KARVY STOCK BROKING

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Institutional Equities

India Research

FMCG

THEME REPORT

Re-rating Party is Passé – Performance to Drive Stock Return

Unlike large-caps, most of the mid-cap consumer companies have delivered significant improvement in their performance despite economic slowdown. Ahead of the market expectation, most of them have beaten their own past performance and net earnings growth, which resulted in outperformance of the sector. The FMCG companies under our coverage have run-up by ~40% (average) in past 12-months. Currently, the sector trades at 140% premium (>2 standard deviation of the past 10-years) over Sensex P/E and trades at ~32x on 12-month forward earnings, which is at its highest levels. We continue to be positive on account of our expectation of maintaining such high net earnings growth, going forward. We initiate coverage on **ITC, HUL, Nestlé India, Dabur, Colgate-Palmolive and Marico while update on Jyothy Labs.**

Sector to Sustain Earnings Growth above Sensex Earnings Growth: The arguments that the defensiveness of the sector has evaporated – amid cyclical policy actions on domestic front and concerted actions by the European & US central banks – are short term phenomenon in our view. We believe high valuation is sustainable going forward, as this rally couldn't only be attributed to weak macro factors. In our view, stable inputs costs, strong rural wage growth, volume trends despite high inflation, market share gains from unorganized sector, high pricing stability and good product mix will sustain the sector's earnings growth above the Sensex earnings growth in next 2 years.

Earnings Trend Remain Robust: We expect most consumer companies to sustain their earnings growth momentum over the forecasted period, supported by gain in market share and softer raw material prices. We expect the universe of stocks covered by us to report 18.1% earnings growth during FY12-15E against the 2-Yr & 5-Yr trailing growth of 18.5% & 16.7%, respectively.

Mid-cap Companies under our Coverage to Outperform Large-cap Counterparts: Growth has been driven by volumes, penetration and price hikes and we believe that the mid-cap consumer companies are in a better position to meet the increased growth expectations. We expect the mid-cap companies in our universe to register 19.8% earnings growth during FY12-15E as compared to 17.5% earnings growth by large cap consumer companies.

We prefer ITC in Large-cap and Dabur, Marico & Jyothy Labs in Mid-cap Space: The large-cap consumer companies are currently trading at a P/E multiple of 25.3x of 24-month forward earnings and mid-cap consumer companies are trading at 25.9x. In mid-cap, companies like Dabur, Marico & Jyothy Labs are at attractive valuations of 21.2x, 21.2x and 16.2x of 24-month forward earnings and offers a decent upside in the mid-cap space at 12-16% from the current levels.

ITC	**BUY**
CMP (Rs)	288
Target Price (Rs)	312
Upside (%)	8
52 Week High/Low (Rs)	289/189
3m ADV (Rs mn /US$ mn)	1,583/29.9
HUL	**HOLD**
CMP (Rs)	573
Target Price (Rs)	576
Upside (%)	1
52 Week High/Low (Rs)	580/325
3m ADV (Rs mn /US$ mn)	1,335/25.2
Nestle	**SELL**
CMP (Rs)	4,760
Target Price (Rs)	4,564
Downside (%)	4
52 Week High/Low (Rs)	5,429/3,925
3m ADV (Rs mn /US$ mn)	147/2.8
Dabur	**BUY**
CMP (Rs)	132
Target Price (Rs)	150
Upside (%)	14
52 Week High/Low (Rs)	139/92
3m ADV (Rs mn /US$ mn)	166/3.1
Colgate	**HOLD**
CMP (Rs)	1,236
Target Price (Rs)	1,322
Upside (%)	7
52 Week High/Low (Rs)	1,288/932
3m ADV (Rs mn /US$ mn)	88/1.7
Marico	**BUY**
CMP (Rs)	204
Target Price (Rs)	231
Upside (%)	14
52 Week High/Low (Rs)	211/134
3m ADV (Rs mn /US$ mn)	65/1.2
Jyothy Labs	**BUY**
CMP (Rs)	172
Target Price (Rs)	201
Upside (%)	17
52 Week High/Low (Rs)	184/63
3m ADV (Rs mn /US$ mn)	48/0.9

Source; Bloomberg, Karvy Institutional Research

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Executive Summary

Earnings Growth above Sensex – Premium to Sustain

The FMCG sector had shown muted performance, with net earnings growth of 6.7% & 0.7% in FY04 & FY05, respectively, which led to absolute decline in sectoral valuation. However, we don't expect such poor show to repeat in coming years. The companies under our coverage universe would report earnings growth of 18.1% earnings growth during FY12-15E vis-à-vis our estimated earnings growth for Sensex at 11.6% CAGR over FY12-15E.

Product Mix & Better Reach to Drive Growth

Most of the FMCG companies have become very aggressive which is evident from: **(I)** Improvement in Product Portfolio & Mix; **(II)** Expansion of Distribution Channels in Rural Area; **(III)** Higher International Growth; **(IV)** Higher Field Level Interaction by Top Management; and **(V)** Opportunity in low-penetration and low per capita consumption categories. Aggressive efforts would have larger and longer positive effects on the businesses of the FMCG companies, and hence many firms would sustain high sales growth momentum, going forward.

Multiple Factors to Boost Profitability

The FMCG companies under our coverage have also protected profitability despite input price pressure. Most of them have taken sharp price hike to pass on the incremental rise in input price, while their brand equity played key role in protecting their market shares and profitability. Their profitability is expected to sustain due to: **(I)** Softening of key RM prices; **(II)** Premiumisation in few categories; and **(III)** Several cost rationalization initiatives. Again, factors like strong cash flow generation business, high ROCE & ROE, low leverage position, and high corporate governance also augur well for the FMCG sector.

FMCG Sector to Show ~16.4% Sales CAGR in FY12-15E

FMCG companies have shown robust sales growth of ~19.7% (largely price-driven) in FY12 v/s 15.9% CAGR in past 5 years. Most of the FMCG companies, during last year, passed on extra cost pressure through consistent price hike and their brand equity played key role in maintaining volume growth too. We anticipate slightly slower sales CAGR of ~16.4% during FY12-15E as we expect further price hike would be limited going forward. We expect ITC & HUL to show 16.4% & 15.7% CAGR in FY12-15E, while Nestle, Dabur, Colgate, Marico & Jyothy Labs should deliver 16.2%, 17.8%, 18.0%, 18.9% & 21.0% CAGR, respectively in FY12-15E.

Expect EBITDA CAGR of 17.8% in FY12-15E

Softening key commodity prices, higher sales contribution by premium products and cost rationalisation initiatives would help companies to improve operational profitability. We expect EBITDA CAGR of 17.8% during FY12-15E. The EBITDA margin of ITC, HUL, Dabur, Marico and Jyothy Labs is expected to expand by 126 bps, 41 bps, 92 bps, 173 bps and 395 bps, respectively during FY12-15E.

Mid-cap Companies to Outperform Large-cap

As the growth of the FMCG companies under our coverage has been driven by volume, penetration and price hike, we believe that they are in a better position to sustain growth, going forward. We expect the mid-cap companies in our universe to register 19.8% earnings growth during FY12-15E as compared to 17.5% earnings growth by large cap consumer companies.

Valuation Summary

In our coverage universe, except Nestle India all other companies have outperformed the BSE Sensex during the past 12-month. In Large Cap, HUL and ITC outperformed BSE Sensex by ~65% and ~29%, in Mid Cap Marico, Dabur, Colgate-Palmolive and Jyothy Labs outperformed by ~29%, ~25%, ~12% and ~114% respectively. While Nestle India underperformed by ~2%.

We initiate coverage on the sector with BUY rating on ITC, Dabur, Marico and Jyothy Labs while HOLD on HUL, Nestle India and Colgate-Palmolive.

