824	86	86	86	86
Other liabilities	427	702	1,094	1,544	2,342
Total liabilities	**1,251**	**787**	**1,180**	**1,630**	**2,428**
Shareholders' equity	240	1,174	1,770	2,476	3,438
Minorities	0	0	0	0	0
Total shareholders' equity	**240**	**1,174**	**1,770**	**2,476**	**3,438**
Net debt	*794*	*16*	*-632*	*-1,480*	*-2,981*
Key Company Metrics					
Sales growth (%)	nm	51.1	43.8	41.1	43.1
DB EPS growth (%)	na	276.6	144.2	31.6	58.0
EBITDA Margin (%)	12.0	15.7	21.9	23.0	24.2
EBIT Margin (%)	5.9	10.0	16.9	18.7	20.6
Payout ratio (%)	0.0	0.0	23.4	29.6	37.5
ROE (%)	33.9	47.3	55.4	50.6	57.4
Capex/sales (%)	19.2	12.3	9.8	7.0	4.9
Capex/depreciation (x)	3.2	2.1	2.0	1.6	1.4
Net debt/equity (%)	331.6	1.3	-35.7	-59.8	-86.7
Net interest cover (x)	1.9	4.6	132.9	208.3	328.5

Source: Company data, Deutsche Bank estimates

Investment thesis

Outlook

A 65% market share in the under-penetrated Indian QSR sector, an exclusive franchisee of a globally successful brand and solid execution (in terms of both new store opening and robust supply chain) drive a 42% revenue CAGR (FY11-13E), 70% gross margin, negative working capital (~11% of revenues) and 60% FCF CAGR over FY11-13E. While the near-term valuation factors in aggressive growth, our FY12E EPS (the basis of our DCF-derived target price) is 14.5% higher than consensus.

JFL operates its pizza stores pursuant to a master franchise agreement with Domino's International, which provides it with the exclusive right to develop and operate Domino's pizza-delivery stores and the associated trademarks in the operation of pizza stores in India, Nepal, Bangladesh and Sri Lanka. This has provided JFL with the ability to use Domino's globally recognised brand name, as well as operational support for pizza and food technology (such as recipes), commissary and logistics management support, global marketing and vendor development know-how. This association with Domino's provides JFL with the technical, marketing and operational expertise to compete successfully with other restaurants in the QSR industry in India. JFL has a dominant 65% market share in the organised pizza home-delivery segment in India.

Valuation

Our DCF-derived target price of INR810 per share is based on the following assumptions:

- Risk-free rate of 6.4% (Deutsche Bank estimates), market-risk premium of 7.2% (Deutsche Bank estimates) and beta of 1, implying a cost of equity of 13.6%.
- Growth in the stable phase of 4.5% (which is the long-term growth rate in the number of households in India). Our valuation for Jubilant Foodworks works out at INR810 per share.

At our target price of INR810 per share, the shares would trade at 30x FY13E earnings.

Risks

Significant dependence on its master franchise agreement with Domino's International
The master franchise agreement between JFL and Domino's International was renewed in September 2009 for another term of 15 years, which will continue until 31 December 2024 and is further extendable for a period of ten years (subject to certain conditions). Should JFL default on the provisions of the agreement, Domino's International would have the right to terminate the agreement.

Royalty to Domino's may increase
JFL paid a royalty of 3% on its revenues in FY10. While the agreement with Domino's is valid until 2024, it is possible that the royalty may increase. The company also pays US$5,000 per new store opened.

Key investment positives

Effective site selection and project management focusing on ROI

One of the major factors behind JFL's continued growth has been its ability to open and profitably operate most of its new stores. A robust store-selection process that takes into consideration factors such as location visibility, presence of competition, household count as well as presence of corporate and other institutions that would enable it to operate the pizza stores in a profitable manner is a key differentiator between JFL and its QSR competitors.

As of 30 September, JFL operated 339 stores in India across 79 cities in 22 states and union territories, as well as five stores in Sri Lanka through a sub-franchisee, DP Lanka Private Limited. These included entry into 22 new cities in FY10. Domino's has mentioned a store target of 700 stores for its India operations. At present, its competitors include Pizza Hut (~150 stores pan-India), KFC (~50 stores pan-India) and McDonalds (~170 stores).

JFL also conducts a return-on-investment analysis based on projected sales and profitability to determine the financial feasibility of the store. The company's internal project management system is designed to ensure that stores purchase standardised equipment from selected vendors, plan in detail the procurement of the standard equipments prior to lease signing and design standardised processes for all functions related to store openings. This has enabled JFL to reduce its store opening time to between 35 and 45 days on average from the date of possession of the premises for a new store location.

Figure 40: 50% of the stores near commissaries (warehouses)

Area	Number of stores	Cumulative number of stores	Cumulative percentage
NCR	68	68	19%
Mumbai/Thane	55	123	35%
Bangalore	39	162	46%
Chennai	22	184	52%
Pune	19	203	57%
Hyderabad	18	221	62%
Kolkata	14	235	66%
Ahmedabad	6	241	68%
Goa	6	247	69%
Chandigarh	4	251	71%
Lucknow	4	255	72%
Vadodra	4	259	73%
Amritsar	3	262	74%
Coimbatore	3	265	74%
Jaipur	3	268	75%
Kanpur	3	271	76%
Mangalore	3	274	77%
Mysore	3	277	78%
Nagpur	3	280	79%
Surat	3	283	79%
Agra	2	285	80%
Bhopal	2	287	81%
Cochin	2	289	81%
Indore	2	291	82%
Kamal	2	293	82%
Ludhiana	2	295	83%
Meerut	2	297	83%
Mohali	2	299	84%
Nasik	2	301	85%
Panchkulla	2	303	85%
Trivandrum	2	305	86%
Others (Single store cities)	51	356	100%

Source: Deutsche Bank

Key investment concerns

Significant dependence on its master franchise agreement with Domino's International

At present, JFL relies to a large extent on its agreement with Domino's International with respect to its business operations. The master franchise agreement was renewed in September 2009 for another term of 15 years, which will continue until 31 December 2024 and is further extendable for a period of ten years (subject to the fulfilment of certain conditions). Should JFL default on the provisions of the agreement, Domino's International would have the right to terminate the agreement.

Royalty to Domino's may increase

JFL paid a royalty of 3% on its revenues in FY10 and a sum of US$5,000 for each new store opened. While the agreement with Domino's is valid until 2024, it is possible that the royalty may increase. However, management clarified that the terms of the agreement are valid until 2024. The company also collects royalties from DP Lanka, a sub-franchisee in Sri Lanka, and shares it with Domino's. We believe that this amount is not material, given that the Indian operations are far bigger than the current operations in Sri Lanka.

Execution risks in new-store openings

JFL's store sales depend on same-store sales and new-store openings. The same-store sales growth refers to year-over-year growth in sales for stores in operation for the whole of the year in both the years. Same-store sales account for a smaller portion of the company's store sales compared with sales from new-store openings. The opening of new stores reduces the delivery area for the existing stores, hence resulting in a reduction in sales of the existing store and overall same-store sales growth. To expand JFL's business operations' successfully, new stores need to be opened on schedule and operated in a profitable manner.

Financials: An FCF machine

Sustainable growth driven by pizza penetration

JFL sold 19m pizzas in FY09 and 27m pizzas in FY10. We believe that as the acceptability and affordability of pizza as a meal option increases, more stores will be required. JFL aims to cater to roughly 20,000 homes per Domino's store. There are about 220m households in India, of which 3.2% is socio-economic class A (SEC-A) and 5.1% is SEC-B. Assuming 75% of SEC-A and 50% of SEC-B to be the target population, we get a total addressable number of households of about 11m, or 5% of total households in India. To be able to cater to these households, approximately 550 stores would be needed (20,000 households per store). The company had 339 stores as of September (a shortfall of 211 stores). At the current rate of 60 stores per year, it would require 3.5 years to cover just the current shortfall. During that time, given 8%-plus GDP growth and a rise in per capita income, more households would become part of the addressable market. For every 1% shift from SEC-C (or lower) categories – currently 92% of the households – to SEC-A/SEC-B would require 110 additional stores.

High gross margins and negative working capital are the key drivers of FCF

JFL has centralised the sourcing, warehousing and distribution of its raw materials, as well as the production of dough at its commissaries; this reduces the storage space required at its stores, thereby enabling JFL to minimise its store-operating costs without incurring significant additional expenses at the commissary level. The effects of its efficient supply chain are reflected in its relatively high gross margins and negative working capital.

Figure 41: High gross profit with negative working cycle for Jubilant Foodworks

	FY09	FY10	FY11E	FY12E	FY13E
Gross profit margin	69%	70%	69%	66%	64%
Inventory turnover (days)	7	6	6	6	6
Debtors turnover (days)	2	3	3	3	3
Creditors turnover (days)	42	47	47	47	47
Cash conversion cycle (days)	(33)	(39)	(39)	(39)	(39)

Source: Deutsche Bank, company data

Efficiency in capex is a driver of FCF

JFL opened 60 stores in fiscal 2009, of which 44 were opened in cities where JFL already had stores. Of the 70 stores opened in fiscal 2010, 31 were in cities where JFL already had stores. To minimise additional capital expenditure and ensure quality control, JFL plans to open new stores in cities and towns less than one day's travel distance from its existing commissaries. For new stores where JFL cannot efficiently serve from its commissaries, the company has developed a back-end production facility model that would enable it to service two to three stores in a city. These back-end production facilities locally procure vegetables and other perishables. JFL believes that its future growth would be driven by its new stores in Tier 2 and Tier 3 towns and, therefore, its back-end production facilities will play a key role for its success in these cities.

Home-delivery model implies control over rentals

Unlike Pizza Hut and Mcdonalds, which follow a footfall-driven dining-out model, JFL has emphasised its home-delivery-led model. This implies smaller stores and, consequently, lower rentals. Space in India, particularly in the cities, is typically at a premium. Mass-market retailers in India historically have struggled to make profits, primarily due to relatively higher rentals. JFL's rentals have been around 9.0% of sales. As JFL expands in the Tier 1 and Tier II cities, we believe rental costs as a proportion of its revenue will remain under control.

Figure 42: Rent as a percentage of sales

	FY09	FY10	FY11E	FY12E	FY13E
Rent (INRm)	267	392	549	731	985
Rent as a % of sales	9.5%	9.3%	9.0%	8.5%	8.0%

Source: Deutsche Bank, company data

Full tax rate factored into our estimates from FY12

We factor in 57% growth in JFL's pre-tax profits between FY11 and FY12. This would imply no tax shelter due to accumulated losses and, hence, JFL becomes a full-tax-paying company with effect from FY12. In the first half of FY11, the company has provided for a 19% effective tax rate, and we have assumed an FY11 tax rate of 20%.

Figure 43: 33% tax rate assumption for FY12 and FY13

INRm	FY09	FY10	FY11E	FY12E	FY13E
Profit before tax	81	335	1,020	1,602	2,532
Tax	0	1	204	529	836
Profit after tax (INR m)	81	334	816	1,074	1,697
Effective tax rate	0.0%	0.2%	20.0%	33.0%	33.0%

Source: Deutsche Bank, company data

Strong operational cash flows, negative working capital imply an FCF machine

We factor in 80% growth in JFL's FCF between FY11 and FY13, driven by a doubling of operating cash flow. We have factored in a capex of INR600m during the next seven years, implying that the company would be able to open 60 stores each year until FY18. (The company opened 33 stores in the first half of FY11.) While management guided for capex of INR7m per store, we factored capex of INR10m into our estimates.

Figure 44: Jubilant Foodworks: FCF

Cash flow (INRm)	FY09	FY10	FY11E	FY12E	FY13E
Cash flow from operations	232	696	1,468	1,816	2,836
Net Capex	-539	-522	-600	-600	-600
Free cash flow	-307	174	868	1,216	2,236

Source: Deutsche Bank, company data

55% top-line growth and 62% PAT growth key highlights for Q3FY11

We expect JFL to continue its impressive performance in 3Q. We estimate 55% top-line growth, driven by same-store sales growth and new-store sales. We expect the EBITDA margin to expand by 293bps due to operating leverage. For the full year, we have factored in an increase of 60 new stores for the current fiscal year. In 1H, JFL opened 33 stores and looks on course to comfortably achieve our target.

Figure 45: 3QFY11 result preview

INR m	3QFY11 (DB est)	3QFY10	YoY Growth	2QFY11	QoQ Growth
Net sales	1818	1174	55%	1634	11%
Gross profit	1364	884	39%	1229	11%
EBITDA	359	197	51%	297	21%
Recurring net profit	229	114	62%	184	24%
Margins			**bps**		**Bps**
EBITDA margin	20%	17%	293	18%	154
Net profit margin	13%	10%	293	11%	134

Source: Deutsche Bank

Valuation

We base our DCF-derived target price of INR810 on the following assumptions.

- Risk-free rate of 6.4% (Deutsche Bank estimates), market-risk premium of 7.2% (Deutsche Bank estimates) and beta of 1, implying a cost of equity of 13.6%.
- Growth in the stable phase of 4.5% (which is the long-term growth rate in the number of households in India). Our value for Jubilant Foodworks works out at INR810 per share.

(*Please see Figure 9.*)

At our target price of INR810, the shares would trade at 30x FY13E earnings. A comparison with the listed Domino's franchisees internationally shows the India franchise is growing the fastest and consequently obtaining a relatively higher multiple.

Figure 46: International comparison

			Revenues		Net profit		PE		EV/EBITDA
(USD m)		Mcap	2011E	2012E	2011E	2012E	2011E	2012E	(2011E EBITDA)
Domino's US	DPZ US Equity	986	1572.2	1600.2	81.1	85.8	11	10	10
Domino's UK	DOM LN Equity	1422	284.7	315.3	40.9	46.4	33	29	22
Domino's Australia	DMP AU Equity	419	247.6	259.3	20.1	23.0	20	18	11
Jubilant Foodworks	JUBI IN Equity	825	135.5	191.2	18.1	23.9	45.5	34.6	19

Source: Deutsche Bank, Bloomberg Finance LP

Typically, high-growth companies are rewarded with higher multiples, and we believe that JFL would be no exception. Comparative examples within consumer and retail would be Nestle and Titan.

Where we are vs. consensus

Our earnings estimates are higher than consensus by 14% in FY11 and 14.5% in FY12. This is driven primarily by higher margins, which is a function of the operating leverage being driven by relatively tight fixed costs due to expansion in scale. During the past three months we have seen earning upgrades on the street and now our numbers are 14.5% higher than consensus as against 18.1% earlier.

