

## FMCG

### Rising input costs to dampen prospects

We expect our FMCG coverage universe to report sales growth of 17.9% YoY in Q3FY11, led largely by volumes. Operating margins, however, are projected to decline 40bps, as input costs have inched up and brand building expenses remain high due to strong competitive intensity in the sector. Adjusted PAT for our coverage universe is likely to grow by 14.8% YoY. We maintain our positive stance on ITC, Asian Paints, Dabur and Marico in staples and United Spirits (UNSP) and Radico Khaitan (RDCK) in the alcoholic beverages space. We have a SELL on Nestle, Emami, Colgate and GSK Consumer & Healthcare.

Overall, we maintain our cautious view on the Indian FMCG sector as its rich valuations overshadow our optimism over the growth momentum in urban and rural spending. High valuation multiples, following the outperformance over the last two years, leave little scope for further upsides, in our view. Moreover, as price hikes lag input costs increases, gross margins in the sector will likely be pressurised. We advise buying on declines in strong business models and prefer large cap stocks. We recommend selling mid caps on further rallies as valuations appear heady and already factor in the strong growth.

**Sales growth at 18% YoY for the quarter:** We expect sales growth of 17.9% YoY for our FMCG universe during the quarter, led by Godrej Consumer Products (GCPL), United Breweries (UBBL), Emami, Britannia and Nestle. GCPL is likely to report a 75.8% YoY increase in its topline mainly on account of inorganic growth driven by Godrej Household Products (GHPL) and other global acquisitions. Asian Paints, after a sluggish Q2, is expected to bounce back with a 20% growth, while Hindustan Unilever (HUL) is likely to report a 9.5% growth on higher volumes. ITC is set for a 17% growth in sales, with cigarette volumes likely to get back to the positive territory from this quarter.

**Operating margins to decline YoY:** The operating margin for our FMCG universe is likely to dip slightly by 40bps YoY, allowing for EBITDA growth of 15.8% YoY. Most of the companies are likely to report a contraction in operating margins led by a gross margin decline, as input commodity costs have inched up. HUL is expected to report an 110bps decline in operating margins on account of higher A&P expenses. We expect the sector to report an adjusted PAT growth of 14.8% for the quarter. UBBL, RDCK, GCPL and Nestle are projected to report strong PAT growth, whereas HUL's profits are likely to remain flat YoY.

**Valuations near top end of historical bands:** FMCG stocks are trading near the top-end of their historical valuation bands in terms of absolute P/E multiples. On a relative basis, the sector is trading above the long-term average premium to the market, though not at the top end. However, we expect market earnings growth to accelerate; this would lower the likelihood of sector outperformance.

#### Recommendation snapshot

Company	CMP	Target	Rating
Asian Paints	2,813	3,000	Buy
Britannia	399	450	Hold
Colgate	849	860	Sell
Dabur	99	115	Buy
Emami	412	450	Sell
GCPL	380	460	Hold
GSK Consumer	2,221	2,200	Sell
HUL	294	330	Hold
ITC	171	210	Buy
Jyothy Labs	262	305	Hold
Marico	120	150	Buy
Nestle	3,664	3,350	Sell
Radico Khaitan	160	190	Buy
United Breweries	518	400	Hold
United Spirits	1,468	1,650	Buy

#### RCML FMCG Universe – Q3FY11E snapshot

(Rs mn)	Q3FY11E	Q3FY10	% Change
Sales	217,545	184,478	17.9
EBITDA	45,979	39,610	16.1
EBITDA margins (%)	21.1	21.5	(40bps)
Adj. PAT	32,162	28,005	14.8
Adj. PAT margins (%)	14.8	15.2	(40bps)

#### Stock performance

Returns (%)	1-mth	3-mth	6-mth
Asian Paints	10.4	1.2	18.9
Britannia	1.6	(8.2)	7.8
Colgate	3.4	(5.5)	0.1
Dabur	4.9	(4.7)	(1.6)
Emami	(5.5)	(12.6)	5.8
GCPL	(8.8)	(4.1)	9.0
GSK Consumer	(2.0)	9.1	23.8
HUL	0.4	(3.9)	10.4
ITC	2.1	(4.0)	15.0
Jyothy Labs	(4.2)	(7.4)	0.6
Marico	(9.5)	(4.6)	(5.4)
Nestle	2.9	9.4	26.0
Radico Khaitan	3.8	(7.4)	37.8
United Breweries	30.4	22.4	128.5
United Spirits	11.3	(7.8)	11.9
BSE FMCG	2.5	(3.3)	13.0
SENSEX	4.6	(0.4)	12.7