Exhibit 1: Sector Earnings

	Revenue (Rs bn)				EBITDA Margin (%)				EPS (Rs)				Sales CAGR (%)	EPS CAGR (%)	CMP	TP	Upside	Rating
	FY12	FY13E	FY14E	FY15E	FY12	FY13E	FY14E	FY15E	FY12	FY13E	FY14E	FY15E	FY12-15E	FY12-15E	(Rs)	(Rs)	(%)	
ITC	262	302	355	413	33.8	34.8	35.1	35.0	8.0	9.4	11.3	13.1	16.4	17.8	288	312	8.3	BUY
HUL	234	271	314	363	14.9	15.2	15.3	15.3	12.5	15.1	17.6	20.3	15.7	17.5	573	576	0.6	HOLD
Nestle India	75	85	100	118	20.8	21.7	21.3	21.3	99.7	110.0	126.6	151.4	16.2	14.9	4,760	4,564	(4.1)	SELL
Dabur	53	63	74	87	16.2	16.8	16.9	17.1	3.7	4.5	5.5	6.7	17.8	22.0	132	150	13.7	BUY
Colgate	27	33	38	44	21.5	22.1	22.0	21.5	32.8	39.5	46.7	53.8	18.0	17.8	1,236	1,322	6.9	HOLD
Marico	40	48	57	67	12.1	14.2	13.8	13.8	5.2	7.0	8.4	10.5	18.9	26.5	204	231	13.8	BUY
Jyothy Labs	11	14	17	20	10.4	13.6	14.4	14.3	3.6	5.9	8.9	11.6	21.0	47.0	172	201	17.0	BUY

Source: Company, Karvy Institutional Research

Exhibit 2: Sector Valuation

	Mkt. Cap	Dividend Yield (%)				P/E (x)				EV/Sales (x)				EV/EBITDA (x)					P/BV (x)		
	(Rs bn)	FY12	FY13E	FY14E	FY15E	FY12	FY13E	FY14E	FY15E	FY12	FY13E	FY14E	FY15E	FY12	FY13E	FY14E	FY15E	FY12	FY13E	FY14E	FY15E
ITC	2,252	1.6	1.6	2.0	2.3	36.0	30.6	25.6	22.0	8.3	7.2	6.0	5.1	24.6	20.6	17.2	14.6	11.6	10.0	8.6	7.4
HUL	1,239	1.3	1.7	2.1	2.4	45.9	37.9	32.5	28.2	5.1	4.4	3.8	3.2	34.3	28.8	24.5	21.1	33.6	28.0	23.7	20.4
Nestle India	459	1.1	1.3	1.5	1.9	47.7	43.3	37.6	31.4	6.2	5.5	4.7	3.9	29.8	25.4	21.9	18.4	36.0	27.7	24.3	22.1
Dabur	230	1.0	0.8	0.8	0.8	35.7	29.1	23.8	19.6	4.4	3.6	3.0	2.5	26.9	21.5	17.8	14.5	13.4	10.0	7.5	5.7
Colgate	168	2.0	2.3	2.5	1.6	37.6	31.3	26.4	23.0	6.1	5.0	4.3	3.6	28.4	22.8	19.4	16.6	38.6	31.9	25.1	15.5
Marico	125	0.4	0.4	0.5	0.7	39.5	29.1	24.1	19.5	3.2	2.8	2.3	1.9	26.6	19.7	16.6	13.6	11.0	6.4	5.2	4.3
Jyothy Labs	28	1.5	2.9	4.1	5.2	47.1	29.1	19.3	14.8	2.8	2.4	1.9	1.6	27.3	17.4	13.3	11.0	4.6	4.5	4.4	4.3

Source: Company, Karvy Institutional Research

Exhibit 3: Valuation Criteria

Company	EPS (Rs)		EPS CAGR (%)	Current P/E (x)	Target P/E (x)	TP (Rs)	PEG on Target P/E (x)	5 Year Avg. PEG (x)	3 Year Avg. PEG (x)
	12-month Fwd	24-month Fwd	24-month Fwd	24-month Fwd	24-month Fwd				
ITC	10.5	12.3	18.2	23.4	25.3	312	1.4	1.0	1.0
HUL	16.6	19.2	17.0	29.9	30.0	576	1.8	2.4	1.1
Nestle India	123.8	147.2	16.6	32.3	31.0	4,564	1.9	1.7	2.1
Dabur	5.1	6.2	22.0	21.2	24.0	150	1.1	1.1	1.3
Colgate	43.7	50.8	17.7	24.3	26.0	1,322	1.5	1.8	1.6
Marico	7.9	9.6	24.2	21.2	24.0	231	1.0	1.0	0.9
Jyothy Labs	7.6	10.6	46.0	16.2	19.0	201	0.4	0.31*	0.25#

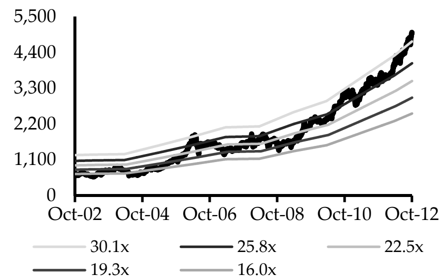
*Source: Company, Karvy Institutional Research, * 2 Year Avg. PEG, # 1 Year Avg. PEG*

Exhibit 4: FMCG Sector Aggregates (Our Coverage)

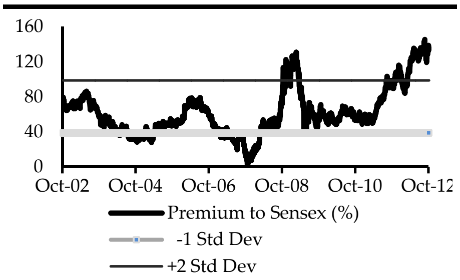
Sector Aggregates (Rs mn)	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Revenue	**336,854**	**400,591**	**448,433**	**509,822**	**586,797**	**702,422**	**816,271**	**955,248**	**1,112,440**
Growth YoY (%)	15.4	18.9	11.9	13.7	15.1	19.7	16.2	17.0	16.5
EBITDA	**72,864**	**85,169**	**94,787**	**117,419**	**131,328**	**159,216**	**191,486**	**225,423**	**261,723**
EBITDA Margin (%)	21.6	21.3	21.1	23.0	22.4	22.7	23.5	23.6	23.5
EBITDA Change	34bps	-37bps	-12bps	189bps	-65bps	29bps	79bps	14bps	-7bps
Net Profit	**52,715**	**62,668**	**67,566**	**80,892**	**92,008**	**113,871**	**135,551**	**161,307**	**188,368**
Net Margin (%)	15.6	15.6	15.1	15.9	15.7	16.2	16.6	16.9	16.9
Net Worth	**149,040**	**156,343**	**184,745**	**200,116**	**234,020**	**283,067**	**340,812**	**401,120**	**473,494**
RoE (%)	35.4	40.1	36.6	40.4	39.3	40.2	39.8	40.2	39.8

Source: Company, Karvy Institutional Research

FMCG Sector is trading at 32x P/E (12M forward earnings)

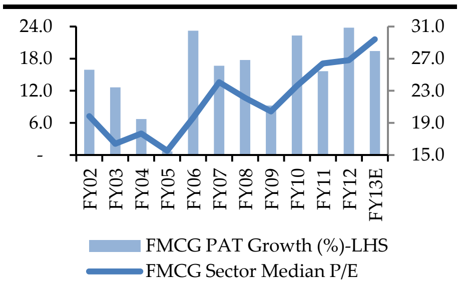


FMCG Sector P/E at 140% premium to Sensex P/E



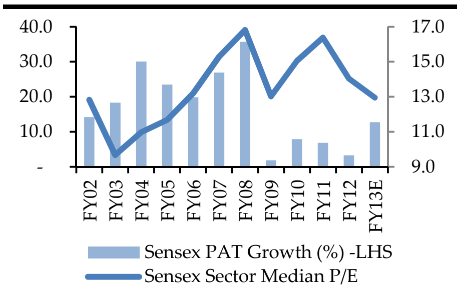
Source: Bloomberg, Karvy Institutional Research

FMCG Sector PAT Growth & Valuation



Source: Bloomberg, Karvy Institutional Research

Sensex PAT Growth & Valuation



Source: Bloomberg, Company, Karvy Institutional Research

A. Concern is not on the FMCG Valuation Premium

Our concern is not over ~140% FMCG valuation premium over Sensex, which is almost at peak level of past several years. However, our concern is to maintain such high valuations by the FMCG companies, going forward.

The FMCG sector currently trades at ~32x on 12-month forward earnings, which is almost at its highest level. Valuation premium expansion of sharp 47bps during past 12-months was not only because of 24% jump in FMCG valuation but also on 4% decline in Sensex valuation.

Weak macro fundamentals vis-à-vis subdued domestic business growth has changed the investment target to FMCG sector where business is largely neutral on currency risk, high interest rate and consumer demand.

Hence, at current juncture we believe net earnings growth of companies would play a key role in their stocks' performance. We prefer stocks on relative basis, where the scope of earnings growth is strong and valuations are relatively at comfort level.

B. FMCG Sector to Deliver almost twice PAT Growth of Sensex companies in the Next Three Years.

Analyzing the historical relationship between FMCG sector & Sensex, we found that FMCG sector's valuation rise/decline has relevance on its net earnings growth rise/decline over the Sensex performance.

In FY05-FY08 period, there was an absolute decline in FMCG sector valuation vs. absolute rise in Sensex. During that time, FMCG sector's net earnings growth was significantly lower than Sensex net earnings growth. Therefore, absolute valuation decline for FMCG sector is possible going forward, only if the earnings growth would be considerably lower than the Sensex earnings. However, we don't expect such poor show to repeat in coming years. The companies under our coverage universe would report earnings growth of 18.1% earnings growth during FY12-15E vis-à-vis our estimated earnings growth for Sensex at 11.6% CAGR over FY12-15E.

