

Morgan Stanley India Company
Private Limited+

Hozefa Topiwalla
Hozefa.Topiwalla@morganstanley.com
+91 22 2209 7808

Divya Gangahar
Divya.Gangahar@morganstanley.com
+91 22 2209 7172

Girish Achhipalia
Girish.Achhipalia@morganstanley.com
+91 22 2209 7170

November 4, 2008

Industry View
Attractive

India Consumer

Cost pressures peaking out

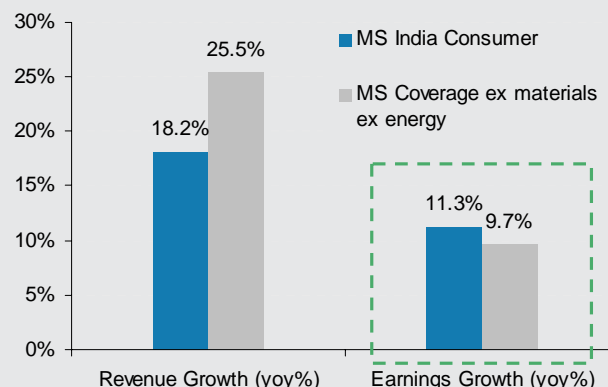
Quick Comment: MS India Consumer delivers top-line growth of 18% in Q2F09: MS India consumer companies reported revenue, operating profit and adjusted net profit growth of 18.2%, 8.2%, and 11.3% versus our expectation of 17.3%, 12.9%, and 13% respectively. Input cost management was the key issue during the quarter as companies under MS India Consumer saw gross margin contraction from 40-780 bps. The quarter was adversely affected by a lag in rising commodity costs. Interestingly, most companies indicated that in the event of continued softening in commodity prices, any rollback in product prices (albeit there maybe an increase in promotions to spur demand) would be unlikely. In such a scenario, FMCG companies could be key beneficiaries and see significant margin expansion in the coming quarters (see *India Consumer: Room for Windfall Margin*; and *Hindustan Unilever: Earnings Upside Due to Potential Fall in Input Costs*). We retain our attractive rating on the industry with HUL, Nestle, and Marico our top picks.

Key Highlights in the Quarter

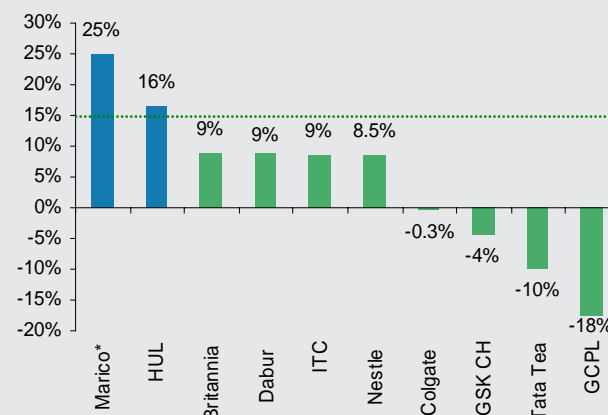
1. There has been **no slowdown in consumption** across key consumer categories. Domestic FMCG sales rose 18.6% this quarter, the highest in the last two years.
2. Interestingly, sharp price hikes have been relatively well-absorbed by consumers as **volume growth remains quite steady**.
3. Severe input cost pressures led to all companies (ex ITC) reporting a **decline in gross profit margin**. The MS Input Cost Index was up 32% YoY during the quarter at 180. However, it has come off 14% from its peak and is currently at 161. (Exhibit 3)
4. Five of eight companies reported a **decline in ad spend to sales ratio** by an average of about 160 bps. The noticeable exception was Colgate, which increased its ad spend ratio by 240 bps.

Reiterate our top 3 picks: The FMCG Index has outperformed Sensex by 29% YTD. We prefer HUL over ITC and also recommend investors consider a basket of mid-cap consumer stocks that includes Nestle & Marico.