Figure 47: Deutsche Bank estimates vs. consensus

	FY11E			FY12E		
INR m	Deutsche Bank estimates	Consensus	% difference	Deutsche Bank estimates	Consensus	% difference
Sales	6098	6412	-4.90%	8603	8905	-3.39%
EBITDA	1335	1191	12.09%	1982	1731	14.50%
PAT	816	715	14.13%	1074	938	14.50%

Source: Deutsche Bank, Bloomberg Finance LP

Figure 48: DCF valuation for Jubilant Foodworks

Cost of Equity =	13.60%
Proportion of Debt: Capital Spending (DR)=	3.35%
Proportion of Debt: Working Capital (DR)=	3.35%
Current Earnings per share=	16.9
(Capital Spending - Depreciation)*(1-DR)	3.5
Change in Working Capital * (1-DR)	5.6
Current FCFE	7.8

Growth Rate in Earnings per share

	Growth Rate	*Weight*
Historical Growth =	64.65%	16.50%
Outside Estimates =	40.00%	0.00%
Fundamental Growth =	30.51%	83.50%
Weighted Average	*36.15%*	

Growth Rate in capital spending, depreciation and working capital

	High Growth	*Stable Growth*
Growth rate in capital spending	36.15%	4.50%
Growth rate in depreciation =	36.15%	4.50%
Growth rate in revenues =	36.15%	4.50%

Working Capital as percent of revenues = -11% (in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	1.00	2.00	3.00	4.00	5.00	6.00
Earnings	23.0	31.3	42.6	58.0	78.9	107.5
- (CapEx-Depreciation)*(1-DR)	4.7	6.4	8.7	11.9	16.2	22.1
-Chg. Working Capital*(1-DR)	- 6.0	- 8.1	- 11.0	- 15.0	- 20.5	- 27.8
Free Cashflow to Equity	24.2	33.0	44.9	61.1	83.2	113.2
Present Value	21.3	25.5	30.6	36.7	44.0	52.7

Growth Rate in Stable Phase =	4.50%
FCFE in Stable Phase =	117.02
Cost of Equity in Stable Phase =	13.60%
Price at the end of growth phase (INR/share) =	1,286

Present Value of FCFE in high growth phase (INR/share)=	211
Present Value of Terminal Price (INR/share) =	598
Value of the stock (INR/share)=	809

Estimating the value of growth (INR/share)

Value of assets in place =	57
Value of stable growth =	32
Value of extraordinary growth =	720
Value of the stock =	809

Source: Deutsche Bank

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Asia India
Consumer

14 January 2011

HUL

Reuters: **HLL.BO** Bloomberg: **HUVR IN**

Pricing test in 2011; maintaining Hold

Pricing test in 2011; maintaining Hold
We expect 2011 to be a test of HUL's pricing power, as incremental volumes in 2010 came on the back of price cuts, discounts, and relatively higher spend on advertising (the highest across the last eight quarters). However, pricing remains the key driver of HUL's revenue trajectory. Since 2005, the importance of pricing across the sector as a driver of revenues has increased as volume growth across 55% of HUL's portfolio (soaps, detergents and tea) has slowed. We maintain our Hold recommendation.

Personal products: The last bastion also under pressure
Skincare, which has been the star of HUL's product portfolio, has been growing by 20%-plus as a category. HUL's own personal product portfolio has grown by 15% in 2QFY11, slower than the category. If one were to assume HUL's skincare portfolio (50% of HUL's personal product portfolio) had grown at industry rates, the implied growth rates for its hair and oral care portfolio works out to a mere 6-7%. EBITDA margins for personal products (accounting for 30% of HUL's sales) declined by 332bps yoy in Q2FY11.

HUL's PE at top-end of historical average band
Largely driven by earnings growth, HUL's earnings multiple has traded in a band of 20-30x over the last five years. Given the current earnings growth multiple, we believe a re-rating beyond its historical band seems unlikely. Also, HUL has historically traded at a dividend yield of 2.8%. The implied stock price at a 2.8% dividend yield is INR250.

Maintaining Hold with revised target price of INR266 per share
Our DCF-derived target price rests on a 10.3% CoE (6.4% RFR, 7.2% ERP and 0.54 beta), 4.5% growth (12% CAGR between FY10-12E) and an implied earnings multiple of 22x FY12E. In line with the change in RFR from 8.1% to 6.4% and ERP from 5.4% to 7.2% for India, we reduced the CoE from 11% to 10.3%. This led to an increase in our target price from INR245 to INR266. An upside risk is continued outperformance of HUL in a weak market. Lower-than-expected volume growth or loss of market share in key categories is the key downside risk.

Forecasts and ratios

Year End Mar 31	2009A	2010A	**2011E**	2012E	2013E
Sales (INRm)	202,393.3	175,238.0	**192,532.2**	216,959.4	257,196.7
EBITDA (INRm)	26,779.6	25,484.4	**25,592.1**	31,675.1	38,609.4
Reported NPAT (INRm)	25,049.6	22,020.3	**21,889.0**	26,370.0	31,678.4
DB EPS FD (INR)	11.47	9.64	**10.03**	12.09	14.52
OLD DB EPS FD (INR)	11.47	9.59	**10.91**	12.09	–
% Change	0.0%	0.5%	**-8.0%**	-0.1%	–
DB EPS growth (%)	41.2	-16.0	**4.1**	20.5	20.1
PER (x)	20.9	26.7	**30.1**	25.0	20.8
DPS (net) (INR)	7.50	6.50	**7.02**	8.46	10.16

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

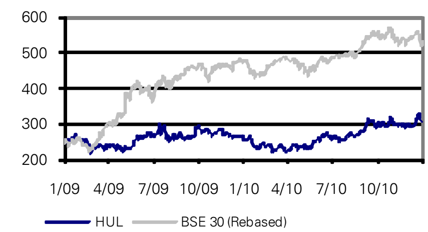
Hold

Price at 13 Jan 2011 (INR)	**302.40**
Price target - 12mth (INR)	**266.00**
52-week range (INR)	**325.65 - 219.60**
BSE 30	**19,183**

Key changes

Price target	245.00 to 266.00	↑	**8.6%**
Sales (FYE)	191,331 to 192,532	↑	**0.6%**
Op prof margin (FYE)	14.1 to 12.2	↓	**-13.5%**
Net profit (FYE)	23,778.7 to 21,889.0	↓	**-7.9%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*0.7*	*0.0*	*14.7*
BSE 30	*-2.6*	*-7.3*	*9.6*

Stock data

Market cap (INRm)	**659,746**
Market cap (USDm)	**14,583**
Shares outstanding (m)	**2,181.7**
Major shareholders	**Unilever (51%)**
Free float (%)	**48**
Avg daily value traded (USDm)	**15.7**

Key indicators (FY1)

ROE (%)	**78.4**
Net debt/equity (%)	**-91.9**
Book value/share (INR)	**13.76**
Price/book (x)	**22.0**
Net interest cover (x)	**–**
Operating profit margin (%)	**12.2**

Model updated:13 January 2011

Running the numbers

Asia

India

Consumer

HUL

Reuters: HLL.BO Bloomberg: HUVR IN

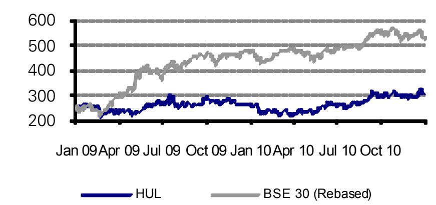
Hold

Price (13 Jan 11)	INR 302.40
Target price	INR 266.00
52-week Range	INR 219.60 - 325.65
Market Cap (m)	INRm 659,746 USDm 14,583

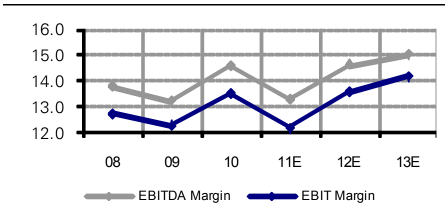
Company Profile

Hindustan Unilever Limited (HLL) is India's largest Fast Moving Consumer Goods company, touching the lives of two out of three Indians with over 20 distinct categories in Home & Personal Care Products and Foods & Beverages.

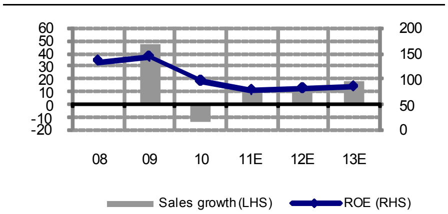
Price Performance



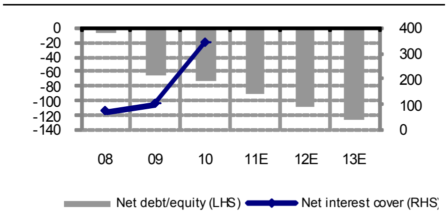
Margin Trends



Growth & Profitability



Solvency



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Fiscal year end 31-Mar	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (INR)	8.12	11.47	9.64	10.03	12.09	14.52
Reported EPS (INR)	8.84	11.49	10.09	10.03	12.09	14.52
DPS (INR)	9.08	7.50	6.50	7.02	8.46	10.16
BVPS (INR)	6.6	9.5	11.8	13.8	16.1	18.9
Weighted average shares (m)	2,177	2,180	2,182	2,182	2,182	2,182
Average market cap (INRm)	451,475	523,828	561,089	659,746	659,746	659,746
Enterprise value (INRm)	435,944	506,948	529,526	619,515	608,592	594,565
Valuation Metrics						
P/E (DB) (x)	25.5	20.9	26.7	30.1	25.0	20.8
P/E (Reported) (x)	23.4	20.9	25.5	30.1	25.0	20.8
P/BV (x)	34.60	25.19	20.16	21.97	18.81	16.04
FCF Yield (%)	4.4	3.8	5.4	4.0	4.9	6.0
Dividend Yield (%)	4.4	3.1	2.5	2.3	2.8	3.4
EV/Sales (x)	3.2	2.5	3.0	3.2	2.8	2.3
EV/EBITDA (x)	23.1	18.9	20.8	24.2	19.2	15.4
EV/EBIT (x)	24.9	20.4	22.4	26.4	20.7	16.3
Income Statement (INRm)						
Sales revenue	**137,178**	**202,393**	**175,238**	**192,532**	**216,959**	**257,197**
Gross profit	**61,832**	**90,704**	**83,632**	**87,615**	**99,669**	**122,980**
EBITDA	**18,857**	**26,780**	**25,484**	**25,592**	**31,675**	**38,609**
Depreciation	1,384	1,953	1,840	2,135	2,245	2,141
Amortisation	0	0	0	0	0	0
EBIT	**17,473**	**24,827**	**23,644**	**23,457**	**29,430**	**36,468**
Net interest income(expense)	-255	-253	-70	-12	-24	-24
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	1,564	43	994	0	0	0
Other pre-tax income/(expense)	4,627	5,678	3,496	5,056	4,930	4,804
Profit before tax	**23,409**	**30,294**	**28,064**	**28,501**	**34,336**	**41,248**
Income tax expense	4,155	5,244	6,044	6,612	7,966	9,570
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**19,255**	**25,050**	**22,020**	**21,889**	**26,370**	**31,678**
DB adjustments (including dilution)	-1,564	-43	-994	0	0	0
DB Net profit	**17,691**	**25,007**	**21,027**	**21,889**	**26,370**	**31,678**
Cash Flow (INRm)						
Cash flow from operations	**23,401**	**25,793**	**35,902**	**26,926**	**34,243**	**41,639**
Net Capex	-3,355	-5,660	-5,412	-560	-2,000	-2,000
Free cash flow	**20,046**	**20,133**	**30,489**	**26,366**	**32,243**	**39,639**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-22,824	-18,879	-16,377	-17,697	-21,320	-25,612
Net inc/(dec) in borrowings	159	3,334	-4,219	300	0	0
Other investing/financing cash flows	489	11,175	-8,743	0	0	0
Net cash flow	**-2,130**	**15,764**	**1,149**	**8,968**	**10,923**	**14,027**
Change in working capital	*2,762*	*-1,167*	*13,035*	*2,902*	*5,628*	*7,820*
Balance Sheet (INRm)						
Cash and other liquid assets	2,009	17,773	18,922	27,891	38,813	52,840
Tangible fixed assets	17,081	20,789	24,361	22,786	22,541	22,400
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	14,408	3,326	12,641	12,641	12,641	12,641
Other assets	34,803	42,627	39,267	42,538	47,341	55,254
Total assets	**68,301**	**84,515**	**95,190**	**105,855**	**121,336**	**143,135**
Interest bearing debt	885	4,219	0	300	300	300
Other liabilities	53,023	59,681	69,355	75,528	85,959	101,691
Total liabilities	**53,908**	**63,900**	**69,355**	**75,828**	**86,259**	**101,991**
Shareholders' equity	14,392	20,615	25,835	30,027	35,077	41,143
Minorities	0	0	0	0	0	0
Total shareholders' equity	**14,392**	**20,615**	**25,835**	**30,027**	**35,077**	**41,143**
Net debt	*-1,123*	*-13,554*	*-18,922*	*-27,591*	*-38,513*	*-52,540*
Key Company Metrics						
Sales growth (%)	nm	47.5	-13.4	9.9	12.7	18.5
DB EPS growth (%)	na	41.2	-16.0	4.1	20.5	20.1
EBITDA Margin (%)	13.7	13.2	14.5	13.3	14.6	15.0
EBIT Margin (%)	12.7	12.3	13.5	12.2	13.6	14.2
Payout ratio (%)	102.6	65.3	64.4	70.0	70.0	70.0
ROE (%)	133.8	143.1	94.8	78.4	81.0	83.1
Capex/sales (%)	2.4	2.8	3.1	0.3	0.9	0.8
Capex/depreciation (x)	2.4	2.9	2.9	0.3	0.9	0.9
Net debt/equity (%)	-7.8	-65.7	-73.2	-91.9	-109.8	-127.7
Net interest cover (x)	68.5	98.0	338.7	nm	nm	nm

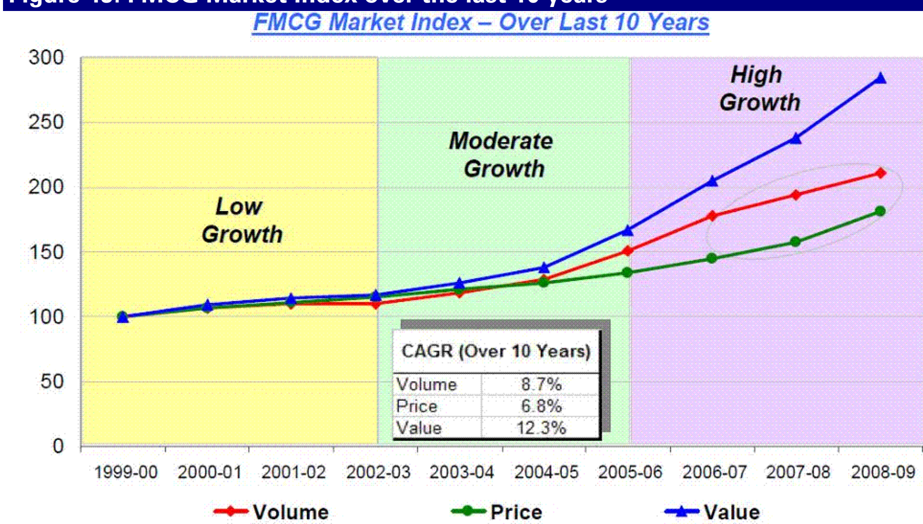
Source: Company data, Deutsche Bank estimates

Pricing test in FY12

We expect 2011 to be a test of HUL's pricing power, as incremental volumes in 2010 came on the back of price cuts, discounts, and relatively higher spend on advertising. Earlier market share losses put the company on a lower sales trajectory.