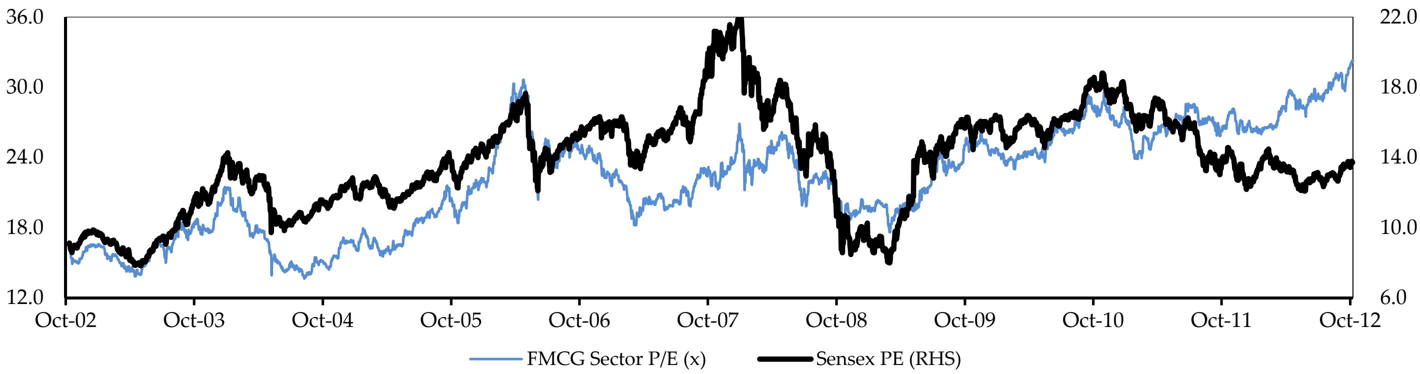
As at current juncture, we don't see such scenario hence, we are bullish that FMCG sector's valuation to sustain, going forward. We prefer stocks on relative basis, where the scope of earnings growth is strong and valuations are relatively at comfort level.

Our Top Picks are: ITC, Dabur, Marico & Jyothy Labs.

Exhibit 5: Historical Trend of FMCG Valuation

Source: Bloomberg, Karvy Institutional Research

Exhibit 6: Valuation Comparison between FMCG Sector and Sensex



Source: Bloomberg, Karvy Institutional Research

Exhibit 7: Valuation & Profitability Comparison between FMCG Sector and Sensex

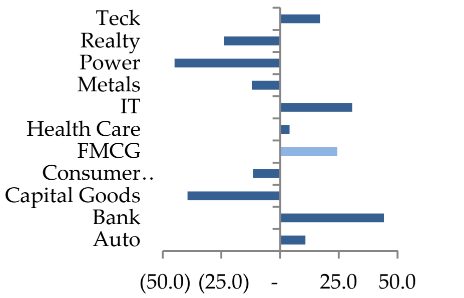
	FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13*
FMCG Sector Median P/E	19.8	16.4	17.7	15.5	19.7	24.1	22.1	20.5	23.6	26.4	26.8	29.4
Sensex Sector Median P/E	12.8	9.7	11.0	11.7	13.2	15.3	16.8	13.0	15.1	16.4	14.0	13.0
FMCG Sector P/E Premium	57.2	68.4	62.7	35.7	49.7	63.8	27.9	67.0	57.3	57.4	91.7	129.2
FMCG PAT Growth (%)	15.9	12.6	6.7	0.7	23.2	16.7	17.8	9.2	22.3	15.6	22.4	20.8
Sensex PAT Growth (%)	14.2	18.3	30.1	23.5	19.9	26.9	35.7	1.9	7.9	6.8	3.3	14.0
FMCG Sector Median P/E Growth (%)		(17.3)	7.8	(12.1)	26.5	22.5	(10.7)	(7.7)	15.6	11.9	1.5	9.7
Sensex Sector Median P/E Growth (%)		(24.6)	13.4	6.5	13.0	15.8	10.0	(22.6)	15.6	8.8	(14.3)	(7.7)
FMCG PAT 24 Month Avg. Growth (%)	14.3	9.7	3.7	12.0	20.0	17.2	13.5	15.8	19.0	19.7	21.6	19.4
Sensex PAT 24 Month Avg. Growth (%)	16.3	24.2	26.8	21.7	23.4	31.3	18.8	4.9	7.4	5.1	8.0	12.2

Source: Bloomberg, Karvy Institutional Research Till Date*

C. Earnings Performance of FMCG Sector vis-à-vis Other Sectors

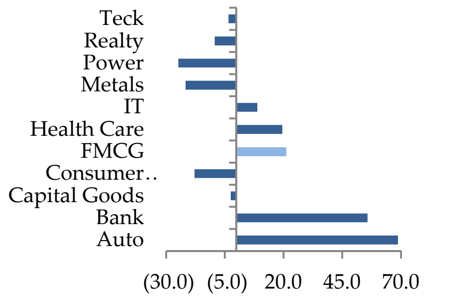
Observing and juxtaposing the performance of FMCG sector vs. other sectors, we have found that the former is among the few, which has maintained its high earnings momentum in past six quarters.

Exhibit 8: Q1FY13 Performance



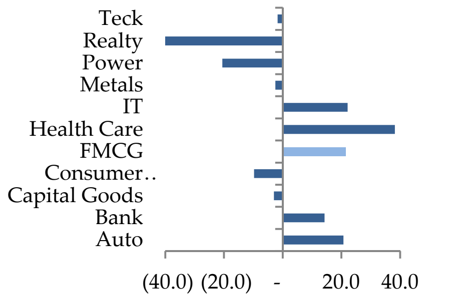
Source: Bloomberg, Karvy Institutional Research

Exhibit 9: Q4FY12 Performance



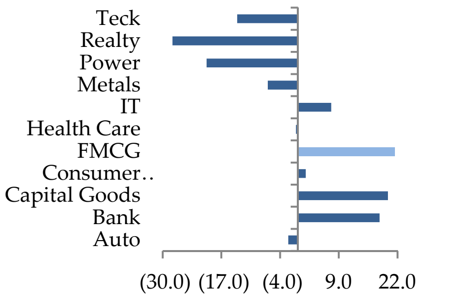
Source: Bloomberg, Karvy Institutional Research

Exhibit 10: Q3FY12 Performance



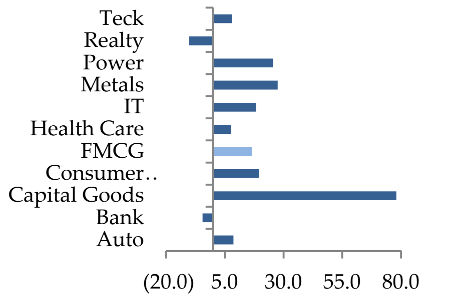
Source: Bloomberg, Karvy Institutional Research

Exhibit 11: Q2FY12 Performance



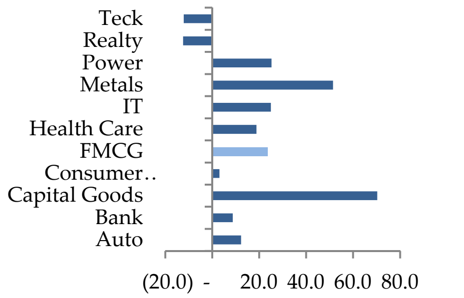
Source: Bloomberg, Karvy Institutional Research

Exhibit 12: Q1FY12 Performance



Source: Bloomberg, Karvy Institutional Research

Exhibit 13: Q4FY11 Performance

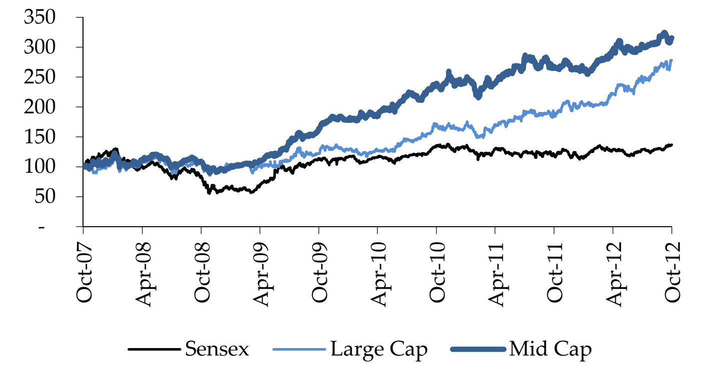


Source: Bloomberg, Karvy Institutional Research

Our View: The FMCG sector has consistently performed strongly over the past few quarters as compared to the other sectors that justifies valuation premium to some extent.