Fig 1 - RCML FMCG Universe: Q3FY11 preview

Company	CMP (Rs)	Target (Rs)	Reco	Sales (Rs mn)			EBITDA margin (%)		PAT (Rs mn)		
				Q3FY11E	Q3FY10	YoY(%)	Q3FY11E	Q3FY10	Q3FY11E	Q3FY10	YoY (%)
Asian Paints	2,813	3,000	Buy	19,440	16,200	20.0	18.1	19.6	2,255	2,118	6.5
Britannia	399	450	Hold	10,665	8,814	21.0	5.3	4.3	363	355	2.4
Colgate	849	860	Sell	5,789	5,110	13.3	21.0	23.7	926	1,164	(20.4)
Dabur	99	115	Buy	10,558	9,262	14.0	19.1	19.1	1,584	1,378	14.9
Emami	412	450	Sell	4,370	3,496	25.0	25.0	30.0	961	782	22.9
GCPL	380	460	Hold	9,100	5,176	75.8	19.0	19.6	1,270	851	49.2
GSK Consumer	2,221	2,200	Sell	5,017	4,181	20.0	11.0	8.8	477	337	41.5
HUL	294	330	Hold	49,322	45,043	9.5	16.4	17.5	6,216	6,141	1.2
ITC	171	210	Buy	53,023	45,319	17.0	36.6	36.6	13,627	11,442	19.1
Jyothi Labs	262	305	Hold	1,560	1,354	15.3	13.8	13.6	195	168	15.8
Marico	120	150	Buy	7,700	6,696	15.0	11.8	14.8	640	632	1.3
Nestle	3,664	3,350	Sell	16,370	13,518	21.1	18.5	14.5	1,964	1,313	49.7
Radico Khaitan	160	190	Buy	2,664	2,378	12.0	15.0	15.1	186	115	61.8
United Breweries	518	400	Hold	5,806	4,466	30.0	11.3	10.3	366	213	72.0
United Spirits	1,468	1,650	Buy	16,161	13,468	20.0	16.0	16.4	1,131	996	13.5
<b>Aggregate</b>	-	-	-	<b>217,545</b>	<b>184,478</b>	<b>17.9</b>	<b>21.1</b>	<b>21.5</b>	<b>32,162</b>	<b>28,005</b>	<b>14.8</b>

Source: RCML Research

Fig 2 - Sector valuation snapshot – HPC and Foods

Company	MCap (Rs mn)	Dividend Yield (%)	Sales Growth (%)		EPS CAGR FY11-13E	EBITDA Margin (%)		ROE (%)		P/E (x)		EV/EBITDA (x)	
			FY12E	FY13E		FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	FY12E	FY13E
Asian Paints	261,246	1.4	17.4	13.8	17.6	18.0	17.9	43.9	39.8	24.1	21.3	16.2	14.3
Britannia	44,794	1.8	18.3	18.4	50.9	6.4	6.7	66.1	68.4	18.9	14.9	15.0	12.0
Colgate	113,561	3.1	13.4	13.3	10.7	21.5	22.0	129.3	134.2	23.8	21.0	20.2	17.4
Dabur	179,295	1.1	28.3	16.9	23.4	18.9	19.1	49.1	43.3	24.8	21.5	18.7	15.9
Emami	63,385	1.1	19.0	18.7	17.5	22.5	22.5	31.9	30.8	22.8	19.3	18.9	15.9
GCPL	126,589	1.6	23.7	15.8	16.7	19.7	19.7	30.9	30.6	21.4	18.3	14.3	12.3
GSK Consumer	90,420	1.1	19.3	17.8	21.2	16.2	16.2	29.1	29.9	26.1	21.2	18.4	15.7
HUL	676,956	2.1	12.2	12.1	13.9	13.9	14.1	75.4	72.5	27.2	24.2	21.8	19.2
ITC	1,326,194	1.6	16.4	15.4	20.2	33.7	33.4	32.2	32.6	22.7	19.2	15.1	13.2
Jyothy Labs	21,932	1.6	22.6	20.7	15.5	14.7	14.4	16.1	16.9	19.2	16.6	15.7	13.4
Marico	74,944	1.0	15.3	16.7	20.3	14.2	14.4	35.8	33.5	21.3	17.7	15.6	13.1
Nestle	368,309	1.1	18.8	19.0	19.5	20.7	20.7	101.6	83.1	38.7	33.1	24.5	20.6
<b>Aggregate</b>	<b>3,347,623</b>	-	<b>16.7</b>	<b>15.2</b>	-	<b>21.1</b>	<b>21.1</b>	-	-	<b>24.8</b>	<b>21.3</b>	<b>17.4</b>	<b>15.1</b>