However, pricing remains the key driver of HUL's (indeed the entire sector's) revenue trajectory. Over the last half a decade, the importance of pricing across the sector as a driver of revenues has increased.

Figure 49: FMCG Market Index over the last 10 years



Source: Company data

Specifically, in HUL's case, the last eighteen years of HUL's category growth clearly show the importance of the pricing in soaps, detergents, and tea (accounting for ~55% of HUL's revenues).

HUL's revenues from soaps tripled between CY92 and CY97 while detergents and tea doubled over the same period. After that period, pricing's importance as a driver of HUL's revenues has only increased.

Relatively higher detergent volumes in 2004 and 2010 are reflective of a price war with P&G. Similarly for tea, the re-entry into the lower end of the tea market (which HUL had earlier vacated) was the key enabler of category volumes in 2010.

However, if HUL increases pricing, we believe volumes will be under pressure. Hence, a tough balancing act is required. We expect core earnings to remain flat in FY11 and grow in FY12 on the back of pricing.

Figure 50: Data from the last 18 years clearly demonstrate a high dependence on pricing for 55% of HUL's portfolio

Year ended 31 December	CY93	CY94	CY95	CY96	CY97	CY98	CY99	CY00	CY01	CY02	CY03	CY04	CY05	CY06	CY07	FY09 (15 months)	FY10
Soaps																	
Value growth (%)	17.7	31.0	7.7	32.30	16.0	0.0	7.1	-2.0	-3.1	10.2	3.7	2.1	6.80	10.46	8.26	41.47	-13.36
Volume growth (%)	5.8	12.1	-0.8	9.00	1.1	0.0	1.7	0.5	-1.5	-0.9	-2.2	-1.0	1.34	5.56	1.41	19.59	-21.48
Price increases (%)	11.3	16.8	8.6	21.38	14.7	0.0	5.3	-2.4	-1.6	11.2	6.0	3.2	5.4	4.6	6.8	18.3	10.3
Synthetic Detergents																	
Value growth (%)	14.0	21.0	20.8	19.1	17.2	11.4	12.3	6.2	2.8	1.0	-4.3	1.4	15.59	15.89	17.81	66.10	-20.36
Volume growth (%)	7.9	18.0	14.1	13.8	1.5	6.7	7.6	4.8	6.8	1.2	-1.2	4.3	10.6	7.4	8.2	27.9	-22.3
Price increases (%)	5.6	2.6	5.9	4.7	15.5	4.4	4.4	1.3	-3.8	-0.2	-3.1	-2.8	4.5	7.9	8.8	29.9	2.5
Beverages																	
Value growth (%)		13.5	0.1	13.6	17.1	18.0	-16.2	29.4	-5.5	-16.7	1.1	-1.0	5.62	-0.94	10.05	39.03	-10.74
Volume growth (%)		13.9	-3.5	0.8	20.3	-3.2	-14.0	14.5	-5.9	-19.5	-4.2	-12.4	11.5	-7.3	-6.5	36.2	-26.6
Price increases (%)		-0.4	3.7	12.7	-2.7	21.9	-2.6	13.0	0.4	3.4	5.6	13.0	-5.3	6.9	17.7	2.1	21.5

Source: Company data

Where is the leverage?

Skincare, which has been the star of HUL's product portfolio, has been growing by 20%-plus as a category. HUL's own personal product portfolio has grown by 15% in Q2FY11, slower than the category. If one were to assume HUL's skincare portfolio (50% of HUL's personal product portfolio) had grown at industry rates, the implied growth rates for its hair and oral care portfolio works out to a mere 6-7%. EBITDA margins for personal products (accounting for 30% of HUL's sales) have seen an EBITDA margin decline of 332bps yoy in Q2FY11. An increase in royalty payments to Unilever could affect EPS by INR1 over the next 18 months.

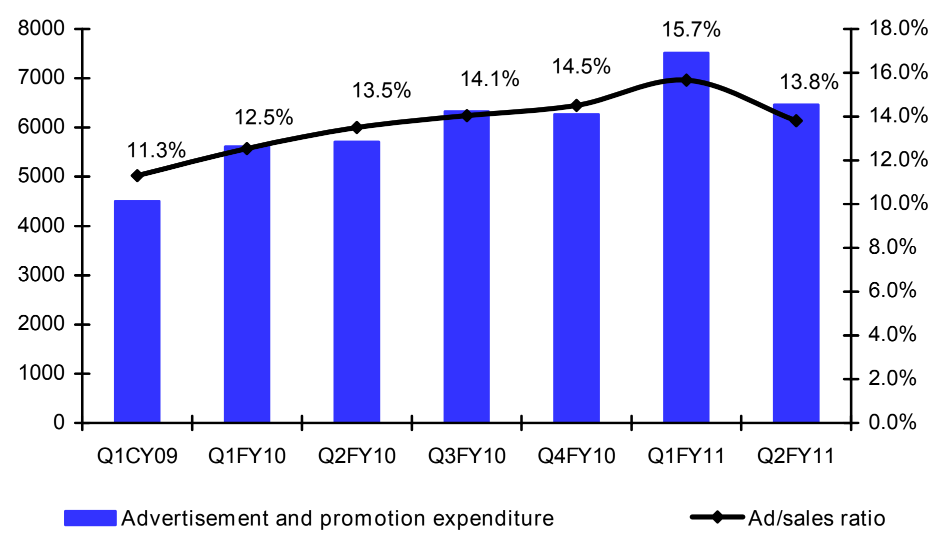
Figure 51: Significant slowdown in revenue growth in key categories with margins also contracting

Revenue growth	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11
Soaps & Detergents	9.5%	0.9%	-2.4%	-1.7%	2.4%	6.3%
Personal Products	14.7%	13.4%	15.5%	20.9%	11.4%	14.7%
Beverages	18.6%	18.0%	7.9%	16.5%	7.7%	9.3%
PBIT Margins (%)						
Soaps & Detergents	17.2%	13.6%	13.4%	12.8%	11.0%	11.7%
Personal Products	22.0%	26.3%	31.9%	21.8%	24.8%	23.0%
Beverages	14.1%	17.0%	14.8%	13.8%	12.9%	15.4%

Source: Company data

Advertising and sales expenses have grown 90bps yoy and amount to 13.8% of HUL's revenues. With media inflation remaining strong, we believe that HUL's advertising and sales promotion expenses are unlikely to slow down. Royalty at 1% of revenues has added to the operating expenses for the quarter, leading to an 8% decline in operational EBITDA.

Figure 52: Ad/sales ratio remains high



Source: Deutsche Bank, company data

Balance sheet efficiency drove treasury income in 2QFY11

The treasury function was the star performer of HUL's 2QFY11 results. Cash from negative working capital was invested resourcefully, generating 80% yoy growth in treasury income. However, a 3% decline in pricing (despite 14% volume growth) led to an 8% yoy decline in operational EBITDA. Excluding treasury and extraordinaries, HUL's net profit has declined 13% yoy. At 30x FY11 and 27x FY12, valuation implies no scope for disappointment. HUL's balance sheet remains strong as ever with marketable investments and cash accounting for 100% of its standalone balance sheet size. At INR7.2bn, HUL's reported treasury income has grown 80% yoy from INR4.2bn in Q2FY11.

Figure 53: Core business performance remains weak

	2QFY11	2QFY10	% change
Core business EPS	2.17	2.40	-10%
Treasury EPS	0.28	0.19	47%
Extraordinary EPS	0.15	-0.62	NA
Reported EPS	2.59	1.97	32%

Source: company data

Figure 54: Q2FY11 quarterly results snapshot

INR m	2QFY11	2QFY10	yoy
Net Sales	46809	42281	10.7%
EBITDA	5631	6108	-7.8%
EBIT	5077	5646	-10.1%
Recurring net profit	5257	5637	-6.7%
PAT (excl exceptional and other income)	4653	5228	-11.0%
Margins			bps
EBITDA Margin	12.03%	14.45%	-242
Net Profit Margin	11.23%	13.33%	-210

Source: Deutsche Bank, company data

Change in FY11 numbers

The key changes to our FY11 numbers are as follows:

- We factored in higher raw material cost due to the increase in the price of palm oil resulting in lower gross margins.
- We factored in lower sales promotion expenditure for FY11.

Figure 55: Changes in FY11 estimates factor in higher raw material costs

(INR m)	FY11 New estimates	FY11 Old estimates	%change	Remarks
Sales	192,532	191331	0.6%	
Raw Materials	104,840	98979	5.9%	We factored in higher raw material cost due to increase in prices of palm oil
Gross Profit	87,692	92352		
S G & A expenses	52,388	53,852	-2.7%	We factored in lesser sales promotion
EBIDTA	25,669	28865	-11.1%	
Profit after tax (INR m)	21,948	23779	-7.7%	
Gross profit margin	46%	48%		
EBITDA margin	13.3%	15.1%		

Source: Deutsche Bank

HUL's PE at top-end of its historical average band

Largely driven by earnings growth, HUL's earnings multiple has traded in a band of 20-30x over the last five years. We believe a re-rating beyond its historical band is unlikely given the current earnings growth multiple.

Figure 56: HUL's one-year forward rolling PE bands

Source: Deutsche Bank, Bloomberg Finance LP

Valuation

We value HUL using DCF valuation methodology, and our target price for HUL works out to INR266 per share. Our key DCF assumptions include:

- Cost of equity of 10.3% (risk-free rate 6.4%, equity risk premium 7.2%) (the Deutsche Bank standard for India) and a beta of 0.54.
- Terminal growth of 4.5% (unchanged).

(For further details on our DCF valuation, please see Figure 58.)

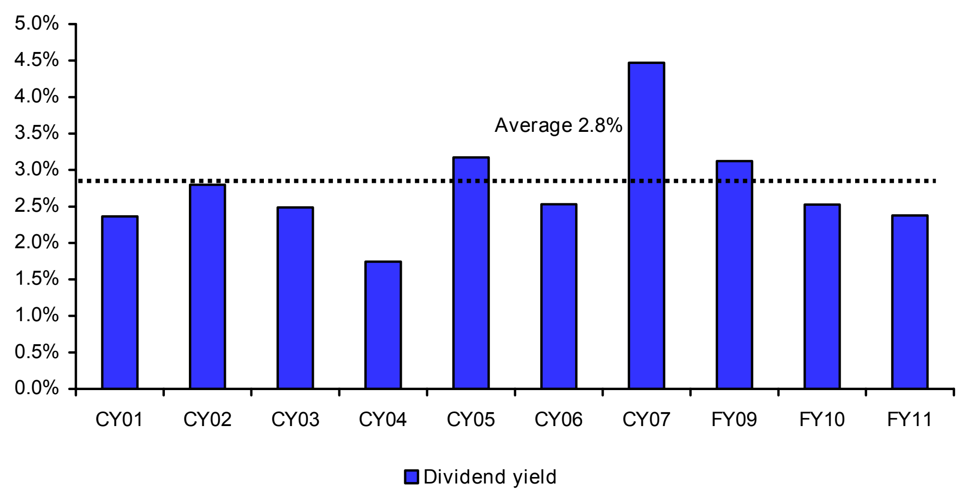
In line with the change in risk-free rate from 8.1% to 6.4% and market risk premium from 5.4% to 7.2% for India, we reduced the cost of equity from 11% to 10.3%. This increased our target price from INR245 to INR266.

At our target price of INR266 per share, the stock would trade at a PE of 26.5x FY11 and 22x FY12.

Long-term dividend yield implies a price of INR250 per share

Historically HUL has traded at a dividend yield of 2.8%. If one were to calculate the stock price on the basis of the average historical dividend yield, the stock price comes to INR250 per share.

Figure 57: Historical dividend yield of HUL



Source: Company data, Bloomberg Finance LP, Deutsche Bank

Figure 58: DCF valuation

Cost of Equity =	10.29%	
Proportion of Debt: Capital Spending (DR)=		0.85%
Proportion of Debt: Working Capital (DR)=		0.85%
Current Earnings per share=		12.1
(Capital Spending - Depreciation)*(1-DR)		- 0.1
Change in Working Capital * (1-DR)		0.2
Current FCFE		12.0

Growth Rate in Earnings per share

	Growth Rate	*Weight*
Historical Growth =	7.53%	90.00%
Outside Estimates =	0.00%	0.00%
Fundamental Growth =	22.55%	10.00%
Weighted Average	*9.03%*	

Growth Rate in capital spending, depreciation and working capital

	High Growth	*Stable Growth*
Growth rate in capital spending =	0.00%	Do not enter
Growth rate in depreciation =	10.00%	Do not enter
Growth rate in revenues =	10.00%	0.00%

Working Capital as percent of revenues = 0% (in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	**1.00**	**2.00**	**3.00**	**4.00**	**5.00**
Earnings	13.2	14.4	15.7	17.1	18.6
- (CapEx-Depreciation)*(1-DR)	- 0.2	- 0.3	- 0.4	- 0.6	- 0.7
-Chg. Working Capital*(1-DR)	0.0	0.0	0.0	0.0	0.0
Free Cashflow to Equity	13.4	14.7	16.1	17.7	19.3
Present Value	**12.1**	**12.1**	**12.0**	**11.9**	**11.9**

Growth Rate in Stable Phase =	4.50%
FCFE in Stable Phase =	19.46
Cost of Equity in Stable Phase =	10.29%
Price at the end of growth phase (INR/share) =	**336**
Present Value of FCFE in high growth phase (INR/share)=	**60**
Present Value of Terminal Price (INR/share) =	**206**
Value of the stock (INR/share)=	**266**

Estimating the value of growth (INR/share)

Value of assets in place =	116
Value of stable growth =	100
Value of extraordinary growth =	50
Value of the stock =	266

Source: Deutsche Bank

Deutsche Bank estimates vs. consensus

We are higher than consensus in terms of revenue and PAT for FY12. Our numbers are based on HUL's ability to take price increases across categories. Hence, at 23% and 20%, EBITDA and earnings growth for FY12E are higher than consensus FY12 EBITDA and PAT estimates of 14% and 13.7%, respectively.