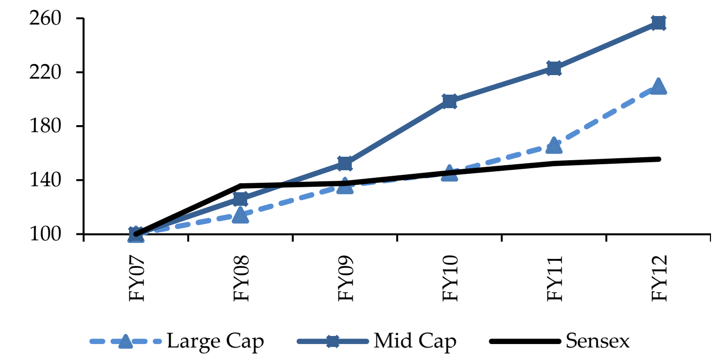
D. Large Cap & Mid Cap FMCG Index and Sensex

Exhibit 14: Past 5 Years' Market Cap Trend in Large Cap & Mid Cap FMCG Index & Sensex



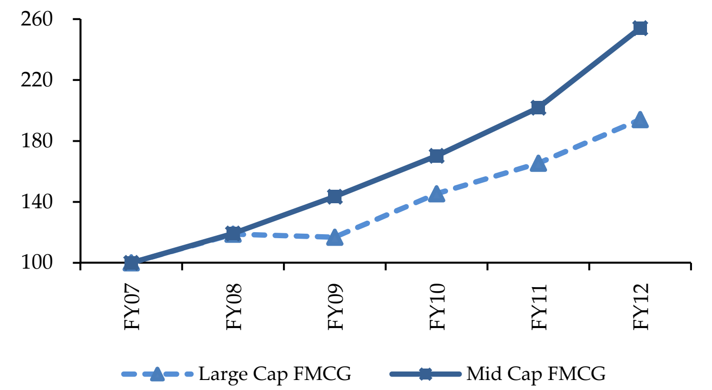
Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 15: Past 5 Years' Earnings Trend between Large Cap & Mid Cap FMCG & Sensex



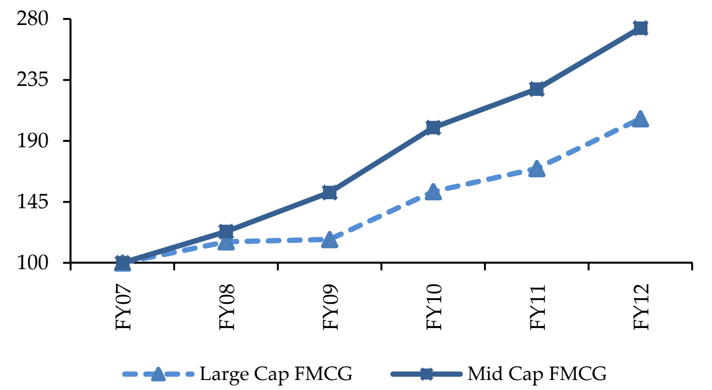
Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 16: Large Cap & Mid Cap FMCG Sales Growth Index of Past 5 Years



*Source: Company, Karvy Institutional Research, Note: Index is based on Karvy Coverage **Only***

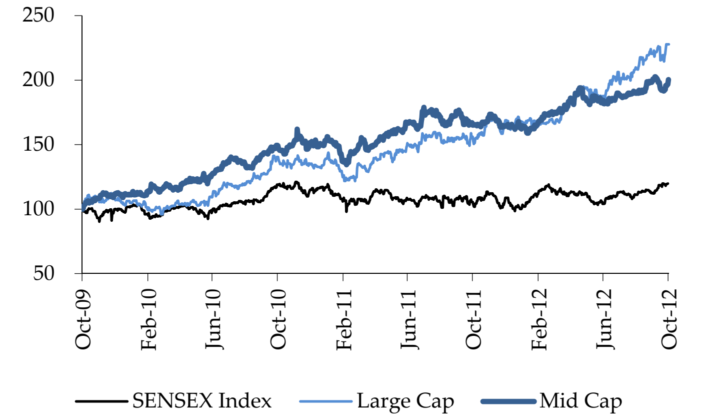
Exhibit 17: Large Cap & Mid Cap FMCG EBITDA Growth Index of Past 5 Years



Source: Company, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

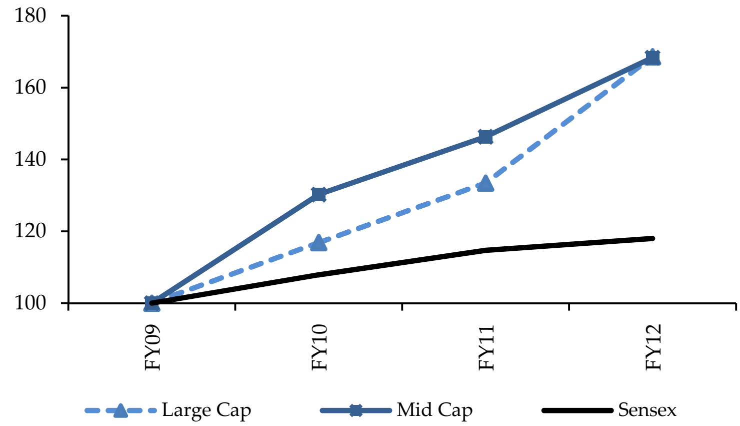
Our View: The mid-cap FMCG companies have outperformed large-cap FMCG companies & Sensex during the past five years, owing to better earnings growth. The mid-cap companies have not only outpaced the sales growth vis-à-vis large-cap FMCG companies, but their operational profitability improvement was also ahead of the large-cap counterparts.

Exhibit 18: Past 3 Years' Market Cap Trend in Large Cap & Mid Cap FMCG Index & Sensex



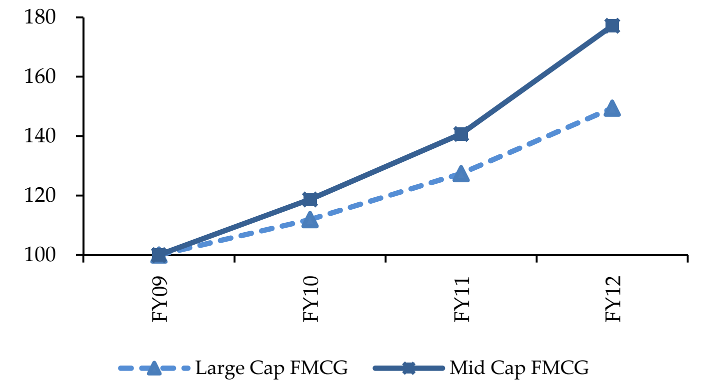
Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 19: Past 3 Years' Earnings Trend between Large Cap & Mid Cap FMCG & Sensex



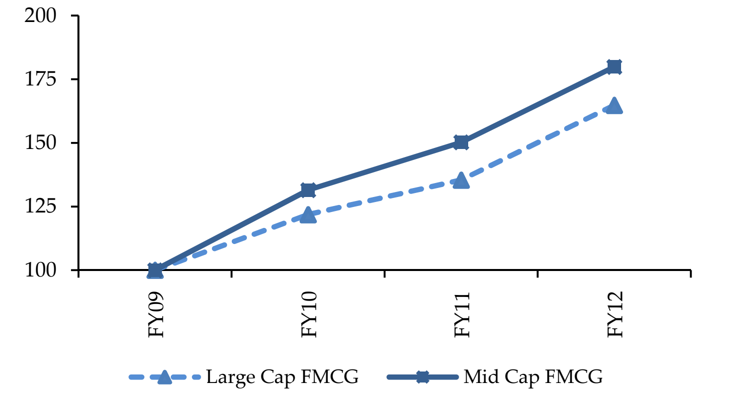
Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 20: Large Cap & Mid Cap FMCG Sales Growth Index of Past 3 Years



Source: Company, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

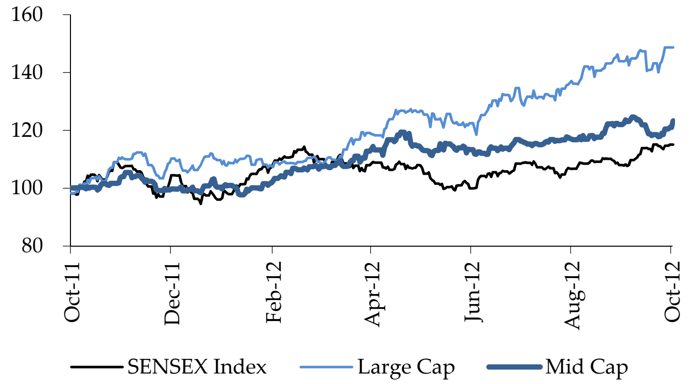
Exhibit 21: Large Cap & Mid Cap FMCG EBITDA Growth Index of Past 3 Years