MS India Consumer Revenue & Earnings Growth vs. MS India ex materials ex energy



HUL & Marico are the only companies that have reported double-digit operating profit growth



*Adjusted for MTM loss

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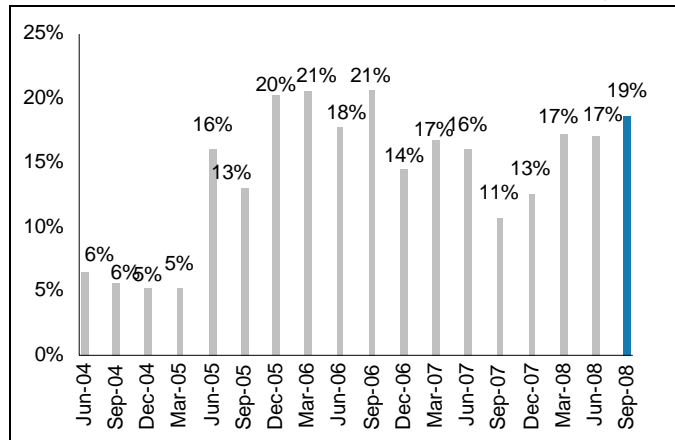
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Exhibit 1

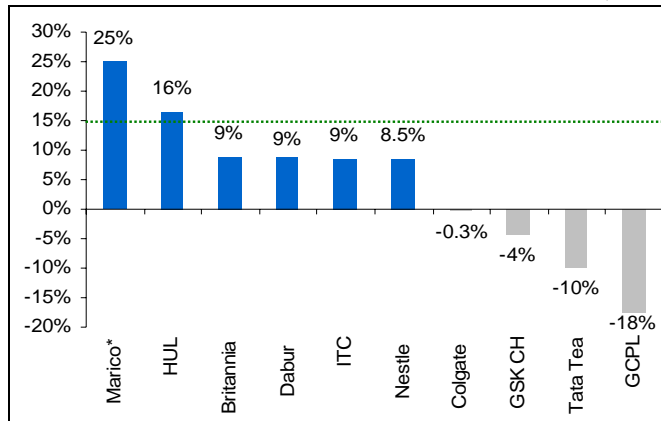
Domestic FMCG Sales Growth Continues in SQ08



Source: Company data, Morgan Stanley Research

Exhibit 4

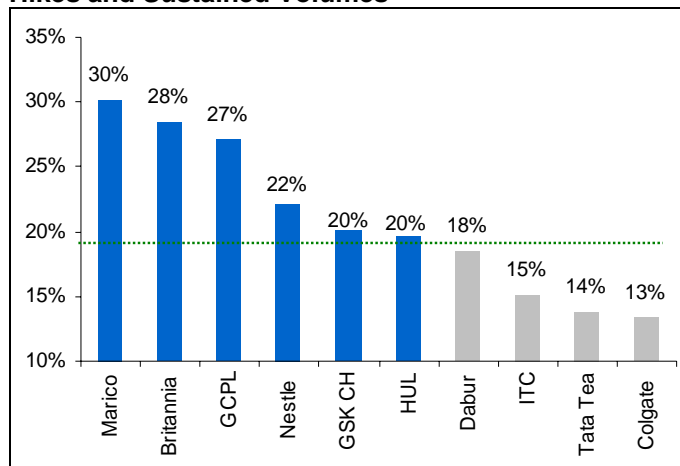
HUL & Marico Led the Pack in OP Growth in SQ08



Source: Company data, Morgan Stanley Research
*Marico operating profit growth adjusted for MTM loss

Exhibit 2

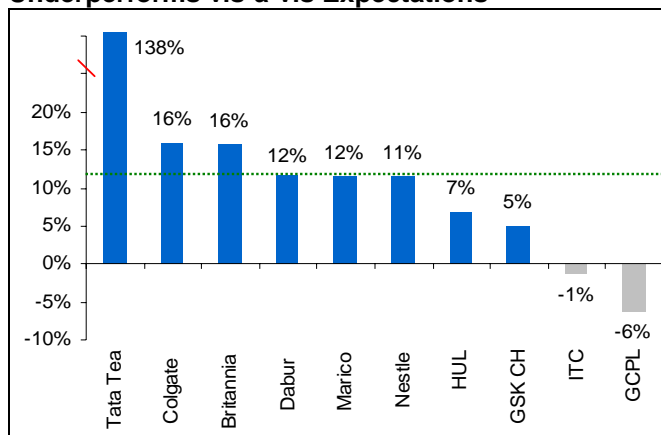
Robust Revenue Growth Driven by a Mix of Price Hikes and Sustained Volumes