Figure 59: Deutsche Bank estimates compared to consensus

	Deutsche Bank			Consensus		
	FY11	FY12	% growth	FY11	FY12	% growth
Sales	192,532	217,898	13.2%	192,725	213,463	10.7%
EBITDA	25,669	31,646	23.3%	28,176	32,161	14.1%
PAT	21,948	26,348	20.0%	22,038	25,063	13.7%

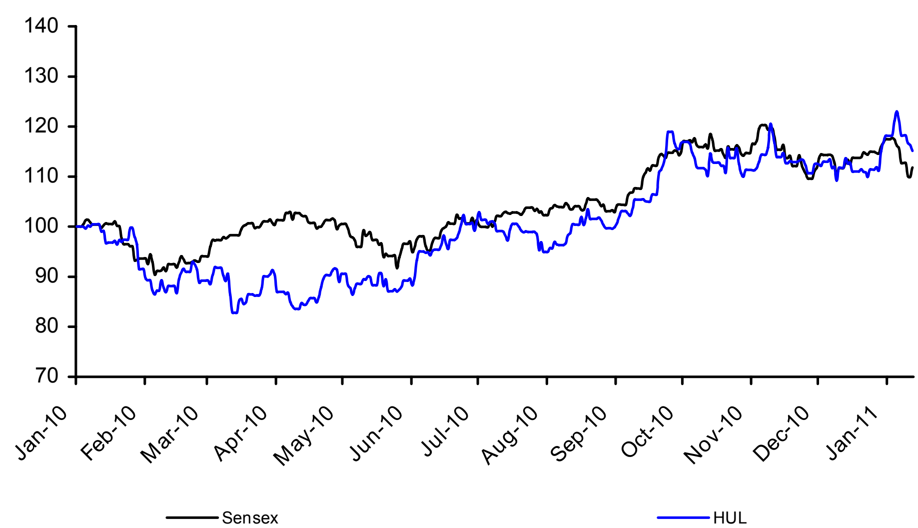
Source: Deutsche Bank, Bloomberg Finance LP

Risks

An upside risk to our call would come from the continued outperformance of HUL in a weak market. Over the past four years of stock price performance, HUL's earnings multiple typically expanded during periods of uncertainty. So while we may highlight struggle in its core categories, the stock trades like an index fund for FMCG, sometimes for the better, sometimes for the worse.

Lower-than-expected volume growth or loss of market share in key categories is the key downside risk.

Figure 60: HUL stock performance vs. Sensex



Source: Deutsche Bank, Bloomberg Finance LP

Asia India
Consumer Retail/Wholesale Trade

14 January 2011

Titan Industries Ltd

Reuters: **TITN.BO** Bloomberg: **TTAN IN**

Great franchise, good opportunity

New target price driven by 2.6% and 6.5% increases in FY11E/12E earnings
We raise our target price to INR4,200 after revising up our FY11 and FY12 earnings forecasts by 2.6% and 6.5%, respectively. The revision in earnings is based on a 32% increase in Titan's jewellery revenues (76% of revenues) in FY11E and 20% in FY12E. Titan demonstrated its pricing power by passing through higher gold prices during the first half of 2010 and this is behind the increase in our estimates. We expect a 20% revenue CAGR in Titan's watches division over FY10-12E. Our 54% earnings CAGR forecast in FY10-12 drives our DCF-derived target price.

Pricing power drives jewellery revenues
A pass through of gold prices remains the key driver of our 34% growth estimate for Titan's jewellery revenues in FY11. Despite international investment demand (especially in ETFs) continuing to drive the dollar price of gold, Titan managed to grow FY10 volumes 4.2% (driven by 46% volume growth in Q4 FY10). We forecast 7.5% jewellery volume growth in FY11 and 5% volume growth in FY12.

Watches division remains a steady performer
Titan's watches division is still a steady performer and we forecast double-digit revenue growth in FY11 and FY12. We expect watch revenues to be driven by 12% volume growth in FY11 and 13% volume growth in FY12.

Maintaining Buy with revised target price of INR4,200
We revise up our FY11 and FY12 earnings estimates by 2.6% and 6.5% respectively. Our upgrades are based on higher growth assumptions in the jewellery division. Our DCF-derived target price of INR4,200 rests on a 13.38% cost of equity and 4% terminal growth (54% CAGR for FY10-12E). Equity dilution and international expansion are potential downside risks (refer to page 8).

Forecasts and ratios

Year End Mar 31	2009A	2010A	**2011E**	2012E	2013E
Sales (INRm)	38,033.8	46,744.2	**59,969.8**	72,069.9	80,191.9
EBITDA (INRm)	2,964.9	3,949.5	**6,796.4**	9,748.2	11,881.2
Reported NPAT (INRm)	1,698.8	2,532.4	**4,326.8**	6,007.6	7,322.1
Reported EPS FD(INR)	38.27	57.05	**97.47**	135.34	164.95
DB EPS FD(INR)	38.27	57.05	**97.47**	135.34	164.95
OLD DB EPS FD(INR)	38.27	57.05	**95.01**	127.11	156.41
% Change	0.0%	0.0%	**2.6%**	6.5%	5.5%
DB EPS growth (%)	7.3	49.1	**70.9**	38.8	21.9
PER (x)	26.3	22.9	**35.0**	25.2	20.7
EV/EBITDA (x)	15.5	14.4	**22.3**	15.4	12.2
DPS (net) (INR)	7.95	15.00	**15.00**	15.00	15.00
Yield (net) (%)	0.8	1.1	**0.4**	0.4	0.4

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

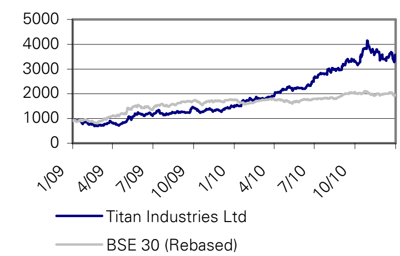
Buy

Price at 13 Jan 2011 (INR)	**3,415.80**
Price target - 12mth (INR)	**4,200.00**
52-week range (INR)	**4,149.85 - 1,497.85**
BSE 30	**19,534**

Key changes

Price target	3,825.00 to 4,200.00 ↑	**9.8%**
Sales (FYE)	58,690 to 59,970 ↑	**2.2%**
Op prof margin (FYE)	10.1 to 10.1 ↑	**0.3%**
Net profit (FYE)	4,217.2 to 4,326.8 ↑	**2.6%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*-2.0*	*3.1*	*132.4*
BSE 30	*-0.8*	*-5.6*	*11.6*

Stock data

Market cap (INRm)	**151,625**
Market cap (USDm)	**3,352**
Shares outstanding (m)	**44.4**
Major shareholders	**TIDCO (28%)**
Free float (%)	**49**
Avg daily value traded (USDm)	**29.583**

Key indicators (FY1)

ROE (%)	**48.0**
Net debt/equity (%)	**-1.6**
Book value/share (INR)	**243.34**
Price/book (x)	**14.0**
Net interest cover (x)	**37.9**
Operating profit margin (%)	**10.1**

Model updated:12 January 2011

Running the numbers

Asia

India

Retail/Wholesale Trade

Titan Industries Ltd

Reuters: TITN.BO Bloomberg: TTAN IN

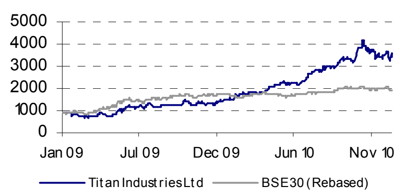
Buy

Price (13 Jan 11)	INR 3,415.80
Target price	INR 4,200.00
52-week Range	INR 1,497.85 - 4,149.85
Market Cap (m)	INRm 151,625 USDm 3,352

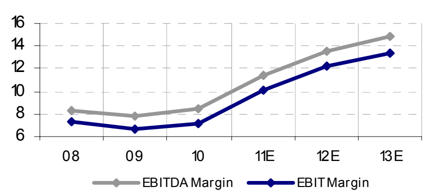
Company Profile

Titan Industries Limited is an India-based manufacturer of watches and jewellery employing 3,800 people. It also manufactures eye wear, precision engineering, machine building and clocks. The Company manufactures over 8 million watches per annum and has a customer base of over 80 million. Titan and Tanishq are among the most admired brands in their categories.

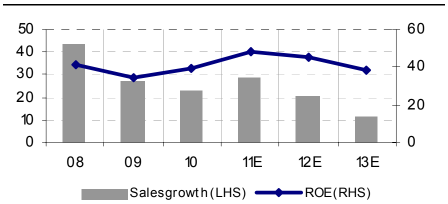
Price Performance



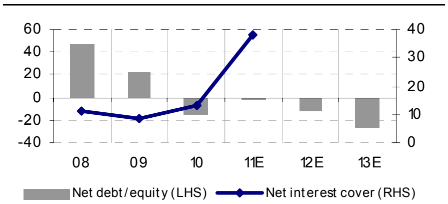
Margin Trends



Growth & Profitability



Solvency



Harrish Zaveri
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Fiscal year end 31-Mar	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (INR)	35.66	38.27	57.05	97.47	135.34	164.95
Reported EPS (INR)	35.66	38.27	57.05	97.47	135.34	164.95
DPS (INR)	8.00	7.95	15.00	15.00	15.00	15.00
BVPS (INR)	98.3	124.2	163.2	243.3	361.4	509.0
Weighted average shares (m)	44	44	44	44	44	44
Average market cap (INRm)	56,236	44,710	58,110	151,625	151,625	151,625
Enterprise value (INRm)	57,821	45,840	56,894	151,372	149,733	145,306
Valuation Metrics						
P/E (DB) (x)	35.5	26.3	22.9	35.0	25.2	20.7
P/E (Reported) (x)	35.5	26.3	22.9	35.0	25.2	20.7
P/BV (x)	10.81	6.28	11.28	14.04	9.45	6.71
FCF Yield (%)	0.5	1.9	5.6	nm	1.6	3.4
Dividend Yield (%)	0.6	0.8	1.1	0.4	0.4	0.4
EV/Sales (x)	1.9	1.2	1.2	2.5	2.1	1.8
EV/EBITDA (x)	23.1	15.5	14.4	22.3	15.4	12.2
EV/EBIT (x)	26.2	18.0	17.0	24.9	17.0	13.5
Income Statement (INRm)						
Sales revenue	**29,937**	**38,034**	**46,744**	**59,970**	**72,070**	**80,192**
Gross profit	**5,105**	**8,844**	**10,741**	**14,486**	**18,503**	**21,805**
EBITDA	**2,504**	**2,965**	**3,950**	**6,796**	**9,748**	**11,881**
Depreciation	297	418	601	724	924	1,124
Amortisation	0	0	0	0	0	0
EBIT	**2,207**	**2,547**	**3,349**	**6,072**	**8,824**	**10,757**
Net interest income(expense)	-201	-294	-254	-160	-4	-4
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	18	53	119	15	15	15
Profit before tax	**2,023**	**2,306**	**3,213**	**5,927**	**8,835**	**10,768**
Income tax expense	440	607	681	1,600	2,827	3,446
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**1,583**	**1,699**	**2,532**	**4,327**	**6,008**	**7,322**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**1,583**	**1,699**	**2,532**	**4,327**	**6,008**	**7,322**
Cash Flow (INRm)						
Cash flow from operations	**984**	**1,598**	**3,691**	**807**	**4,408**	**7,197**
Net Capex	-723	-767	-410	-1,000	-2,000	-2,000
Free cash flow	**261**	**831**	**3,281**	**-193**	**2,408**	**5,197**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-410	-408	-776	-769	-769	-769
Net inc/(dec) in borrowings	109	-825	-1,026	0	-708	0
Other investing/financing cash flows	31	430	-159	0	0	0
Net cash flow	**-9**	**28**	**1,320**	**-963**	**931**	**4,428**
Change in working capital	*-938*	*-519*	*558*	*-4,245*	*-2,524*	*-1,250*
Balance Sheet (INRm)						
Cash and other liquid assets	519	547	1,867	905	1,835	6,263
Tangible fixed assets	2,825	2,940	2,749	3,025	4,101	4,976
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	474	77	76	76	76	76
Other assets	12,167	14,230	16,170	22,489	27,027	29,628
Total assets	**15,985**	**17,794**	**20,863**	**26,495**	**33,039**	**40,943**
Interest bearing debt	2,579	1,754	728	728	20	20
Other liabilities	9,048	10,528	12,891	14,965	16,979	18,330
Total liabilities	**11,627**	**12,282**	**13,619**	**15,693**	**16,999**	**18,350**
Shareholders' equity	4,362	5,512	7,244	10,802	16,040	22,593
Minorities	0	0	0	0	0	0
Total shareholders' equity	**4,362**	**5,512**	**7,244**	**10,802**	**16,040**	**22,593**
Net debt	*2,060*	*1,207*	*-1,139*	*-177*	*-1,815*	*-6,243*
Key Company Metrics						
Sales growth (%)	43.2	27.0	22.9	28.3	20.2	11.3
DB EPS growth (%)	34.0	7.3	49.1	70.9	38.8	21.9
EBITDA Margin (%)	8.4	7.8	8.4	11.3	13.5	14.8
EBIT Margin (%)	7.4	6.7	7.2	10.1	12.2	13.4
Payout ratio (%)	22.4	20.8	26.3	15.4	11.1	9.1
ROE (%)	41.5	34.4	39.7	48.0	44.8	37.9
Capex/sales (%)	2.4	2.0	0.9	1.7	2.8	2.5
Capex/depreciation (x)	2.4	1.8	0.7	1.4	2.2	1.8
Net debt/equity (%)	47.2	21.9	-15.7	-1.6	-11.3	-27.6
Net interest cover (x)	11.0	8.7	13.2	37.9	nm	nm

Source: Company data, Deutsche Bank estimates

Connotations of luxury

Pricing power drives jewellery revenues

A pass through of gold prices remains the key driver of our 34% growth estimate for Titan's jewellery revenues in FY11. Despite international investment demand (especially ETFs) continuing to drive the dollar price of gold, Titan managed to grow FY10 volumes 4.2% (driven by 46% volume growth in Q4 FY10). Titan has seen 42% revenue growth in jewellery in the first half of FY11, driven by both price and volume increases.

Despite the high gold prices, total gold imports by volume in 2010 were 700-750 tonnes, vs. 557 tonnes in 2009 (25-35% growth). However, we have been slightly conservative in our estimates of 7.5% and 5% jewellery volume growth for FY11 and FY12 respectively.