Source: Company, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

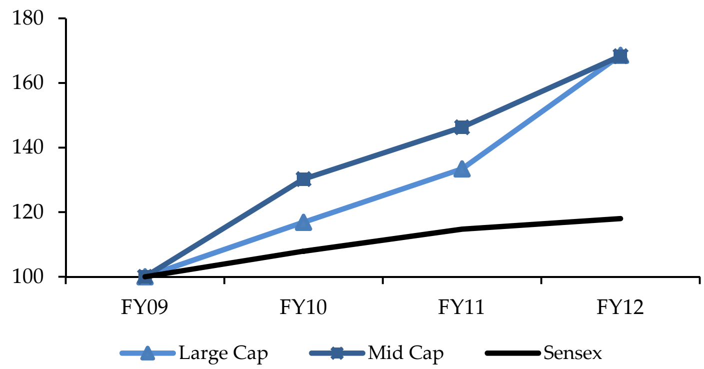
Our View: The Large-cap FMCG Index outperformed the Sensex & Mid-cap FMCG Index during the past 12-months. The large-cap companies through their strong pricing power expanded their EBITDA margin by ~90 bps in FY12 contrary to a decline of ~80 bps by the mid-cap companies. Therefore, large-cap Index has given average return of 53% in the past 12-month, as compared to the average return of 44% by the Mid-cap Index.

Exhibit 22: Past 1 Year's Market Cap Trend in Large Cap & Mid Cap FMCG Index & Sensex



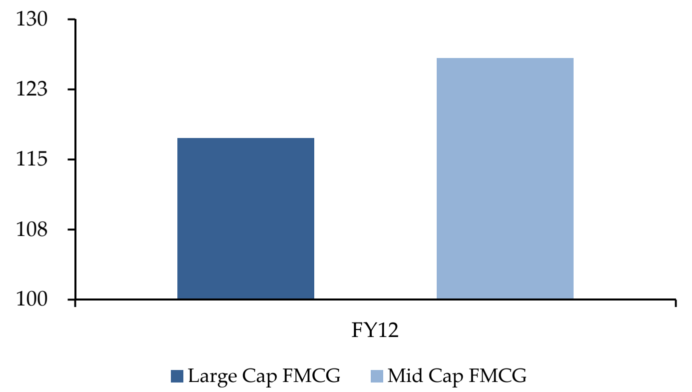
Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 23: Past 1 Year's Earnings Trend between Large Cap & Mid Cap FMCG & Sensex



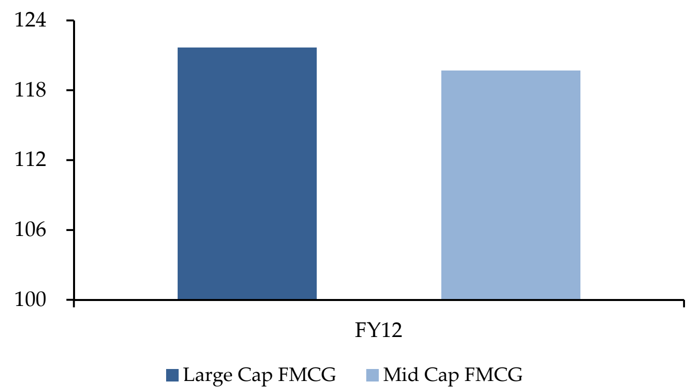
Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 24: Large Cap & Mid Cap FMCG Sales Growth Index of Last Year



Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 25: Large Cap & Mid Cap FMCG EBITDA Growth Index of Last Year



Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

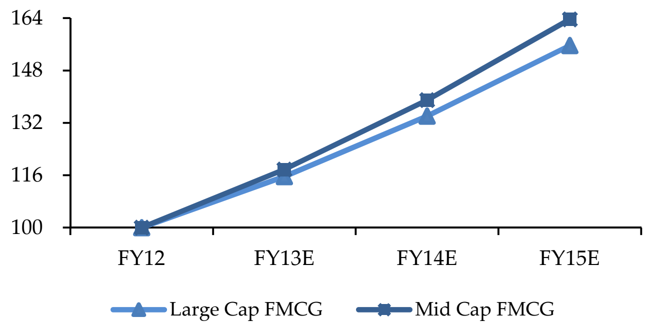
How do we see Business going forward?

We expect the mid-cap FMCG companies would operationally perform better than their large-cap counterparts. The mid-cap FMCG companies would be benefited on account of:

- Focus on development of product basket,
- Better foothold in the International space,
- Consistent focus on distribution expansion, and
- Unlocking value in the recent acquisitions.
- Cost rationalisation initiatives

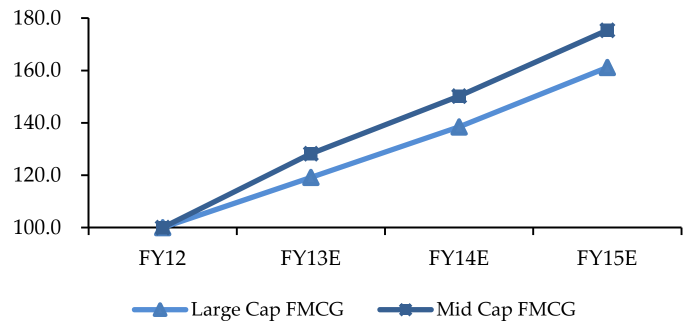
We expect Mid Cap FMCG companies would show ~19% EBITDA CAGR during FY12-15E as compared to ~17% EBITDA CAGR in the Large Cap companies. We believe higher stock run up by large cap companies has captured most of the earnings upside while we expect enough space in the mid cap companies. Therefore, we expect Mid Cap companies has more potential to give better stock return as compared to Large Cap companies.

Exhibit 26: Next 3 Years' Estimated Sales Growth Trend in Large Cap & Mid Cap FMCG



Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

Exhibit 27: Next 3 Years' Estimated EBITDA Growth Trend between Large Cap & Mid Cap FMCG



Source: Bloomberg, Karvy Institutional Research, Note: Index is based on Karvy Coverage Only

E. Quant analysis of BSE FMCG Index to forecast the Index Market Cap in 2013FY and 2014FY:

Stocks from BSE-FMCG Index are taken for the analysis and Market Cap is forecasted for the year 2013 and 2014. Historical data of PAT from 2003 to 2012 has taken for the analysis. Statistically it was seen that PAT of individual companies are highly correlated with the Market Cap of that companies. The following equation is used for finding the statistical relationship between the PAT and Market Cap values of the stocks.

$Mktcap^i = Const^i + \beta^i * PAT^i$

Here we represent the stock of BSE-FMCG sector.

Through regression equation we derived the β^i (correlation coefficient) and const. value. Estimated PAT of individual companies have derived through fundamental analyses and used it to obtain the Market Cap of BSE-FMCG Index 2013 and 2014. Even we applied the t-statistics (t-test) for verifying the result. We used the STATA12 software for the analysis. STATA is very powerful software which can even test the multicollinearity and validation of the equation.

Exhibit 28: Market Cap Forecast for BSE FMCG Companies

Particulars (Rs mn)	PAT-2013	PAT-2014	Avg. Mktcap-2012	Const	Beta-coefficient	Avg. Mktcap-2013	Avg. Mktcap-2014
Colgate-Palm.	5,231	6,194	151,776	-41,953	28.0	142,482	169,485
Nestle India	1,0731	12,296	40,2332	-59,949	48.1	455,960	531,200
HUL	32,634	37,751	90,7765	-30,237	28.8	912,397	106,020
ITC	72,412	84,689	1,773,604	-266,314	32.9	2,116,761	2,520,796
Tata Global	4,276	4,927	69,292	37,136	7.9	71,291	76,491
Dabur India	7,754	9,325	185,359	-10,905	30.2	223,874	271,441
United Spirits	3,360	4,683	79,265	64,684	8.3	92,643	103,651
Jubilant Food.	1,550	2,187	76,023	-10,617	78.1	110,557	160,356
Godrej Consumer	7,159	8,828	163,224	-338	22.3	159,802	197,136
United Breweries	2,254	3,044	143,080	10,710	75.6	181,280	241,063

Source: Bloomberg, Karvy Institutional Research

It was observed that Market Cap of Colgate is expected to decrease in 2013 as against increase in Market Cap of rest of the other companies. In 2014, we expect better performance of these companies would result into higher increase in Market Cap as compared to 2013.