Source: RCML Research

Fig 3 - Sector valuation snapshot – Alcoholic Beverages

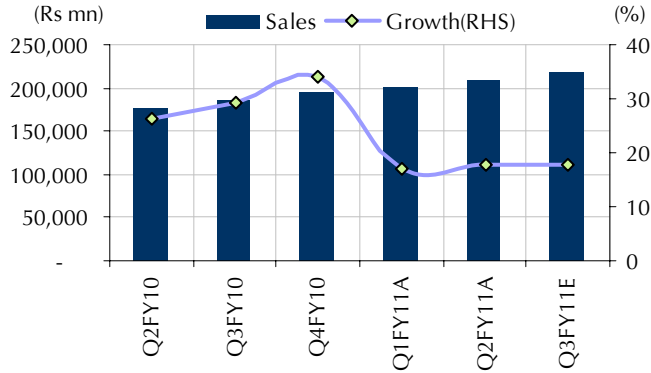
Company	MCap (Rs mn)	Dividend Yield (%)	Sales Growth (%)		EPS CAGR FY11-13E	EBITDA Margin (%)		ROE (%)		P/E (x)		EV/EBITDA (x)	
			FY12E	FY13E		FY12E	FY13E	FY12E	FY13E	FY12E	FY13E		
United Spirits	163,279	0.3	17.9	15.5	40.1	19.1	19.0	14.8	15.9	23.9	19.4	13.5	11.8
United Breweries	115,595	0.3	19.3	19.4	27.9	13.7	14.5	22.8	25.6	44.0	32.8	23.6	18.7
Radico Khaitan	20,316	0.7	20.8	21.0	34.3	16.9	17.2	15.4	17.6	18.8	14.5	12.2	9.9
<b>Aggregate</b>	<b>299,190</b>	-	<b>18.6</b>	<b>17.1</b>	-	<b>17.4</b>	<b>17.5</b>	-	-	<b>28.5</b>	<b>22.5</b>	<b>15.7</b>	<b>13.3</b>