Figure 61: Revenue assumptions

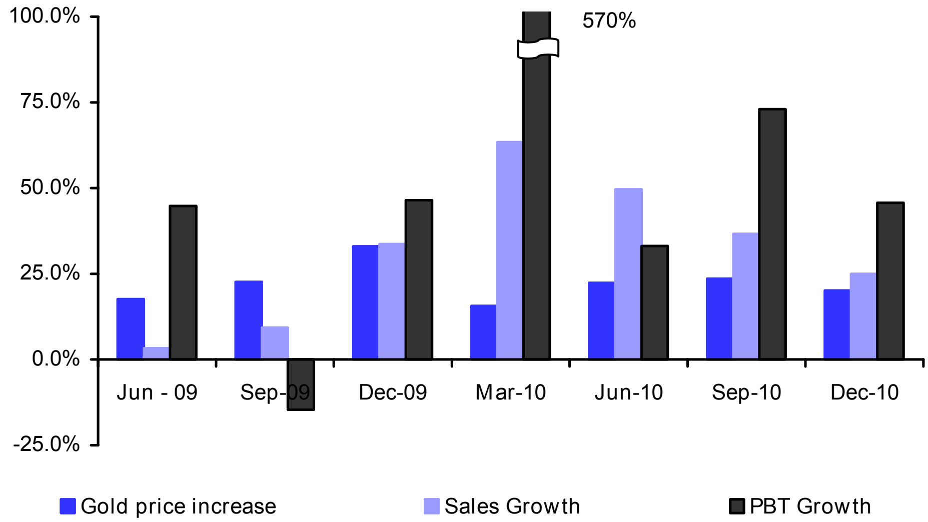
Income	FY09	FY10	FY11E	FY12E	FY13E
Watches	8,900	9,903	12,090	14,345	16,388
Growth%	16.0%	11.3%	22.1%	18.7%	14.2%
Jewellery	22,650	29,613	39,792	48,049	53,469
Growth%	32.3%	30.7%	34.4%	20.8%	11.3%
Gold coins	4,913	5,362	6,441	7,737	7,845
Growth%	56.9%	9.1%	20.1%	20.1%	1.4%
Clocks, sunglasses, etc.	655	954	1,116	1,492	2,076
Growth%	22.1%	45.6%	17.0%	33.8%	39.1%
Others	1,359	1,199	1,259	1,322	1,389
% growth	-30%	-12%	5%	5%	5%
Gross revenue	38,477	47,031	60,698	72,945	81,166
Excise duty	443	287	728	875	974
Excise duty rate	1.2%	1.0%	1.2%	1.2%	1.2%
Sales Income	38,034	46,744	59,970	72,070	80,192
Growth	27.0%	22.9%	28.3%	20.2%	11.3%

Source: Deutsche Bank, company data

Titan charges a percentage of gold sales as making charges and therefore, all else remaining equal, any increase in gold price gives it very strong PBT growth, reflected in relatively strong 44% growth in its jewellery PBT.

Over the last eight quarters Titan's jewellery sales growth has mirrored the increase in gold prices. The impact on its jewellery pre-tax profits reflects the operating leverage within the business.

Figure 62: Impact of gold price increase and volume growth on PBT growth



Source: Deutsche Bank

We have assumed higher capex to factor in new eye plus store openings. Also, the company has opened flagship jewellery stores in Delhi (7,200 square feet) and Chennai (20,000 square feet). These are company-owned stores and we have factored store opening across the major metros during FY11 and FY12 into our capex estimates.

We believe that the eye plus business is getting a lot of traction and should be able to clock revenues of INR900mn. However, breakeven in the business is still some time away.

Figure 63: Capex spend

	FY08	FY09	FY10	FY11E	FY12E	FY13E
Capex	723	767	410	1000	1000	1000

Source: Deutsche Bank, company data

Figure 64: Retail space and positioning of stores

Premium	Helios 1 Store 2,700 sq ft	Zoya 2 Stores 6,700 sq ft	
Mid-Premium	World of Titan 283 stores 275,000 sq ft Fast track 14 stores 8,000 Sq ft	Tanishq 115 Stores 247,700 sq ft	Titan eye+ 77 stores 72,800 sq ft
Mass		Gold Plus 29 Stores 4,200 sq ft	
	Watches	Jewellery	Others

Source: Deutsche Bank

Watches division remains a steady performer

Titan's watches division is still a steady performer and we forecast double-digit revenue growth in FY11 and FY12. We expect the watch revenues to be driven by 13% volume growth in FY12 and 12% volume growth in FY13.

3QFY11 preview

The third quarter is seasonally the best quarter for gold sales. Both Diwali and Dhanteras, the two big gold buying festivals of India, boost sales for Titan. We have factored in 24% top-line growth for Titan driven by strong jewellery sales growth of 25% (20% price and 5% volume) and 18% growth in sales of watches.

Figure 65: 3QFY11 results preview

INR mn	3QFY11 (DB estimates)	3QFY10	YoY
Net Sales	16600	13338	24%
Operating Profit	1594	1075	48%
Net Profit	1063	784	36%
Margins			bps
EBITDA	9.6%	8.1%	155
Net Profit	6.4%	5.9%	53

Source: Deutsche Bank, company data

Figure 66: 3QFY11 segmental sales estimates

Segmental sales (INR mn)	3QFY11 (DB estimates)	3QFY10	YoY
Jewellery	13182	10545	25%
Watches	2843	2409	18%
others	580	403	44%

PBIT (INR mn)	3QFY11 (DB estimates)	3QFY10	YoY
Jewellery	1081	742	46%
Watches	469	354	33%
others	-30	-61	NA

Source: Deutsche Bank, company data

Valuation

54% earnings CAGR FY10-12 drives target price of INR4,200

A 54% CAGR in FY10-FY12 earnings is the driver of our DCF-derived target price of INR4,200. We have factored in higher capex of INR10bn each year over FY10-12E (vs. INR6.3bn on average in FY08-FY10). Our DCF-derived target price of INR4,200 is based on a cost of equity of 13.38% and 4% terminal growth.

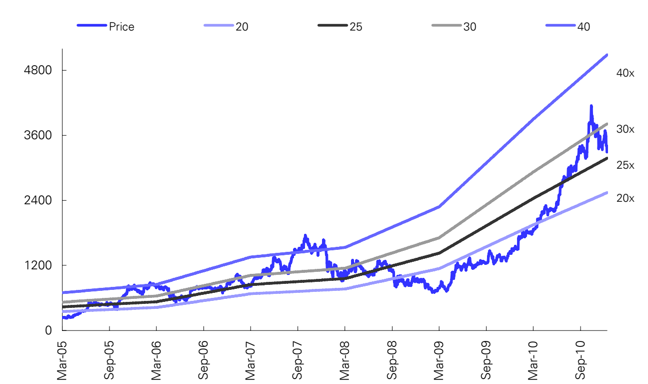
The key assumptions for our two-stage FCFE methodology are:

a) Risk free rate of 6.4%, market risk premium of 7.2% (we apply a standard estimated risk-free rate and market risk premium to all the Indian companies we cover) and Beta of 0.97 (Bloomberg data).

b) We have taken growth in the stable phase of 4%. We have taken this growth rate based on the assumption that long-term growth would be driven by the penetration of organized retail and consequently demand for branded watches, jewelry and eyewear.

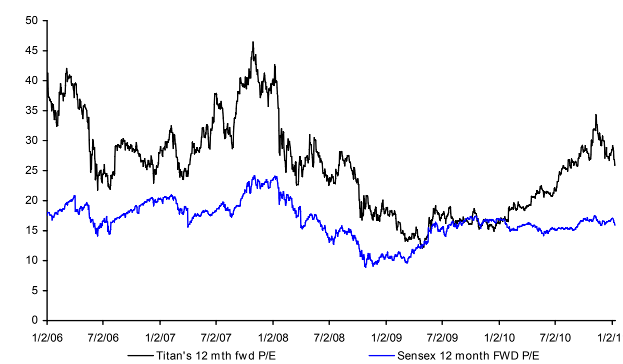
Our valuation for Titan comes to INR4,200 per share. At our target price the exit PE works out to 31x FY12E.

Figure 67: Rolling one-year forward P/E bands



Source: Deutsche Bank, Bloomberg Finance LP

Figure 68: One-year forward Titan's P/E vs. Sensex



Source: Deutsche Bank, Bloomberg Finance LP

Figure 69: DCF valuation for Titan

Cost of Equity =	13.38%
Proportion of Debt: Capital Spending (DR)=	0.12%
Proportion of Debt: Working Capital (DR)=	0.12%
Current Earnings per share=	135.3
(Capital Spending - Depreciation)*(1-DR)	24.2
Change in Working Capital * (1-DR)	- 56.8
Current FCFE	167.9

Growth Rate in Earnings per share

	Growth Rate	*Weight*
Historical Growth =	44.87%	50.00%
Outside Estimates =	45.23%	0.00%
Fundamental Growth =	33.30%	50.00%
Weighted Average	*39.09%*	

Growth Rate in capital spending, depreciation and working capital

	High Growth	*Stable Growth*
Growth rate in capital spending =	39.09%	4.00%
Growth rate in depreciation =	39.09%	4.00%
Growth rate in revenues =	39.09%	4.00%

Working Capital as percent of revenues = 16% (in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	**1.00**	**2.00**	**3.00**	**4.00**	**5.00**
Earnings	188.2	261.8	364.2	506.5	704.5
- (CapEx-Depreciation)*(1-DR)	33.7	46.8	65.1	90.6	126.0
-Chg. Working Capital*(1-DR)	104.9	145.9	203.0	282.3	392.7
Free Cashflow to Equity	49.6	69.1	96.0	133.6	185.8
Present Value	**43.8**	**53.7**	**65.9**	**80.8**	**99.1**

Growth Rate in Stable Phase =	4.00%
FCFE in Stable Phase =	676.78
Cost of Equity in Stable Phase =	13.38%
Price at the end of growth phase (INR/share) =	**7,212**

Present Value of FCFE in high growth phase (INR/share)=	**343**
Present Value of Terminal Price (INR/share) =	**3,849**
Value of the stock (INR/share)=	**4,192**

Estimating the value of growth (INR/share)

Value of assets in place =	1,255
Value of stable growth =	606
Value of extraordinary growth =	2,331
Value of the stock =	4,192

Source: Deutsche Bank

Risks and concerns

Equity dilution

According to management, if gold on lease arrangement (which is a part of current liabilities) were included, the company's debt:equity ratio would be slightly aggressive. Should it prove necessary, the decision to raise capital through a rights issue will be made by the joint promoters, TIDCO and Tata. We believe that dilution is a risk, but assume it is unlikely to be an issue for the next 12 months.

International presence

Titan opened 12 stores in Europe in the 1990s and had to write off its international foray. Management clarified that it has no plans for any major acquisitions – India is its focus market. Moreover, it also confirmed that any such acquisition would have to be vetted by the two promoters, TIDCO and Tata.

Asia India
Consumer Food & Beverage

14 January 2011

Nestle India Limited

Reuters: **NEST.BO** Bloomberg: **NEST IN**

Strong volumes, sustainable margins; raising target price

Strong volumes, sustainable margins; maintaining Buy

A dominant market share in milk (43% of revenues, 86% market share) gives Nestle tremendous pricing power that we expect it to exercise in 2011. Volume growth in Maggi (25% YoY) and chocolates (17% YoY) will likely sustain. A 28% CAGR in earnings CY10-12e makes Nestle one of the best consumer franchisees. We maintain our Buy rating and are revising our target price to INR4,200.

Beating the drum

Nestle's food business grew at a 13.3% CAGR during CY01-2009. Its volume growth was relatively faster than that of its competition, despite facing similar cost pressures. EBITDA growth of a 15.8% CAGR during the same period is impressive, in our opinion. We see merit in the argument that culinary items/chocolate are recession proof as there are 8m Indian households for whom product (not pricing) is the key issue. Milk solid prices and spending on new launches in 2011 mean some caution is appropriate, though the fundamentals seem remarkably solid.

Earnings growth of 28% during CY10-CY12E

We expect Nestle to grow earnings by a 28% CAGR during CY10-CY12 (after providing for contingencies of INR400m over two years). Nestle has a credit balance of INR2.3bn in its contingencies account. Typically, Nestle writes back provisions whenever litigation is settled.

Maintaining Buy; raising target price to INR4,200

We have increased our earnings by 5% to factor in relatively higher margins in CY11 and have rolled over to CY12 numbers, resulting in an increase of 33% in our target price. Our DCF-derived target price of INR4,200 rests on a CoE of 11.15%, beta of 0.66, and 4.5% terminal growth. Our target price implies a P/E multiple of 32x for CY12E vs. an earnings CAGR in CY10-12E of 28%. Major risks include price increases in milk solids, green coffee, wheat and sugar

Forecasts and ratios

Year End Dec 31	2008A	2009A	**2010E**	2011E	2012E
Sales (INRm)	43,241.9	51,293.8	**62,104.7**	75,135.5	90,449.9
EBITDA (INRm)	8,636.8	10,344.9	**12,179.3**	16,479.3	19,748.8
Reported NPAT (INRm)	5,340.2	6,550.1	**7,936.5**	10,866.0	13,063.7
Reported EPS FD(INR)	55.39	67.94	**82.32**	112.70	135.49
DB EPS FD (INR)	55.39	67.94	**82.32**	112.70	135.49
OLD DB EPS FD (INR)	55.39	67.94	**82.32**	107.17	128.83
% Change	0.0%	0.0%	**0.0%**	5.2%	5.2%
DB EPS growth (%)	59.3	22.7	**21.2**	36.9	20.2
PER (x)	27.9	29.3	**46.0**	33.6	27.9
EV/EBITDA (x)	17.0	18.2	**29.8**	21.9	18.2
DPS (net) (INR)	42.51	48.50	**65.85**	90.16	108.39
Yield (net) (%)	2.8	2.4	**1.7**	2.4	2.9

Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

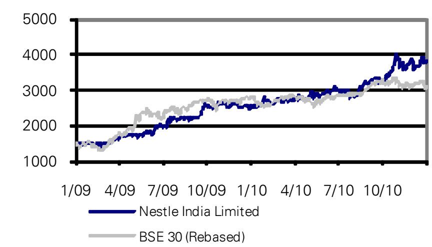
Buy

Price at 13 Jan 2011 (INR)	**3,784.50**
Price target - 12mth (INR)	**4,200.00**
52-week range (INR)	**4,015.20 - 2,517.00**
BSE 30	**19,183**

Key changes

Price target	3,160.00 to 4,200.00 ↑	**32.9%**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*-2.5*	*14.5*	*52.1*
BSE 30	*-2.6*	*-7.3*	*9.6*

Stock data

Market cap (INRm)	**364,885**
Market cap (USDm)	**8,066**
Shares outstanding (m)	**96.4**
Major shareholders	**Nestle SA (61.85%)**
Free float (%)	**34**
Avg daily value traded (USDm)	**2.8**

Key indicators (FY1)

ROE (%)	**129.8**
Net debt/equity (%)	**-13.1**
Book value/share (INR)	**66.54**
Price/book (x)	**56.9**
Net interest cover (x)	**776.2**
Operating profit margin (%)	**17.5**

Model updated:12 January 2011

Running the numbers

Asia

India

Food & Beverage

Nestle India Limited

Reuters: NEST.BO Bloomberg: NEST IN

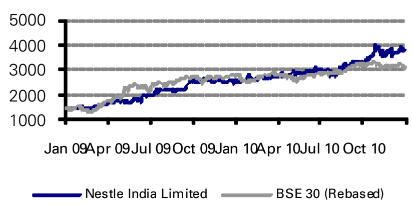
Buy

Price (13 Jan 11)	INR 3,784.50
Target price	INR 4,200.00
52-week Range	INR 2,517.00 - 4,015.20
Market Cap (m)	INRm 364,885 USDm 8,066

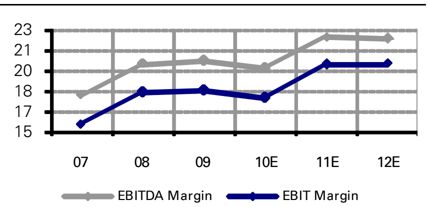
Company Profile

Nestle India manufactures products of truly international quality under internationally famous brand names such as NESCAFE, MAGGI, MILKYBAR, MILO, KIT KAT, BAR-ONE, MILKMAID and NESTEA and in recent years the Company has also introduced products of daily consumption and use such as NESTLE Milk, NESTLE SLIM Milk, NESTLE Fresh 'n' Natural Dahi and NESTLE Jeera Raita.