These forecasted Market Cap of companies are extended for the finding the BSE-FMCG Index. Market Cap of all the stocks are regressed with the index value of FMCG.

$$BSE\text{-}FMCG^{\text{Index value}} = \alpha^{BSE\text{-}FMCG} + \beta^{colgate} * Mktcap^{colgate} + \beta^{nestle} * Mktcap^{nestle} + B^{hul} * Mktcap^{hul} + \beta^{ITC} * Mktcap^{ITC} + \beta^{Tataglobal} * Mktcap^{Tataglobal} + B^{Dabur} * Mktcap^{Dabur} + \beta^{unitedsprit} * Mktcap^{unitedsprit} + B^{jubfood} * Mktcap^{jubfood} + \beta^{Godrej} * Mktcap^{Godrej} + \beta^{unitedbrew} * Mktcap^{unitedbrew}$$

First, Regression has been done between the stocks' market capital and BSE-FMCG sector index value from the above equation. It was found that there is a strong case of Multicollenearity between the market capital of stocks and FMCG-index value. We tried to remove the multicollinearity by taking the weight defined by BSE-FMCG weight. We tried to eliminate almost all the multicollinearity existing in the data. It can be seen from the correlation coefficient in the below table that it is the case of multicollnearity. STSTA12 software can easily find the multicollinearity, if it exists in data.

Exhibit 29: Correlation Coefficient of BSE FMCG Companies

	FMCG	Colgate	Nestle	HUL	ITC	Tata Global	Dabur	Unit Spirit	Godrej	United Breweries
FMCG	1.00									
Colgate	0.98	1.00								
Nestle	0.95	0.96	1.00							
HUL	0.92	0.92	0.90	1.00						
ITC	0.96	0.99	0.97	0.90	1.00					
Tata Global	0.86	0.90	0.85	0.71	0.93	1.00				
Dabur	0.95	0.97	0.96	0.85	0.98	0.94	1.00			
Unit Spirit	0.56	0.60	0.62	0.39	0.63	0.79	0.76	1.00		
Godrej	0.97	0.98	0.98	0.92	0.98	0.86	0.94	0.52	1.00	
United Breweries	0.91	0.92	0.94	0.89	0.95	0.82	0.92	0.53	0.95	1.00

Source: Karvy Institutional Research

After eliminating the multicolinearity and taking the ITC, HUL, Nestle, Colgate, Dabur into one group and rest of the stock in another group and done the regression. It was found that R-square is 94.3%. We got the coefficient value 330 and beta values are 0.0037 and 0.003 for that assigned group. By applying the regression result, we got the BSE-FMCG index value 5,927 and 6,680 in the year 2013 and 2014.

F. Comparative Price Performance & Valuation – Domestic vs. Global FMCG Firms

Exhibit 30: Strong Earnings Growth Expectation from Indian FMCG Companies has resulted into Strong Stock Return as Compared to Global Peer Companies that widen the Premium Valuation Enjoyed by Indian companies.

	CMP	Absolute Performance (%)					P/E (x)			Earning CAGR
Company	(Rs)	5D	1M	3M	6M	YTD	FY12	FY13E	FY14E	FY12-14E (%)
India										
ITC	286	1.0	12.7	12.3	18.5	42.3	36.9	31.1	26.4	18.1
HUL	573	0.2	7.5	28.3	35.4	40.5	48.1	39.5	34.2	18.5
Nestle India	4,770	2.7	8.4	6.0	(3.8)	16.5	46.3	41.0	34.0	16.8
Dabur	131	0.5	5.2	13.5	18.1	32.0	35.5	29.9	25.0	19.2
Colgate	1,237	(0.2)	3.1	6.5	9.1	24.9	37.7	32.1	27.1	17.9
Marico	206	1.5	8.1	11.8	14.7	41.7	38.8	30.7	25.1	24.3
Jyothy Labs	175	14.2	10.3	38.5	106.8	116.4	48.3	34.4	23.8	42.4
GCPL	689	2.9	6.1	18.9	33.8	78.7	39.8	31.0	25.3	25.4
GSK Consumers	2,984	(1.1)	1.9	12.9	5.0	17.5	34.9	29.0	24.4	19.7
Emami	511	0.2	2.3	4.1	14.0	50.9	29.3	25.2	21.2	17.5
Britannia Industries	489	(2.3)	0.2	(4.3)	(14.3)	9.0	31.8	23.2	20.5	24.6
Jubilant FoodWorks	1,307	(3.3)	1.6	6.4	11.8	73.3	79.6	55.5	39.4	42.2
Bajaj Corp	185	(0.3)	8.8	41.1	43.2	87.0	23.1	18.5	15.5	21.9
Europe										
Danone	47	1.4	(3.8)	(6.7)	(12.2)	(2.6)	16.2	15.5	14.2	7.0
Nestle SA	62	1.6	5.5	5.2	9.9	15.3	20.2	18.3	17.0	9.2
Unilever	2,346	2.0	2.9	7.7	13.7	8.5	18.5	18.2	16.7	5.3
Reckitt Benckiser Group	3,670	2.9	1.2	3.4	0.9	15.4	15.0	14.9	14.7	1.2
Henkel AG & Co	63	0.6	2.5	10.5	13.4	40.8	19.9	17.2	15.7	12.9
Beiersdorf	58	1.8	3.2	7.1	15.7	33.0	32.1	28.1	25.0	13.4
US										
Colgate-Palmolive	111	2.7	4.3	5.0	12.3	19.7	22.0	20.6	18.8	8.2
Procter & Gamble	69	2.0	0.4	7.2	4.1	4.1	18.2	17.9	16.5	5.1
Hershey	71	0.3	(0.1)	(1.2)	13.7	14.8	25.1	21.9	19.9	12.4
Kellogg	53	2.8	5.1	10.0	(1.4)	4.5	15.7	15.9	14.7	3.4
HJ Heinz	58	1.9	2.5	4.3	9.0	6.5	17.3	16.3	15.2	6.5
Regional										
China Resources Enterprise	25	(2.0)	(4.0)	24.1	(11.1)	(6.4)	24.3	23.6	21.1	7.4
Tingyi (Cayman Isln) Hldg Co	24	-	1.5	22.3	10.5	0.6	38.3	35.6	28.6	15.7
Huabao International Holding	4	(1.2)	(1.0)	23.8	(13.9)	5.8	7.7	7.1	6.3	10.8
China Foods	8	(6.9)	12.3	7.1	2.0	33.3	33.4	24.1	19.6	30.6
Indofood Sukses Makmur	6,000	4.3	10.1	13.2	29.0	30.4	16.4	15.4	13.5	10.0
Olam International	2	6.0	(2.4)	9.4	(14.0)	(4.7)	14.2	12.0	9.4	23.2
Hengan Intl Group	75	2.8	(1.6)	-	(7.2)	3.0	35.5	26.5	21.5	28.4

Source: Bloomberg, Karvy Institutional Research

Summary of the Companies under Coverage

ITC: (CMP: Rs. 288; Target Price: Rs. 312) – BUY

ITC's dominance on cigarette would continue going forward, owing to extensive portfolio, large distribution network, and suitable backward integration. We expect strong pricing power and likely foray into 64 mm cigarette segment would aid ITC in maintaining healthy growth momentum. Besides, better cigarette revenue mix with pricing power, higher operational efficiency would boost PBIT/stick to 109 paisa by FY15E from 80 paisa in FY12P.

Outlook & Valuation: Valuing the stock using DCF methodology – *as relative valuation is not feasible in the lack of suitable comparison* – we initiate coverage on ITC with **"BUY"** recommendation with a target price of Rs. 312 apiece, having 8% upside potential from the CMP.

HUL: (CMP: Rs. 573; Target Price: Rs. 576) – HOLD

The higher involvement of top management at the field level, setting up of aggressive sales targets, improvement in product portfolio and expansion in distribution network have improved the visibility in the business. We expect it would help in delivering better revenue going forward which HUL was missing in previous several years. We expect sales and net earnings to show 15.7% and 17.5% CAGR during FY12-15E vs. 14% and 13.5% growth in FY10-12 respectively.

Outlook & Valuation: Valuing HUL at P/E of 30x (1.8x PEG) on 24-month forward earnings – which is ~10% premium to FMCG sector's valuations and ~20% higher than its past three years median P/E – we initiate coverage on HUL with **"HOLD"** recommendation with target price of Rs. 576 apiece, having 1% upside potential from the CMP.

Nestlé India: (CMP: Rs. 4,760; Target Price: Rs. 4,564) – SELL

Consistent price hike, low discretionary spending amid rising competition across all categories has been impacting Nestlé India's volume growth for past few quarters. However, recent new launches with higher focus on rural market would aid the Company in showing better volume growth, going forward. Higher spending on capacity expansion would force Nestlé India to focus more on volume growth. As the likely pressure on pricing power would limit further expansion in EBITDA margin, we expect Nestlé India to maintain EBITDA margin at ~21% in CY12E & CY13E.