Source: RCML Research



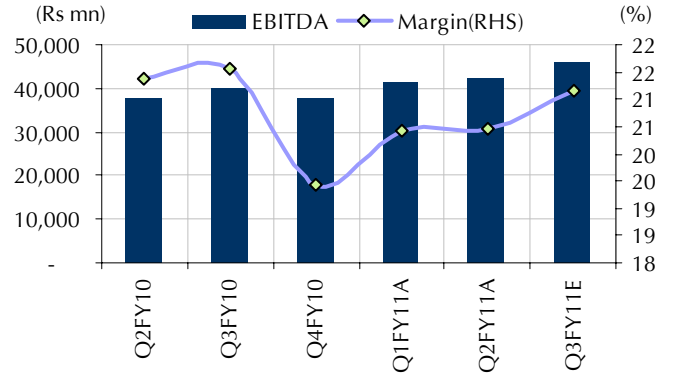
## Quarterly trends

Fig 4 - RCML FMCG universe – Sales growth trend



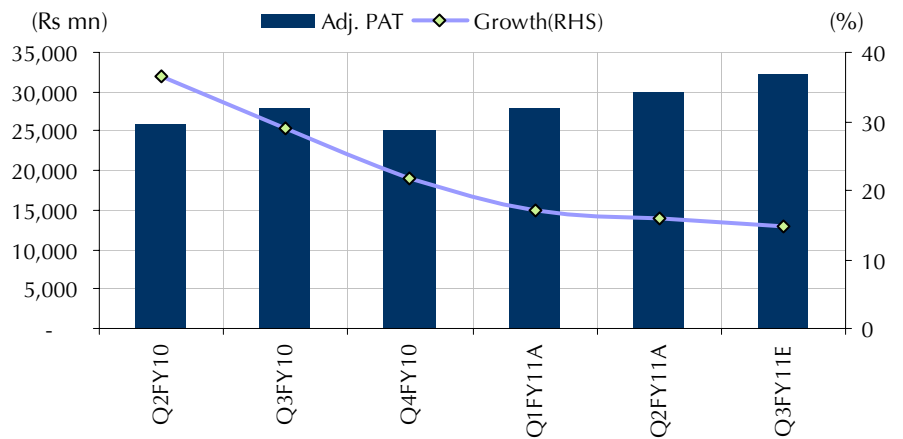
Source: RCML Research

Fig 5 - RCML FMCG universe – EBITDA margin trend



Source: RCML Research

Fig 6 - RCML FMCG universe – Adj. PAT growth trend



Source: RCML Research



## Companies

**Fig 7 - Asian Paints**

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	19,440	16,200	20.0	
EBITDA	3,519	3,181	10.6	Recovery in sales expected post sluggish Q2 results as volumes recover and benefits of price increases (~11% YTD) start flowing in
EBITDA margin (%)	18.1	19.6	(154bps)	
Adj. PAT	2,255	2,118	6.5	Margin contraction to stem from decline in gross margins as crude oil and titanium dioxide prices are up YoY
Adj. PAT margin (%)	11.6	13.1	(147bps)	

Source: RCML Research

**Fig 8 - Britannia**

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	10,665	8,814	21.0	
EBITDA	565	380	48.8	Strong sales growth momentum to continue
EBITDA margin (%)	5.3	4.3	99bps	
Adj. PAT	363	355	2.4	PAT margins to decline YoY on account of higher interest expenses
Adj. PAT margin (%)	3.4	4.0	(61bps)	

Source: RCML Research

**Fig 9 - Colgate**

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	5,789	5,110	13.3	
EBITDA	1,216	1,212	0.3	Net sales growth to be largely volume-led
EBITDA margin (%)	21.0	23.7	(271bps)	Margin pressure likely on account of decline in gross margins
Adj. PAT	940	1,164	(19.2)	Lower tax in previous quarter to pull down PAT
Adj. PAT margin (%)	16.3	22.8	(653bps)	

Source: RCML Research

**Fig 10 - Dabur**

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	10,558	9,262	14.0	
EBITDA	2,017	1,773	13.7	Sales growth to be driven primarily by volumes
EBITDA margin (%)	19.1	19.2	(5bps)	Operating margins to remain flat YoY
Adj. PAT	1,584	1,378	14.9	
Adj. PAT margin (%)	15.0	14.9	12bps	

Source: RCML Research

**Fig 11 - Emami**

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	4,265	3,496	22.0	
EBITDA	1,066	1,050	1.6	Strong sales growth momentum to continue in the quarter
EBITDA margin (%)	25.0	30.0	(503bps)	Margins to decline on account of increase in LLP and menthol prices
Adj. PAT	938	782	19.9	Lower interest costs to aid PAT growth
Adj. PAT margin (%)	22.0	22.4	(38bps)	

Source: RCML Research



Fig 12 - GCPL

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	9,100	5,176	75.8	
EBITDA	1,730	1,014	70.6	Robust 75% YoY sales growth expected owing to consolidation of GHPL and other international acquisitions
EBITDA margin (%)	19.0	19.6	(59bps)	
Adj. PAT	1,270	851	49.2	Margins in the domestic business could be under pressure on account of higher input costs
Adj. PAT margin (%)	14.0	16.5	(250bps)	

Source: RCML Research

Fig 13 - GSK Consumer

(Rs mn)	Q4CY10E	Q4CY09A	Change %	Comments
Net Sales	5,017	4,181	20.0	
EBITDA	552	368	50.1	Sales growth at 20% YoY
EBITDA margin (%)	11.0	8.8	221bps	Brand building costs arising from new product launches to impact profitability going forward
Adj. PAT	477	337	41.5	
Adj. PAT margin (%)	9.5	8.1	144bps	

Source: RCML Research

Fig 14 - HUL

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	49,322	45,043	9.5	
EBITDA	8,089	7,875	2.7	Set for continued double-digit volume growth on the back of price cuts taken across key segments
EBITDA margin (%)	16.4	17.5	(108bps)	
Adj. PAT	6,216	6,141	1.2	Operating margins to remain under pressure on account of higher brand building costs
Adj. PAT margin (%)	12.6	13.6	(103bps)	

Source: RCML Research

Fig 15 - ITC

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	53,023	45,319	17.0	
EBITDA	19,406	16,593	17.0	Cigarette volumes likely to improve sequentially as against a 1% decline seen in Q2FY11. FMCG, hotels and agri business to report strong growth
EBITDA margin (%)	36.6	36.6	(2 bps)	
Adj. PAT	13,627	11,442	19.1	FMCG losses expected to decline YoY, margins to remain stable
Adj. PAT margin (%)	25.7	25.3	45 bps	