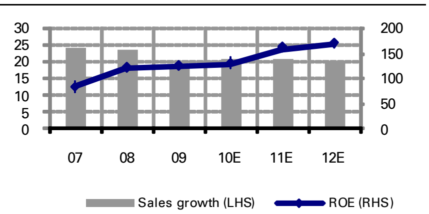
Price Performance



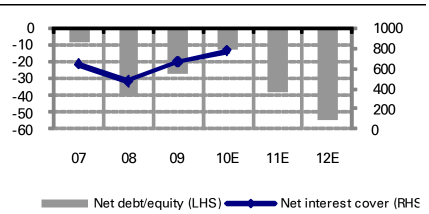
Margin Trends



Growth & Profitability



Solvency



Harrish Zaveri
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Fiscal year end 31-Dec	2007	2008	2009	2010E	2011E	2012E
Financial Summary						
DB EPS (INR)	34.77	55.39	67.94	82.32	112.70	135.49
Reported EPS (INR)	34.77	55.39	67.94	82.32	112.70	135.49
DPS (INR)	33.01	42.51	48.50	65.85	90.16	108.39
BVPS (INR)	43.4	49.1	60.3	66.5	75.1	85.4
Weighted average shares (m)	96	96	96	96	96	96
Average market cap (INRm)	113,709	148,911	191,812	364,885	364,885	364,885
Enterprise value (INRm)	112,416	146,633	188,224	363,490	361,535	359,861
Valuation Metrics						
P/E (DB) (x)	33.9	27.9	29.3	46.0	33.6	27.9
P/E (Reported) (x)	33.9	27.9	29.3	46.0	33.6	27.9
P/BV (x)	34.56	29.59	42.26	56.87	50.39	44.31
FCF Yield (%)	3.2	3.9	3.6	1.4	3.3	3.8
Dividend Yield (%)	2.8	2.8	2.4	1.7	2.4	2.9
EV/Sales (x)	3.2	3.4	3.7	5.9	4.8	4.0
EV/EBITDA (x)	18.2	17.0	18.2	29.8	21.9	18.2
EV/EBIT (x)	20.7	19.0	20.4	33.5	24.1	19.9
Income Statement (INRm)						
Sales revenue	**35,044**	**43,242**	**51,294**	**62,105**	**75,136**	**90,450**
Gross profit	**16,804**	**21,478**	**25,986**	**30,387**	**37,978**	**45,315**
EBITDA	**6,177**	**8,637**	**10,345**	**12,179**	**16,479**	**19,749**
Depreciation	747	924	1,113	1,324	1,499	1,674
Amortisation	0	0	0	0	0	0
EBIT	**5,430**	**7,713**	**9,232**	**10,856**	**14,981**	**18,075**
Net interest income(expense)	-9	-16	-14	-14	-14	-14
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	79	31	-48	336	337	338
Profit before tax	**5,501**	**7,728**	**9,170**	**11,178**	**15,304**	**18,400**
Income tax expense	2,148	2,387	2,620	3,242	4,438	5,336
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**3,353**	**5,340**	**6,550**	**7,937**	**10,866**	**13,064**
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	**3,353**	**5,340**	**6,550**	**7,937**	**10,866**	**13,064**
Cash Flow (INRm)						
Cash flow from operations	**5,368**	**8,566**	**9,137**	**7,639**	**14,495**	**16,245**
Net Capex	-1,702	-2,790	-2,249	-2,500	-2,500	-2,500
Free cash flow	**3,666**	**5,776**	**6,888**	**5,139**	**11,995**	**13,745**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-3,675	-4,795	-5,401	-7,333	-10,040	-12,071
Net inc/(dec) in borrowings	0	0	0	0	0	0
Other investing/financing cash flows	-167	595	-1,684	1,480	-1	-1
Net cash flow	**-176**	**1,576**	**-197**	**-714**	**1,954**	**1,673**
Change in working capital	*1,093*	*1,994*	*1,048*	*-1,821*	*1,931*	*1,308*
Balance Sheet (INRm)						
Cash and other liquid assets	378	1,937	1,556	842	2,796	4,469
Tangible fixed assets	6,755	8,622	9,758	10,935	11,936	12,763
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	944	349	2,033	553	554	555
Other assets	6,409	6,432	7,478	8,526	10,216	12,203
Total assets	**14,486**	**17,339**	**20,824**	**20,855**	**25,502**	**29,990**
Interest bearing debt	29	8	0	0	0	0
Other liabilities	10,273	12,598	15,012	14,439	18,261	21,756
Total liabilities	**10,302**	**12,606**	**15,012**	**14,439**	**18,261**	**21,756**
Shareholders' equity	4,184	4,733	5,813	6,416	7,242	8,234
Minorities	0	0	0	0	0	0
Total shareholders' equity	**4,184**	**4,733**	**5,813**	**6,416**	**7,242**	**8,234**
Net debt	*-349*	*-1,929*	*-1,556*	*-842*	*-2,796*	*-4,469*
Key Company Metrics						
Sales growth (%)	24.4	23.4	18.6	21.1	21.0	20.4
DB EPS growth (%)	6.4	59.3	22.7	21.2	36.9	20.2
EBITDA Margin (%)	17.6	20.0	20.2	19.6	21.9	21.8
EBIT Margin (%)	15.5	17.8	18.0	17.5	19.9	20.0
Payout ratio (%)	94.9	76.7	71.4	80.0	80.0	80.0
ROE (%)	83.1	119.8	124.2	129.8	159.1	168.8
Capex/sales (%)	4.9	6.5	4.4	4.0	3.3	2.8
Capex/depreciation (x)	2.3	3.0	2.0	1.9	1.7	1.5
Net debt/equity (%)	-8.3	-40.7	-26.8	-13.1	-38.6	-54.3
Net interest cover (x)	635.4	469.5	660.2	776.2	nm	nm

Source: Company data, Deutsche Bank estimates

Strong volumes, sustainable margins

Beating the drum

Nestle's food business grew at a 13.3% CAGR during CY01-2009. The volume growth was faster than we had dared to hope, particularly as Nestle faced similar cost pressures to its peers. EBITDA growth of a 15.8% CAGR during the same period is stunning, in our opinion.
We see merit in the argument that culinary items/chocolate are recession proof as there are 8m Indian households for whom product (not pricing) is the key issue All in all, we believe this creates a robust trading picture. .Milk solid prices and spending on new launches in 2011 mean some caution is appropriate, though the company's fundamentals seem remarkably solid. Hence, we maintain our EPS forecasts for CY11 and CY12.

Growth across categories; demonstrable pricing power in milk and coffee

Nestle's impressive top-line growth is driven by strong volume growth across culinary and milk. Price increases across milk and coffee remain the key drivers of the forecast 21% CAGR between CY10 and CY12.

Figure 70: Sales breakdown

Year ended 31 December	CY07	CY08	CY09	CY10E	CY11E	CY12E
Milk Products						
Value	15,756	19,388	23,113	28,729	35,710	43,995
yoy growth (%)	22.55	23.05	19.21	24.30	24.30	23.20
Quantity (MT)	107,736	118,651	134,142	151,580	171,286	191,840
Volume yoy growth (%)	5%	10%	13%	13%	13%	12%
Average price (per MT) (in 000's)	146	163	172	190	208	229
yoy growth (%)	16%	12%	5%	10%	10%	10%
Beverages						
Value	7219	8008	8042	8782	9590	10472
yoy growth (%)	19.35	10.94	0.42	9.20	9.20	9.20
Quantity (MT)	24107	24114	23369	24537	25764	27053
Volume yoy growth (%)	8%	0%	-3%	5%	5%	5%
Average price (per MT) (in 000's)	299.44	332.09	344.13	358	372	387
yoy growth (%)	11%	11%	4%	4%	4%	4%
Prepared dishes						
Value	7811	10519	13350	17356	21660	27031
yoy growth (%)	30.62	34.67	26.91	30.00	24.80	24.80
Quantity (MT)	98259	127835	155555	194444	233333	279999
Volume yoy growth (%)	25%	30%	22%	25%	20%	20%
Average price (per MT) (in 000's)	79.50	82	86	89	93	97
yoy growth (%)	5%	4%	4%	4%	4%	4%
Chocolates & Confectionery						
Value	5686	6795	7719	8831	10102	11557
yoy growth (%)	24.77	19.51	13.60	14.40	14.40	14.40
Quantity (MT)	35752	40200	44116	48528	53380	58718
Volume yoy growth (%)	18%	12%	10%	10%	10%	10%
Average price (per MT) (in 000's)	159	169	175	182	189	197
yoy growth (%)	6.1%	6.3%	3.5%	4%	4%	4%
Total Sales Value	**36,472**	**44,710**	**52,224**	**63,697**	**77,062**	**93,055**
Growth	**24%**	**23%**	**17%**	**22%**	**21%**	**21%**

Source: Deutsche Bank

We have factored in a relatively slower rate of growth due to our expectation of relatively lower price increases. We maintain our expectation of 22% in CY10 and CY11.

Figure 71: Revenue breakdown (% of sales)

Year ended 31 Dec	CY07	CY08	CY09	CY10	CY11E	CY12E
Milk products	43.2	43	44	45	46	47
Soluble beverage powder	19.8	18	15	14	12	11
Prepared dishes	21.4	24	26	27	28	29
Chocolates and confectionery	15.6	15	15	14	13	12
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: Deutsche Bank

We expect pricing to drive margins in CY11

Nestle has been operating with carryover pricing in milk. Contrary to the Street's expectations, Nestle was relatively unaffected by higher milk prices in CY09 and CY10.

Our estimates factor in a gross margin increase from 49% in CY10 to 50% in CY11, primarily based on higher milk prices.

We have factored in price increases in key raw materials in CY11E of 13% in fresh milk, 15% in green coffee and 15% in cocoa.

Tight working capital management – negative working capital a kicker to FCF growth

Nestle's cash-conversion cycle improved from 46 days of sales in CY96 to five days in CY02, and has been negative since CY04. Collections from debtors improved from 32 days to four days during the same period. Nestle carries 35 days of inventory, primarily because it needs to maintain inventories of agricultural commodities that comprise its key raw materials. We believe Nestle would be able to maintain its cash-conversion cycle at current levels between CY10E and CY12E.

The negative working capital provides a kicker to Nestle's FCF growth of a 64% CAGR between CY10 and CY12.

Earnings growth of 28% between CY10 and CY12E

We expect Nestle to grow earnings by a 28% CAGR between CY10 and CY12 (after providing for contingencies of INR400m over two years). Nestle has a credit balance of INR2.3bn in its contingencies account. Typically, Nestle writes back provisions whenever litigation is settled.

INR5bn capex committed; INR17bn planned in the next five years

As the current capacities reach high levels of utilization, Nestle has planned capex of INR17bn for the next five years on expanding current capacities and adding new ones. The capex would be focused on doubling the capacity of the following.

- Prepared dishes and cooking aids
- Milk products and nutrition
- Chocolate and confectionery

The funding for the capex would be a mix of debt and internal accruals.

Where are we vis-à-vis consensus?

Our earnings estimates are 10.9% higher than consensus in CY11 and 11.3% higher in CY12. This is primarily due to better margins, driven by Nestle's pricing power.

Figure 72: Deutsche Bank estimates vs. consensus

	---------------CY11------------			-----------------CY12------------		
	DBe	Consensus	% chg	DBe	Consensus	% chg
Sales	75,136	73,267	2.6%	90,450	85,970	5.2%
EBITDA	16,479	15,038	9.6%	19,749	17,893	10.4%
PAT	10,866	9,800	10.9%	13,064	11,742	11.3%

Source: Deutsche Bank, Bloomberg Finance LP

4QCY10 results preview

We estimate 17% YoY growth in revenues in 4Q, driven entirely by volumes. We have factored in a gross margin decline of 78 bps. We forecast recurring profit growth of 22% YoY.

Figure 73: 4QCY10 estimates

INR m	4QCY10 (DB est)	4QCY09	YoY %
Net sales	15788	13518	17%
Gross profit	7832	6996	12%
EBITDA	2467	1981	24%
Recurring net profit	1568	1286	22%
Margins			**bps**
Gross profit margin	50%	52%	-78
EBITDA margin	16%	15%	539
Net profit margin	10%	8%	537

Source: Deutsche Bank

Valuation and risks

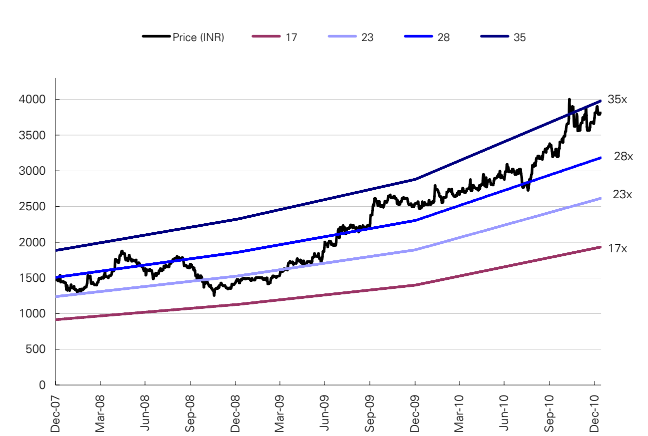
Raising our target price to INR4,200

We are revising our target price to INR4,200 due to a rollover to CY12 numbers. We have calculated our target price based on the FCF to equity methodology. The key assumptions for our two-stage FCFE methodology are as follows.