Outlook & Valuation: Nestlé India's valuations premium has declined to 25% compared to 40% in the previous year. We give 31x (PEG of 1.9x) multiple on 24-month forward earnings and derive target price at Rs4,564. We initiate coverage on Nestlé India with **"SELL"** recommendation..

Dabur India: (CMP: Rs. 132; Target Price: Rs. 150) – BUY

Strong presence in domestic market has enabled Dabur to maintain high revenue growth momentum. On the back of initiative to expand rural distribution network, we expect Dabur to report better sales growth in the rural business in ensuing quarters. Besides, its global business is also expected to maintain high growth momentum as Dabur's overseas acquired entities that Hobi Kozmetic and Namaste Group have been integrated completely and their portfolio is being extended across geographies.

Outlook & Valuation: Valuing the stock on 24x P/E on 24-month forward earnings, we initiate coverage on Dabur with **"BUY"** recommendation with a target price of Rs. 150 apiece.

Colgate: (CMP: Rs. 1,236; Target Price: Rs. 1,322) – HOLD

Colgate-Palmolive is expected to maintain EBITDA margin at ~21-22% in FY13 & FY14 owing to favorable revenue mix and better price growth expectation. The Company is expected to sustain its volume growth owing to its regular launches, higher rural focus and continued dental awareness programmes. However, we believe that its A&P spend would continue to remain higher in FY13 & FY14 in order to maintain the healthy volume growth.

Outlook & Valuation: Based on give 26x P/E on 24-month forward earnings, we initiate coverage on Colgate-Palmolive with **"HOLD"** recommendation with a target price Rs 1,322 apiece.

Marico: (CMP: Rs. 204; Target Price: Rs. 232) – BUY

Its Parachute portfolio has been contributing significantly towards its volume growth, which we expect to remain high albeit at slightly slower pace in comparison to past few quarters. Again, Saffola, personal care portfolio of Paras Pharma and global business would continue to contribute to the Company's overall sales growth. Copra prices correction and addition of high margin Paras Pharma's personal care business would also help in maintaining the EBITDA margin.

Outlook & Valuation: Based on 24x P/E on 24-month earnings, we initiate Marico with **"BUY"** recommendation with a target price of Rs. 231 apiece.

Jyothy Labs: (CMP: Rs. 172; Target Price: Rs. 201) – BUY

We are bullish on long-term business outlook on account of Jyothy's higher focus on product development, synergy benefits through Henkel India acquisition, better Rural: Urban mix and scope of improvement in EBITDA margin. Jyothy's core business is expected to deliver ~20% CAGR during FY12-15E. Meanwhile, as the Company has almost turnaround Henkel India's performance, we expect better sales growth from Henkel India on account of price hike and increase in the distribution reach.

Outlook & Valuation: We reiterate our **"BUY"** recommendation on Jyothy Labs and our target price of Rs. 201 apiece is based on 19x P/E of 24-month forward earnings.

Sectoral Dynamics

A. Who can sustain this Performance?

Most of Companies would show better earnings CAGR in FY12-15E. Among this Dabur, Marico and Jyothy Labs would show substantially higher earnings growth CAGR.

The current juncture is marked with high valuation of most of the FMCG companies backed by strong earnings performance in the past 12-months. We believe that the companies who can sustain this performance would give better stock return.

We expect ITC to maintain its past ~20% net earnings growth, going forward while HUL, Dabur, Marico and Jyothy Labs are also likely to surpass their past performance (past two year earning CAGR).

Nestlé India, which has been reporting slower volume growth in past 4-5 quarters, would continue to see sluggish growth due to limited scope for price hike amid rising competition in most of the categories.

Exhibit 31: Financial Summary

Particulars	Last 5 Year	Last 2 Year	Last 1 Year	1 Year (E)	3 Year (E)
Sales Growth (%)					
ITC	15.8	17.0	17.5	15.5	16.4
HUL	12.6	14.0	17.1	15.8	15.7
Nestle India	21.6	20.8	19.8	13.5	16.2
Dabur India	21.0	24.8	29.5	18.3	17.8
Colgate-Palmolive	15.1	15.5	17.9	20.9	18.0
Marico	20.8	22.7	28.1	21.0	18.9
Jyothy Labs	25.5	36.9	81.4	22.2	21.0
EBITDA Growth (%)					
ITC	16.7	18.7	19.1	19.1	17.7
HUL	13.1	10.8	28.8	18.6	16.6
Nestle India	24.2	22.2	24.3	18.1	16.9
Dabur India	19.7	16.1	14.0	23.0	19.8
Colgate-Palmolive	25.4	9.8	12.4	24.5	17.8
Marico	19.5	13.6	18.2	41.7	24.0
Jyothy Labs	16.5	11.8	59.9	59.9	34.3
Adjusted PAT Growth (%)					
ITC	17.9	23.4	26.3	17.5	17.6
HUL	11.4	13.5	26.5	20.9	17.4
Nestle India	24.0	20.9	17.4	10.3	14.8
Dabur India	18.6	14.7	16.3	22.4	21.8
Colgate-Palmolive	18.1	5.1	10.9	20.2	17.7
Marico	26.3	11.9	19.0	42.8	28.3
Jyothy Labs	2.6	(11.0)	(14.4)	61.9	46.5

Source: Company, Karvy Institutional Research

Exhibit 32: Performance Expectation

Companies	Sales	EBITDA Performance
ITC	ITC is test-marketing a portfolio of new cigarette brands in 64 mm which we believe to aid volume from FY14 onwards. Moreover, Agri (20% of net sales) & Paper (~13% of net sales) businesses would maintain growth momentum although quarterly performance deviation has been witnessed. We don't expect any major performance deviation from these two businesses on annual basis. Hotel business (~4% of net sales) is consistently showing sluggish performance owing to low FTAs.	Its EBITDA margin expanded in last 4-5 quarters due to improvement in cigarette PBIT margin. FMCG business has reduced losses and we expect it to be breakeven by the end of FY13. We expect ITC to maintain its EBITDA margin at ~35% in FY12-15E.
HUL	Soaps & Detergent (S&D) segment – accounting for ~48% of sales – has surprisingly displayed >20% growth in the past few quarters, compared to growth of 6.4% & 1.5% in FY11 & FY10 respectively. S&D has been benefiting of premiumisation and HUL particularly gained market share in the segment through better distribution reach and regular launches and re-launches. We expect HUL should maintain the growth momentum owing to increase in the distribution reach, higher focus at the field level and incremental growth from the new launches.	Its EBITDA margin has improved in the past 4 quarters due softening of key input prices and several cost saving initiatives. We expect HUL should maintain EBITDA margin at ~15% in FY12-15E.
Nestlé India	Consistent price hike, low discretionary spending by consumers along with rise in competition in most of the categories has been impacting Nestlé India's volume growth in the past few quarter. We believe, as Nestlé India is spending high on the capacity expansion, it would have to focus more on the volume growth, going forward.	Its EBITDA margin expanded through price hike and better sales of premium products. We don't expect further improvement in EBITDA margin as the Company to spend high on marketing efforts for volume growth.
Dabur	Dabur is expected to report better sales growth in the rural business in the coming quarters. Its international business is consistently showing higher double digit growth due to expansion in geographies, which would maintain high growth momentum.	Its EBITDA margin remained slightly under pressure in the past few quarters due to high input prices and higher marketing spend overseas. We expect higher contribution from the international business would cap the overall EBITDA margin at ~17%.
Colgate-Palmolive	It has maintained 12% volume growth in the past several quarters, which encouraged the Company to undertake ~10% price hike. We expect volume growth to sustain owing to its regular product launches, higher rural focus and continued dental awareness programs.	The Company is expected to maintain its EBITDA margin at ~21-22% in FY12-15E.
Marico	Parachute's pricing power played critical role with sharp price hike of >30% in FY12 undertaken without affecting the volume. However, we expect lower growth of Parachute volume growth, going forward. Besides, Saffola and International business both supporting to the overall sales growth for Marico.	We expect ~200 bps rise in EBITDA margin in FY13 largely due to correction in Copra prices and acquisition of high margin personal care business from Paras Pharma.
Jyothy Labs	In the core business, Exo has become a new Avatar as it has shown 70% growth in the past 4 quarters as compared to 33% growth of Jyothy's standalone business. We expect Exo would continue to show strong growth on account of Jyothy's plan is to launch Exo in All-India by the end of FY13 as compared to its availability in 5 states. We expect standalone business should deliver ~20% growth during FY12-15E. Besides, we expect Henkel India would improve its performance on account of increase in the distribution reach and sufficient scope of price hike. We expect Henkel should clock 23% sales CAGR during FY12-15E.	Jyothy has expanded its core business EBITDA margin to sustainable level, while turning around Henkel India's business. We expect overall EBITDA CAGR of 46.5% during FY12-15E.