Source: Company data, Morgan Stanley Research

Exhibit 5

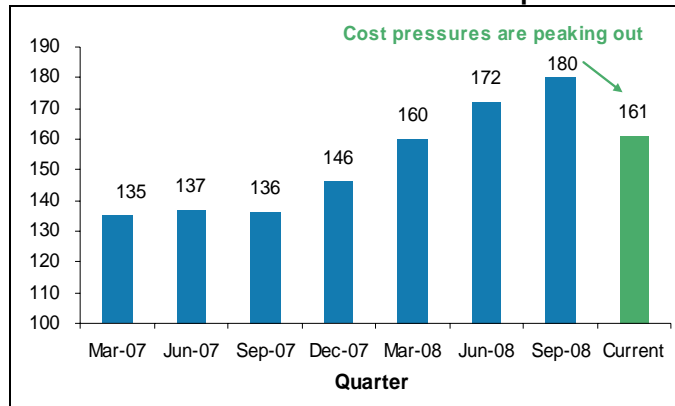
Earnings Growth for SQ08: Bottom-line Growth Underperforms vis-à-vis Expectations



Source: Company data, Morgan Stanley Research

Exhibit 3

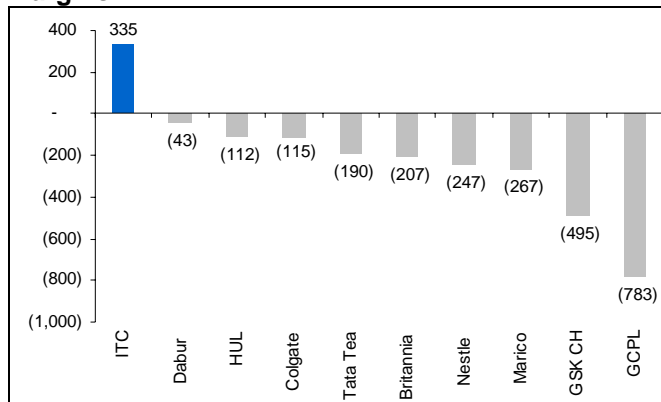
MS ICX Has Come off 14% from its 2008 peak



Source: Company data, Morgan Stanley Research

Exhibit 6

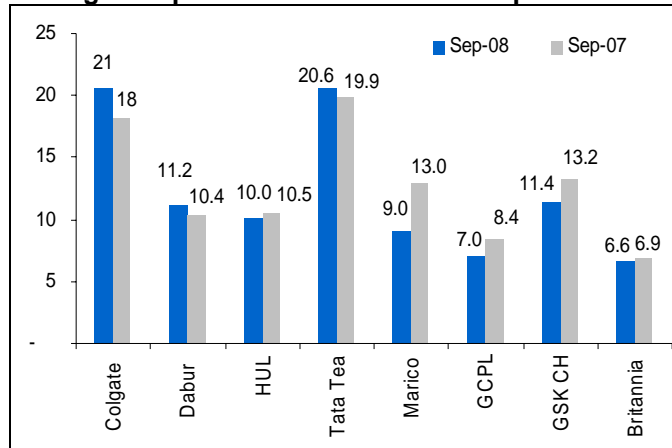
All (ex ITC) Reported Contraction in Gross Profit Margins



Source: Company data, Morgan Stanley Research

Exhibit 7

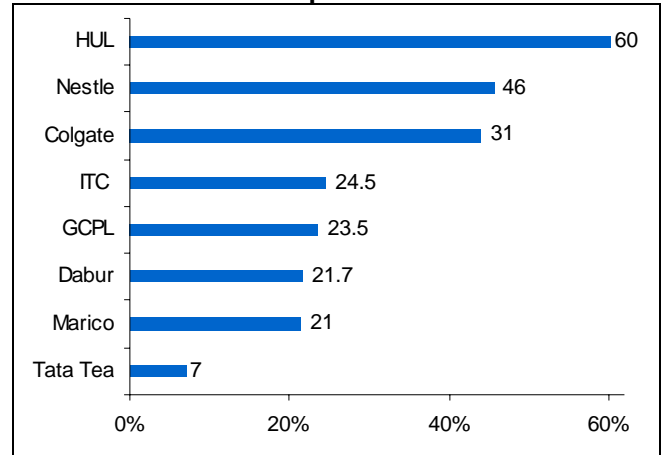
Average Adspend Ratio Was Down 50 bps YoY