- The standard estimated risk-free rate of 6.4% and market-risk premium of 7.2%, which we apply to all the Indian companies we cover, and a beta of 0.66 (Bloomberg Finance LP), implying a cost of equity of 11.15%; and
- Growth in the stable phase of 4.5% (the long-term growth rate on the number of households in India).

Our FCFE analysis gives a target price of INR4,200 (Figure 7).

Figure 74: Rolling one-year forward P/E bands



Source: Deutsche Bank

Figure 75: One-year forward Nestle P/E vs. Sensex

Source: Deutsche Bank

Figure 76: Nestle: FCF valuation

Cost of Equity =	11.15%

Proportion of Debt: Capital Spending (DR)=	0.00%
Proportion of Debt: Working Capital (DR)=	0.00%

Current Earnings per share=	135.5
(Capital Spending - Depreciation)*(1-DR)	8.6
Change in Working Capital * (1-DR)	13.6
Current FCFE	113.4

Growth Rate in Earnings per share

	Growth Rate	*Weight*
Historical Growth =	31.26%	100.00%
Outside Estimates =	0.00%	0.00%
Fundamental Growth =	31.73%	0.00%
Weighted Average	*31.26%*	

Growth Rate in capital spending, depreciation and working capital

	High Growth	*Stable Growth*
Growth rate in capital spending =	31.26%	4.50%
Growth rate in depreciation =	31.26%	4.50%
Growth rate in revenues =	31.26%	4.50%

Working Capital as percent of revenues =	-8%	(in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	**1.00**	**2.00**	**3.00**
Earnings	177.9	233.5	306.4
- (CapEx-Depreciation)*(1-DR)	11.3	14.8	19.4
-Chg. Working Capital*(1-DR)	- 24.1	- 31.7	- 41.6
Free Cashflow to Equity	190.7	250.4	328.6
Present Value	**171.6**	**202.6**	**239.3**

Growth Rate in Stable Phase =	4.50%
FCFE in Stable Phase =	328.08
Cost of Equity in Stable Phase =	11.15%
Price at the end of growth phase (INR/share) =	**4,932**

Present Value of FCFE in high growth phase (INR/share)=	**614**
Present Value of Terminal Price (INR/share) =	**3,591**
Value of the stock (INR/share)=	**4,205**

Estimating the value of growth (INR/share)

Value of assets in place =	1,016
Value of stable growth =	764
Value of extraordinary growth =	2,424
Value of the stock =	4,205

Source: Deutsche Bank

Risks

Raw milk prices a major downside risk

Raw milk prices are the key risk to our investment stance; Nestle's profit growth is dependent on raw milk prices as the company almost always passes on any increase in milk prices to consumers. India produces 100m tons of milk annually, and domestic demand-supply has been the key driver of prices. Over the longer term, as the moves to reduce milk subsidies in Europe and the US acquire momentum, it is likely that nations with a milk surplus (such as India) will witness higher competition with new entrants, such as Danone and Kraft entering the race for milk procurement. Hence, our forward estimates on milk prices factor in 14% growth in CY10; should our estimates prove incorrect, this could undermine our investment stance. Other risks include price increases in green coffee, sugar and wheat.

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Asia India
Consumer Retail/Wholesale Trade

14 January 2011

Marico Limited

Reuters: **MRCO.BO** Bloomberg: **MRCO IN**

Unusually high copra price presents an opportunity

Modest 3QFY11 results, an opportunity to buy

The sudden spike in copra prices (40% of raw material cost) is not structural but temporary and should ease in February when the best copra produce for the year floods the market. The recent price hikes should be withdrawn only gradually as copra prices fall to make up for lost margins in 3QFY11. Nonetheless, we believe third quarter numbers should be weak and, along with the recent stock price correction, should present a good opportunity to buy the stock. We maintain Buy on Marico.

Price hikes – 24% in Parachute, 13% in Saffola

To pass on the copra price increase, Marico has increased the price of Parachute 24% over the last four months. Marico has also made a 13% price hike in Saffola without a corresponding increase in raw material prices, which has been relatively easy to implement as Sundrop, Saffola's key competitor, has increased prices 15%.

Top-line growth of 22%and flat bottom line for 3QFY11E

An effective 13.5% price hike for Parachute and a 9% price hike in Saffola for 3QFY11E would be insufficient to counter the raw material price increase and would result in a 591bps decline in gross margins in our opinion. However, a 200bps reduction in the ad-to-sales ratio could help contain the EBITDA margin decline to only 277bps.

Maintaining Buy with a target price of INR150

Our DCF-derived target price of INR150 rests on a 6.4% risk-free rate, 7.2% market risk premium, a beta of 0.5, a 28% FY10-12E earnings CAGR and a 3% terminal growth rate. At our target price, the exit PE would be 23x FY12E earnings. Key downside risks include a continued high copra price even after February, an adverse verdict on the coconut excise duty case and continued losses in the Kaya business.

Forecasts and ratios

Year End Mar 31	2009A	2010A	**2011E**	2012E	2013E
Sales (INRm)	23,884.2	26,607.6	**32,249.8**	38,148.5	44,816.3
EBITDA (INRm)	3,040.4	3,751.7	**4,533.8**	5,458.3	6,504.5
Reported NPAT (INRm)	1,887.2	2,316.9	**3,158.7**	3,990.7	4,870.3
Reported EPS FD(INR)	3.10	3.80	**5.18**	6.55	7.99
DB EPS FD(INR)	3.35	3.96	**5.18**	6.55	7.99
DB EPS growth (%)	28.5	18.4	**30.8**	26.3	22.0
PER (x)	17.4	22.5	**23.7**	18.7	15.3
EV/EBITDA (x)	12.5	15.2	**16.6**	13.3	10.7
DPS (net) (INR)	0.66	0.66	**0.70**	0.70	0.70
Yield (net) (%)	1.1	0.7	**0.6**	0.6	0.6

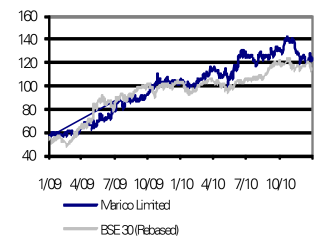
Source: Deutsche Bank estimates, company data

[1] DB EPS is fully diluted and excludes non-recurring items
[2] Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Buy

Price at 13 Jan 2011 (INR)	**122.65**
Price target - 12mth (INR)	**150.00**
52-week range (INR)	**141.25 - 97.85**
BSE 30	**19,534**

Price/price relative



Performance (%)	1m	3m	12m
Absolute	*0.2*	*-7.2*	*19.0*
BSE 30	*-0.8*	*-5.6*	*11.6*

Stock data

Market cap (INRm)	**74,694**
Market cap (USDm)	**1,651**
Shares outstanding (m)	**609.0**
Major shareholders	**Harsh Mariwala (63.5%)**
Free float (%)	**40**
Avg daily value traded (USDm)	**1.122**

Key indicators (FY1)

ROE (%)	**40.1**
Net debt/equity (%)	**15.7**
Book value/share (INR)	**15.11**
Price/book (x)	**8.1**
Net interest cover (x)	**19.5**
Operating profit margin (%)	**12.4**

Model updated:22 October 2010

Running the numbers

Asia

India

Retail/Wholesale Trade

Marico Limited

Reuters: MRCO.BO Bloomberg: MRCO IN

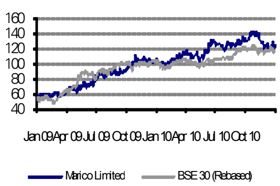
Buy

Price (13 Jan 11)	INR 122.65
Target price	INR 150.00
52-week Range	INR 97.85 - 141.25
Market Cap (m)	INRm 74,694 USDm 1,651

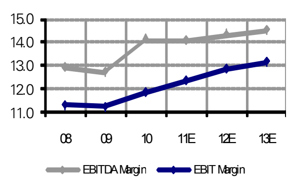
Company Profile

Marico is a leading Indian group in consumer products and services in the global beauty and wellness space. Marico's products and services in hair care, skin care and healthy foods generated during 2008-09 a turnover of about Rs23.9 billion (US$500 million).

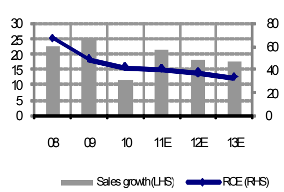
Price Performance



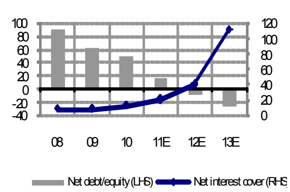
Margin Trends



Growth & Profitability



Solvency



Gaurav Bhatia
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Fiscal year end 31-Mar	2008	2009	2010	2011E	2012E	2013E
Financial Summary						
DB EPS (INR)	2.60	3.35	3.96	5.18	6.55	7.99
Reported EPS (INR)	2.78	3.10	3.80	5.18	6.55	7.99
DPS (INR)	0.66	0.66	0.66	0.70	0.70	0.70
BVPS (INR)	5.2	7.4	10.7	15.1	20.8	28.0
Weighted average shares (m)	609	609	609	609	609	609
Average market cap (INRm)	37,522	35,410	54,305	74,694	74,694	74,694
Enterprise value (INRm)	40,350	38,116	56,947	75,457	72,828	69,404
Valuation Metrics						
P/E (DB) (x)	23.7	17.4	22.5	23.7	18.7	15.3
P/E (Reported) (x)	22.2	18.8	23.4	23.7	18.7	15.3
P/BV (x)	13.02	8.06	10.11	8.12	5.88	4.37
FCF Yield (%)	nm	1.2	0.9	3.2	4.2	5.2
Dividend Yield (%)	1.1	1.1	0.7	0.6	0.6	0.6
EV/Sales (x)	2.1	1.6	2.1	2.3	1.9	1.5
EV/EBITDA (x)	16.4	12.5	15.2	16.6	13.3	10.7
EV/EBIT (x)	18.7	14.2	18.1	18.9	14.9	11.8
Income Statement (INRm)						
Sales revenue	**19,067**	**23,884**	**26,608**	**32,250**	**38,148**	**44,816**
Gross profit	**9,024**	**10,711**	**13,587**	**15,973**	**18,364**	**21,493**
EBITDA	**2,463**	**3,040**	**3,752**	**4,534**	**5,458**	**6,505**
Depreciation	309	358	601	550	560	604
Amortisation	0	0	0	0	0	0
EBIT	**2,155**	**2,683**	**3,151**	**3,984**	**4,898**	**5,900**
Net interest income(expense)	-276	-357	-257	-204	-121	-53
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	106	-151	-98	0	0	0
Other pre-tax income/(expense)	67	122	183	120	150	165
Profit before tax	**2,051**	**2,296**	**2,979**	**3,900**	**4,927**	**6,013**
Income tax expense	360	409	643	741	936	1,142
Minorities	0	0	19	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	**1,692**	**1,887**	**2,317**	**3,159**	**3,991**	**4,870**
DB adjustments (including dilution)	-106	151	98	0	0	0
DB Net profit	**1,586**	**2,038**	**2,415**	**3,159**	**3,991**	**4,870**
Cash Flow (INRm)						
Cash flow from operations	**1,068**	**1,333**	**1,955**	**2,872**	**3,621**	**4,417**
Net Capex	-1,659	-904	-1,486	-500	-500	-500
Free cash flow	**-590**	**430**	**468**	**2,372**	**3,121**	**3,917**
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-499	-461	-515	-493	-493	-493
Net inc/(dec) in borrowings	1,070	170	709	-1,500	-1,500	-1,000
Other investing/financing cash flows	208	220	-681	0	0	0
Net cash flow	**189**	**359**	**-18**	**379**	**1,129**	**2,425**
Change in working capital	*-827*	*-1,062*	*-1,080*	*-837*	*-929*	*-1,057*
Balance Sheet (INRm)						
Cash and other liquid assets	753	922	1,115	1,494	2,622	5,047
Tangible fixed assets	2,573	3,111	3,997	3,946	3,887	3,782
Goodwill/intangible assets	842	850	850	850	850	850
Associates/investments	0	121	827	827	827	827
Other assets	5,510	6,438	8,471	9,706	11,402	13,331
Total assets	**9,678**	**11,442**	**15,260**	**16,824**	**19,588**	**23,837**
Interest bearing debt	3,579	3,750	4,459	2,959	1,459	459
Other liabilities	2,952	3,158	4,136	4,534	5,300	6,172
Total liabilities	**6,531**	**6,908**	**8,595**	**7,493**	**6,759**	**6,631**
Shareholders' equity	3,146	4,535	6,540	9,206	12,704	17,081
Minorities	1	0	125	125	125	125
Total shareholders' equity	**3,147**	**4,535**	**6,665**	**9,331**	**12,829**	**17,207**
Net debt	*2,827*	*2,828*	*3,344*	*1,465*	*-1,164*	*-4,588*
Key Company Metrics						
Sales growth (%)	22.5	25.3	11.4	21.2	18.3	17.5
DB EPS growth (%)	46.9	28.5	18.4	30.8	26.3	22.0
EBITDA Margin (%)	12.9	12.7	14.1	14.1	14.3	14.5
EBIT Margin (%)	11.3	11.2	11.8	12.4	12.8	13.2
Payout ratio (%)	23.6	21.1	17.4	13.5	10.7	8.8
ROE (%)	66.8	49.1	41.8	40.1	36.4	32.7
Capex/sales (%)	8.7	3.8	5.6	1.6	1.3	1.1
Capex/depreciation (x)	5.4	2.5	2.5	0.9	0.9	0.8
Net debt/equity (%)	89.8	62.4	50.2	15.7	-9.1	-26.7
Net interest cover (x)	7.8	7.5	12.3	19.5	40.3	111.9

Source: Company data, Deutsche Bank estimates

Unusually high copra price presents an opportunity

The copra price has risen to an all-time high of INR6200/Quintal. The average price for 3QFY11 is up 67% over 3QFY10. Even if one considers 3QFY10 as a low base as prices were down 24% over 3QFY09, the rise has been substantial (26% over 3QFY09) and sudden.

Figure 77: Average copra price for the quarter

	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11E	Current price
Copra	4090	3769	3327	3169	3103	3385	3428	3903	5187	6200
yoy growth	27.9%				-24.1%				67.2%	

Source: Bloomberg Finance LP

If one were to look at the average price of copra for FY11 (to date), the price is 29% higher than FY10 (low base) but just 4% higher than FY09.