Source: RCML Research

Fig 16 - Jyothy Labs

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	1,557	1,354	15.0	
EBITDA	215	184	16.9	Sales growth in <i>Ujala</i> to be aided by price hikes of 14% effected by the company in Q2
EBITDA margin (%)	13.8	13.6	23bps	
Adj. PAT	195	168	15.5	Margins to remain stable YoY
Adj. PAT margin (%)	12.5	12.5	6bps	

Source: RCML Research



Fig 17 - Marico

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	7,700	6,696	15.0	
EBITDA	909	988	(8.0)	High double-digit volume growth projected; impact of price increase in <i>Parachute</i> to aid sales growth this quarter
EBITDA margin (%)	11.8	14.5	(295bps)	
Adj. PAT	616	632	(2.5)	Operating margins to be hit on account of rise in <i>copra</i> prices
Adj. PAT margin (%)	8.0	9.4	(143bps)	

Source: RCML Research

Fig 18 - Nestle

(Rs mn)	Q4CY10E	Q4CY09A	Change %	Comments
Net Sales	16,370	13,518	21.2	
EBITDA	3,028	1,961	54.4	Net sales growth to be aided by healthy volume uptick
EBITDA margin (%)	18.5	14.5	399bps	Previous quarter margins impacted on account of one-time provisioning for employee costs
Adj. PAT	1,964	1,305	50.5	
Adj. PAT margin (%)	12.0	9.6	234bps	

Source: RCML Research

Fig 19 - Radico Khaitan

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	2,664	2,378	12.0	
EBITDA	400	360	11.0	
EBITDA margin (%)	15.0	15.1	(14bps)	Sales growth to slow down on account of the higher base last year
Adj. PAT	186	115	61.8	Margins to largely remain stable on a YoY basis
Adj. PAT margin (%)	7.0	4.9	215bps	

Source: RCML Research

Fig 20 - United Breweries

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	5,806	4,466	30.0	
EBITDA	656	461	42.4	Strong sales growth, largely volume-driven, to continue in Q3FY11
EBITDA margin (%)	11.3	10.3	98bps	Strong PAT growth to be led by sales growth
Adj. PAT	366	213	72.0	
Adj. PAT margin (%)	6.3	4.8	154bps	

Source: RCML Research

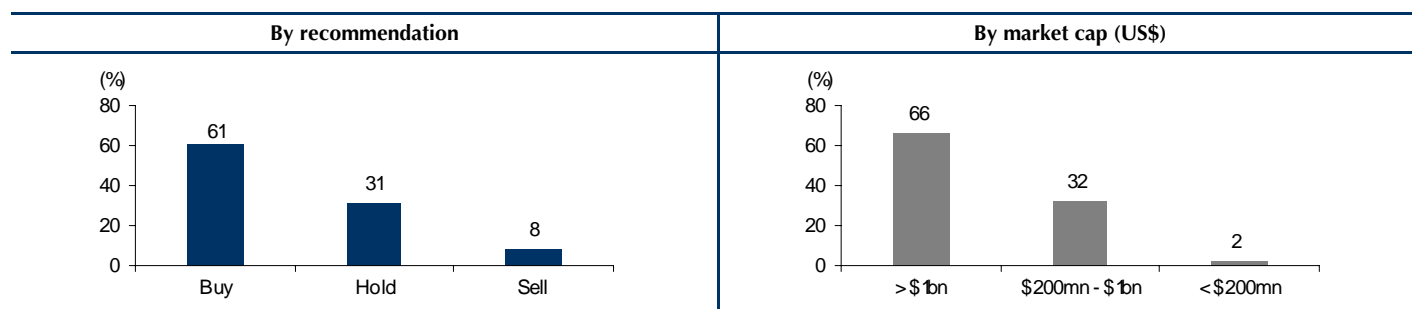
Fig 21 - United Spirits

(Rs mn)	Q3FY11E	Q3FY10A	Change %	Comments
Net Sales	16,161	13,468	20.0	
EBITDA	2,586	2,212	16.9	Strong sales growth to continue with volume growth likely remaining strong at 11–12%
EBITDA margin (%)	16.0	16.4	(42bps)	
Adj. PAT	1,131	996	13.5	Margins to largely remain stable on a YoY basis
Adj. PAT margin (%)	7.0	7.4	(40bps)	

Source: RCML Research



### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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