Source: Company data, Morgan Stanley Research

Exhibit 8

YTD Relative Stock Outperformance Continues



Source: Bloomberg, Morgan Stanley Research *Relative to Sensex

Exhibit 9

India Consumer: Valuation Matrix

Company	Share Price	Price Target	Market Cap (USD mn)	P/E		P/B		EV/Sales		EV/EBITDA		Dividend Yield		EPS CAGR 2009-11e	Rating
				2009e	2010e	2009e	2010e	2009e	2010e	2009e	2010e	2009e	2010e		
Hindustan Unilever	238	300	10,574	20.9	21.1	28.3	23.5	2.4	2.6	16.2	16.5	3.6% e p	3.6% e	18%	OW
ITC Ltd.	159	139	12,116	16.6	14.4	4.3	3.7	3.5	3.0	11.3	9.6	2.5% e	2.9% e	15%	UW
Colgate-Palmolive India	387	400	1,068	20.2	17.2	29.7	27.3	3.0	2.6	15.2	13.0	4.1% e	4.9% e	17%	OW
Marico Limited	50	80	614	16.4	13.9	7.7	6.1	1.5	1.3	11.1	9.5	3.0% e	3.4% e	17%	OW
Nestle India	1450	1824	2,835	26.4	21.9	28.7	25.0	3.2	2.7	16.4	13.7	2.9% e	3.6% e	20%	OW
Dabur India	83	125	1,446	18.0	15.1	9.2	7.3	2.5	2.0	14.4	12.0	2.4% e	2.9% e	19%	OW
Tata Tea	526	809	658	7.6	6.8	0.9	0.8	0.8	0.7	4.7	4.0	3.4% e	3.6% e	12%	OW
GCPL	101	135	465	13.9	11.6	4.2	3.6	1.8	1.5	10.4	8.6	4.2% e	4.3% e	20%	EW
Non-covered Stocks															
United Spirits*	925	NR	1,571	21.2	16.6	4.3	3.6	2.1	1.5	12.2	6.7	0.5%	0.7%	25%	NR
Britannia*	1177	NR	576	12.0	9.8	3.1	2.6	1.0	0.8	12.0	9.6	1.9%	2.3%	18%	NR
GSK Cons Health*	600	NR	517	13.9	12.0	3.3	2.8	1.6	1.4	9.8	8.5	2.2%	2.6%	19%	NR
Emami Ltd*	234	NR	298	11.7	12.3	4.0	3.1	2.4	2.0	12.2	10.1	2.1%	2.6%	19%	NR
Jyothy Laboratories*	248	NR	74	5.8	4.1	NA	NA	0.6	0.5	3.5	NA	4.6%	5.1%	NA	NR
Average				15.7	13.6	10.6	9.1	2.0	1.7	11.5	10.1	2.9%	3.3%	18%	

Source: Factset, Morgan Stanley Research

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	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	869	39%	275	42%	32%
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Underweight/Sell	403	18%	89	14%	22%
Total	2,255		650		

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Overweight (O or Over) - The stock's total return is expected to exceed the total return of the relevant country MSCI Index, on a risk-adjusted basis over the next 12-18 months.

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The Americas

1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1) 212 761 4000

Europe

20 Bank Street, Canary Wharf
London E14 4AD
United Kingdom
Tel: +44 (0) 20 7 425 8000

Japan

4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0) 3 5424 5000

Asia/Pacific

Three Exchange Square
Central
Hong Kong
Tel: +852 2848 5200

Industry Coverage:India Consumer

Company (Ticker)	Rating (as of)	Price (11/03/2008)
Hozefa Topiwalla		
Colgate-Palmolive India (COLG.BO)	O (01/10/2005)	Rs387.1
Dabur India (DABU.BO)	O (10/18/2006)	Rs82.95
Godrej Consumer Products Limited (GOCP.BO)	E (08/12/2008)	Rs101.45
Hindustan Unilever (HLL.BO)	O (01/07/2008)	Rs237.8
ITC Ltd. (ITC.BO)	U (03/03/2008)	Rs158.6
Marico Limited (MRCO.BO)	O (07/06/2007)	Rs49.7
Nestle India (NEST.BO)	O (05/02/2002)	Rs1,449.7
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