Figure 78: Average copra price for the full year

	FY08	FY09	FY10	FY11 (to date)
Copra price INR/Quintal	3307	4055	3283	4235
yoy growth		22.6%	-19.0%	29.0%

Source: Bloomberg Finance LP

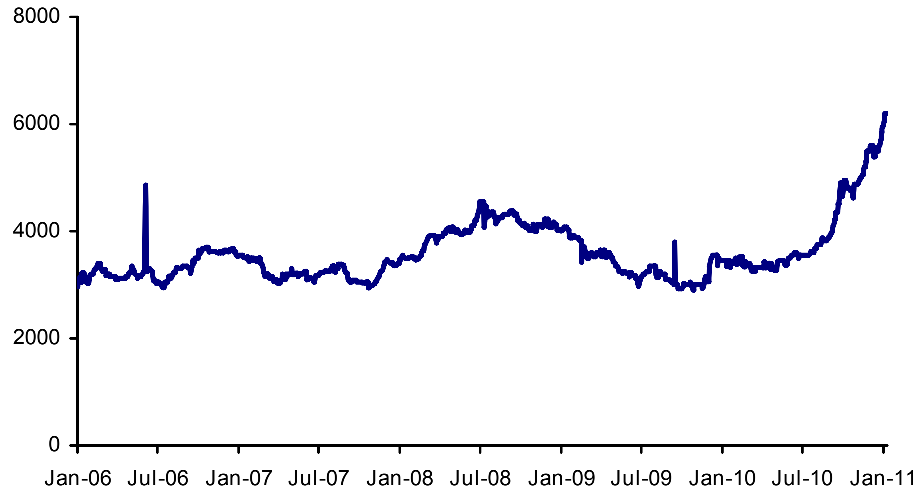
The average price for FY11 is substantially lower (at INR4235/Quintal) than the current market price (INR6200/Quintal) as prices have only increased in the last three to four months. We believe this sudden spike in prices has been due to 1) a shortage in the domestic market due to less area under cultivation and lower yield from the two southern states, Kerela and Tamil Nadu (71% of coconut produce in India), and b) an increase in other vegetable oil prices, especially palm oil prices, which has rubbed off on copra prices. Adverse weather conditions in South America have raised concerns about a lower soy bean supply and heavy rains in Malaysia and Indonesia have raised concerns about lower palm oil produce.

We believe the current high copra price is a deviation from normal and should not be considered as a long-term demand-supply mismatch as illustrated by the copra price chart.

When can one expect prices to come down?

Although copra is produced during the entire year, the best copra produce enters the market by mid-February and copra prices being to fall slightly before that in anticipation of good quality copra flooding the market. We therefore believe copra prices are close to their peak levels and should start to cool off by February.

Figure 79: Copra price chart since 2006; prices are currently above normal



Source: Bloomberg Finance LP

Price hikes – 24% in Parachute, 13% in Saffola

24% price hike in Parachute

Marico has recently made three price hikes in Parachute - one in August (5%), one at the end of September (7%) and one towards the end of December (10%). The effective price hike in the coconut oil portfolio has been around 24%. Since the price hike has been made in a staggered manner, the effective price hike in Parachute for 3QFY11E should be lower at around 13.5%, which would be insufficient to counter the raw material price and would result in a margin decline.

At the same time, we believe that if copra prices were to fall in February, the company would only gradually withdraw the price hike, making up for the decline in profits during an unusually high copra price period.

Having said that, we also believe volume growth in Parachute in FY11 should be lower than the average 8% volume growth, as indicated by management. Volume growth was 11% in the first quarter (14% in rigid packs) and 6% in the second quarter (10% in rigid packs). We have assumed a 3% volume growth in Parachute for the third quarter.

13% price hike in Saffola

We are excited about Marico's Saffola franchise. Marico's cooking oil franchise is just 4% of the organized/branded edible oil market in India, which is just 25% of the c. INR750bn Indian edible oil market. Saffola operates at the top end of the spectrum and has a market share of just over 50% in the top-end refined cooking oil segment (Sundrop being the other half) and growing at 14-16% by volume.

We continue to believe the RM price increase in edible oil (except for Marico) provides Marico with significant room to exercise pricing power. The price increase in RM for cooking oil has been relatively low, with Safflower oil down 4% yoy (3QFY11 vs. 3QFY10) and rice bran oil up 9% yoy (3QFY11 vs. 3QFY10). Yet, Marico has recently taken a price hike of c. 13% in the Saffola franchise. This price hike would have been very easy to implement as key competitor Sundrop (Agrotech foods) had to raise prices 15% due to high RM prices. Agrotech foods has a PAT margin of about 4% and hence has little scope of absorbing RM shocks.

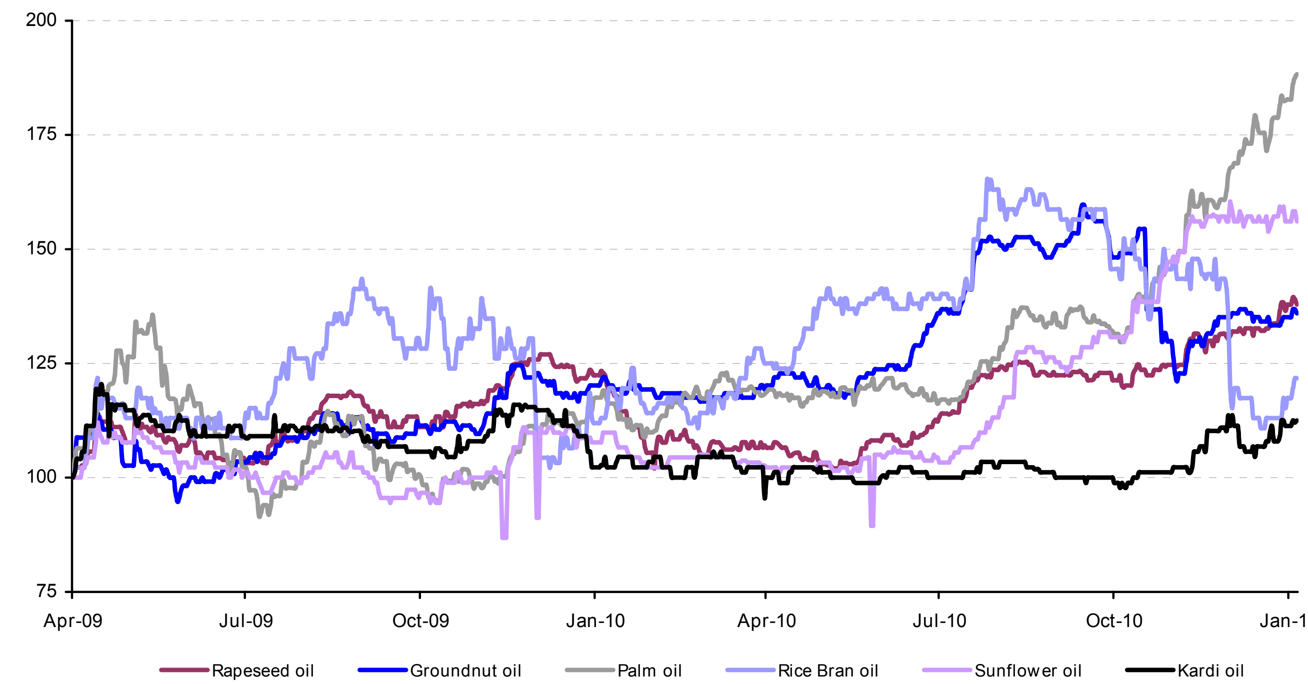
Marico uses safflower oil, rice bran oil and a small proportion of sunflower oil (for the Sweekar brand – c.22% of the cooking oil portfolio, the rest is Saffola), whereas Sundrop (key competitor with 50% market share) uses more sunflower oil

Figure 80: Average price increases for various edible oils used in India

	Q3FY11E		Year to date (9MFY11 vs. 9MFY10)
	% yoy	% qoq	% yoy
Palm oil	50%	22%	25%
Sunflower oil	45%	25%	21%
Groundnut oil	16%	-9%	24%
Rice Bran oil	9%	-13%	17%
Rapeseed oil	7%	6%	5%
Safflower oil	-4%	4%	-7%

Source: Deutsche Bank, Bloomberg Finance LP

Figure 81: Price chart of various edible oils rebased with 1 April 2009 as base 100



Source: Deutsche Bank, Bloomberg Finance LP

The recent price correction presents a good opportunity

Marico's stock price has corrected about 13.5% over the last two months, primarily due to concerns about high copra prices. Although the RM price hike should affect margins in 3QFY11, we believe the price shock is not structural but a temporary one and the correction should be treated as an opportunity to enter the stock.

Top-line growth of 22%and flat bottom line for 3QFY11E

High copra prices should result in a 590bps decline in the gross margin. The recent 24% price hike has been staggered and therefore the effective price hike for the third quarter should be about 13.5%.

Figure 82: 3QFY11 estimates

Particulars	Q3FY11 (Deutsche Bank estimate)	3QFY10	yoy	Q3FY11 (Consensus)	yoy consensus
Net sales	**8,157**	**6,696**	**21.8%**	**7,907**	**18%**
Gross profit	3,816	3,528	8.1%		-
EBITDA	**977**	**988**	**-1.0%**	**1,018**	**3%**
Net profit	641	631	1.6%	702	11%
EPS	**1.05**	**1.04**	**1.6%**	**1.15**	
Margins			**bps**		**bps**
Gross margins	46.8%	52.7%	-591		
Ad/sales ratio	10.7%	12.8%	-208		
EBITDA margin	12.0%	14.8%	-277	12.9%	-188
Net profit margin	7.9%	9.4%	-157	9.5%	12

Source: Deutsche Bank, Company data

The following assumptions were made when calculating 3QFY11E numbers.

Figure 83: Raw material price assumption for core India business

	% of RM	% price hike
Copra	40%	60%
Safflower oil	13%	-4%
Rice bran oil	11%	11%
Packing	16%	5%
Others	20%	5%
Effective raw material price hike		**26.5%**

Source: Deutsche Bank

Figure 84: Price/volume assumptions for core India business

	% of sales	% price hike	% volume growth
Parachute	49%	13.5%	3.0%
Saffola	24%	9.0%	14.0%
Sweekar	7%	8.0%	7.0%
Hair oil	21%	5.0%	13.0%
Effective price/volume hike		**10.3%**	**7.9%**

Source: Deutsche Bank

We expect a 200bps reduction in the ad-to-sales ratio to balance the effect of high RM. On Kaya we expect a marginal qoq improvement with INR650m revenue in 3QFY11E over INR624m in 2QFY11. For the international business we expect 24% growth (18% volume, 10% price and -4% currency effect).

DCF valuation

We valued Marico on a DCF basis. The key assumptions for our two-stage FCFE methodology are:

- Risk-free rate of 6.4% (Deutsche Bank estimates), market risk premium of 7.2% (Deutsche Bank estimates) and beta of 0.5 (Bloomberg Finance LP data), implying a cost of equity of 10%
- Growth in the stable phase of 3% is based on long-term growth of households in India and their long-term usage of branded edible oil.

Our valuation for Marico works out to be INR150. This implies an earnings multiple of 29x FY11E and 22.9x FY12E.

(Refer to Figure 85.)

Risks

High copra prices
Continued high copra prices should act as a growth dampener.

Excise duty on coconut oil
A potential excise duty on coconut oil sold in quantities below 200ml (as demanded by the excise board) would be a downside risk for the company. The case is currently in court. However, since Marico provisions 75% of the duty payable, the effect on the P&L would be limited. Mario has introduced 250ml packs to reduce the sales of packs below 200ml.

Increase in losses in the Kaya business
Losses in the Kaya India business continue to lay heavy on the minds of the investors. Increasing losses in the Kaya business is a key risk for the company.

Figure 85: DCF valuation for Marico

Cost of Equity =	10.00%	
Proportion of Debt: Capital Spending (DR)=		10.30%
Proportion of Debt: Working Capital (DR)=		10.30%
Current Earnings per share=		6.5
(Capital Spending - Depreciation)*(1-DR)		- 0.1
Change in Working Capital * (1-DR)		1.4
Current FCFE		5.3

Growth Rate in Earnings per share

	Growth Rate	*Weight*
Historical Growth =	29.87%	100.00%
Outside Estimates =	0.00%	0.00%
Fundamental Growth =	28.06%	0.00%
Weighted Average	*29.87%*	

Growth Rate in capital spending, depreciation and working capital

	High Growth	*Stable Growth*
Growth rate in capital spending =	29.87%	3.00%
Growth rate in depreciation =	29.87%	3.00%
Growth rate in revenues =	29.87%	3.00%

Working Capital as percent of revenues = 10% (in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	**1.00**	**2.00**	**3.00**
Earnings	8.5	11.0	14.3
- (CapEx-Depreciation)*(1-DR)	- 0.1	- 0.1	- 0.2
-Chg. Working Capital*(1-DR)	1.6	2.1	2.7
Free Cashflow to Equity	7.0	9.1	11.9
Present Value	**6.4**	**7.5**	**8.9**

Growth Rate in Stable Phase =	3.00%
FCFE in Stable Phase =	11.86
Cost of Equity in Stable Phase =	10.00%
Price at the end of growth phase (INR/share) =	169

Present Value of FCFE in high growth phase (INR/share)=	23
Present Value of Terminal Price (INR/share) =	127
Value of the stock (INR/share)=	150

Estimating the value of growth (INR/share)

Value of assets in place =	53
Value of stable growth =	25
Value of extraordinary growth =	73
Value of the stock =	150

Source: Deutsche Bank

Appendix 1

Important Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on a security mentioned in this report, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr.

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst about the subject issuers and the securities of those issuers. In addition, the undersigned lead analyst has not and will not receive any compensation for providing a specific recommendation or view in this report. Harrish Zaveri

Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.

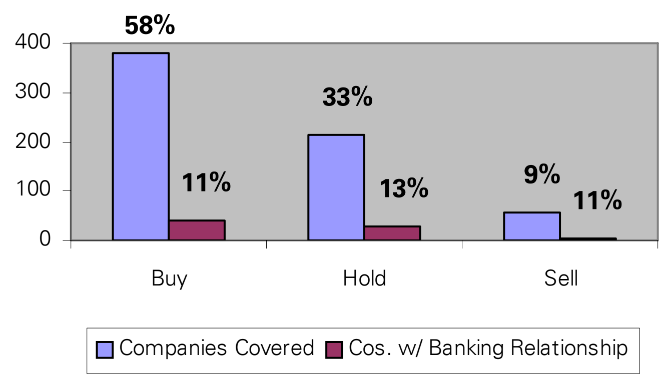
2. Ratings definitions prior to 27 January, 2007 were:

Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships



Asia-Pacific Universe

Regulatory Disclosures

1. Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2. Short-Term Trade Ideas

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