Source: Company, Karvy Institutional Research

B. Segment-wise Competitiveness

I. Oral Care: Colgate-Palmolive has consistently maintained ~12% volume growth in the past few quarters despite undertaking ~8-9% price hike. Regular new launches and entry into the sensitive segment has enabled the Company to enhance its market share. Dabur's oral care portfolio remained under pressure due to rise in competitive intensity especially in economy segment. Its premium offerings i.e. Meswak & Dabur Red has performed well, while its flagship brand Babool remained under huge pressure. HUL has recently launched Pepsodent Expert Care range and forayed in mouthwash segment through introduction of Pepsodent Mouthwashes.

Exhibit 33: Oral Care Company Performance

Particular	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Colgate									
Sales Growth (%)	13.0	13.2	13.8	12.6	15.6	19.1	20.0	17.9	20.5
Volume Growth (%)	13.0	13.0	12.0	12.0	12.0	13.0	12.0	12.0	11.0
Price Growth (%)	(0.0)	0.2	1.8	0.6	3.6	6.1	8.0	5.9	9.5
Market Share (%)	53.2	53.3	53.4	52.2	53.0	52.6	52.5	54.0	54.5
Dabur									
Sales Growth (%)	20.2	11.0	9.4	5.3	12.7	6.0	11.6	7.7	8.1

Source: Company, Karvy Institutional Research

II. Hair Oil: In past 4-5 quarters, Marico, Bajaj Corp and Dabur all reported strong growth in hair oil segment. Brand equity played key role in this performance and these companies snatched the market share from the unbranded players.

Exhibit 34: Hail Oil Company Performance

Particular	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Marico									
Parachute Rigid Pack Volume Growth (%)	14.0	11.0	5.0	5.0	10.0	10.0	13.0	11.1	18.0
Coconut Hair Oil Market Share (%)	53.3	53.0	52.4	52.6	52.3	53.3	53.9	55.0	56.0
Value Added Hair Oil Volume Growth (%)	27.0	14.0	31.0	21.0	32.0	26.0	20.0	17.5	25.0
Bajaj Corp									
ADHO Sales Growth (%)	20.0	21.9	29.2	31.7	25.2	32.8	30.7	29.2	32.7
ADHO Volume Growth (%)	12.5	13.4	21.3	24.5	17.0	22.9	20.4	19.4	24.4
ADHO Price Growth (%)	6.7	7.6	6.6	5.8	7.0	8.1	8.5	8.2	6.6
ADHO Value Market Share in LHO (%)	50.8	51.9	52.3	53.0	54.2	53.9	53.3	54.0	54.3
ADHO Volume Market Share in LHO (%)	48.0	48.8	48.7	49.1	50.4	50.2	49.9	50.9	51.9
Dabur									
Hair Oil Sales Growth (%)	16.5	10.0	12.4	15.0	16.1	26.6	22.0	20.2	8.4

Source: Company, Karvy Institutional Research

III. Soaps & Detergents: HUL's soaps sales in FY12 was ahead of FY10 & FY11 although it was relatively slower than its competitors.

Exhibit 35: Soap Players' Performance

Soaps	FY08	FY09	FY10	FY11	FY12
HUL	8.3	13.2	8.3	5.7	9.2
Reckitt Benckiser	25.0	36.1	29.8	22.5	14.1
Nirma	(3.4)	6.5	1.8	(2.4)	NA
GCPL	19.3	26.0	16.1	(3.9)	27.6
Wipro	25.6	26.4	17.8	12.4	30.8
Jyothy Labs (Inc Henkel India)	(4.9)	13.9	7.0	(0.1)	7.4

Source: Company, Karvy Institutional Research

Exhibit 36: Detergent Players' Performance

Detergent	FY08	FY09	FY10	FY11	FY12
HUL	17.8	32.9	(0.4)	6.4	29.2
Nirma	12.6	22.0	(19.6)	(11.2)	na
P&G	29.2	31.5	7.2	24.0	na
Rohit Surfactants	42.0	24.4	20.2	na	na
Jyothy Labs (Inc Henkel India)	34.4	14.0	8.7	(1.3)	0.4

Source: Company, Karvy Institutional Research

IV. Shampoo: Dabur's shampoo sales have slightly recovered during the past three quarters, after sliding by 22% & 24% in FY11 & H1FY12. Low base of previous quarters along with better marketing efforts have helped the Company to show better shampoo sales in H2FY12 & Q1FY13. HUL pushed Clinic plus business through high promotional campaigns that dragged Dabur's sales severely. Regular new launches across all its brands i.e. Dove, Clinic and Sunsilk and brand extension of these brands into conditioner has been benefiting HUL in delivering good sales growth in hair care portfolio.

V. Cigarette: ITC continues to outperform its peers in cigarette segment, while the pricing has enabled ITC to consistently register strong sales growth in past several quarters. ITC is test-marketing a portfolio of new cigarette brands in 64 mm cigarette i.e. Flake Deluxe, Scissors Deluxe, Bristol Deluxe, Gold Flake Superstar and Capstan Deluxe simultaneously to snatch business from the illegal market (~20% of the total cigarette market). We believe these new launches would start helping cigarette volume growth from FY14 onwards.

Exhibit 37: Cigarette Players' Performance

Cigarette	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
ITC									
Sales Growth (%)	15.8	15.9	18.9	12.8	15.7	16.4	16.6	17.4	15.0
PBIT Margin (%)	52.5	57.2	55.3	53.1	54.9	58.2	57.0	54.1	57.5
VST									
Sales Growth (%)	1.6	34.9	9.2	49.7	14.9	5.9	25.8	24.1	5.2
EBITDA Margin (%)	16.1	20.6	29.2	27.8	33.3	28.9	31.8	29.3	27.4
Godfrey Phillips									
Sales Growth (%)	(5.4)	18.5	21.5	30.6	18.8	13.5	13.5	21.2	11.6
EBITDA Margin (%)	8.8	18.2	13.1	19.0	21.1	9.1	13.7	14.0	10.7

Source: Company, Karvy Institutional Research

C. Competitive Matrix

We analyze below the FMCG companies (our coverage) based on their competitive positioning on various fundamental parameters. We have ranked them on a scale of 1-15 where one implies the weak fundamental position, while 15 is for the best fundamental position. We believe that higher score on these parameters would help these companies to sustain their performance going forward which would eventually result in maintaining their high valuation.

Exhibit 38: Competitive Matrix

Particulars	ITC	HUL	Nestle	Dabur	Colgate	Marico	Jyothy Labs
RIVER Scores	11	14	12	12	12	11	11
Leadership Position	14	12	11	11	12	11	11
Profitability Profile	14	12	13	11	13	10	11
Category Growth (%)	9	13	13	12	11	12	11
Low Commodity Exposure	14	11	12	11	13	11	11
Net Debt/Equity (x)	14	14	12	11	13	11	10
Valuation Comfort	10	8	4	12	8	11	14
Total	**86**	**84**	**77**	**80**	**82**	**77**	**79**

Source: Company, Karvy Institutional Research, Scores: 1-15 where 15 is for the best

I. RIVER Score

As per our RIVER (Range, Innovation, Value Proposition, Engage and Reach) analysis, we believe HUL, ITC and Nestlé India are best placed among its peers.

Range: The range of any brand in terms of price points and variety should be considered as a key trait. It is observed that the companies have benefited by launching products at low price points that ensures high volume and the margins.

Innovation: This trait is the key for any industry and FMCG industry is not an exception. Innovations includes: consistent improvement in usability, product extension, packaging and quality etc.

Value Proposition: Unlike the days when the consumers' psyche was largely governed by *"Value for Money"* concept, now the consumers buy products through mathematical matrix that calculates each item's weightage in monthly budget. The importance of brand plays a key role in choosing products.

Engage: It is observed that brand loyalty has been reducing over a period of time with consistent changes in brands. The companies should bring in products with improved features, packing, quality and better schemes to fulfill the new demand.

Reach: It is a proven fact that long-term survival of any brand depends on its reach to the customers. Good companies consistently develop their distribution channel and always wait for the opportunities to come to challenge the competitor.

Exhibit 39: RIVER Scores

Particulars	ITC	HUL	Nestle	Dabur	Colgate	Marico	Jyothy Labs
Range	2.5	3.0	2.5	2.0	2.5	2.5	2.5
Innovation	2.0	2.5	2.0	2.0	2.0	2.0	2.0
Value Proposition	2.0	2.5	3.0	3.0	2.0	2.0	2.0
Engage	2.0	3.0	2.0	2.0	2.0	2.0	2.0
Reach	2.5	2.5	2.0	2.5	3.0	2.5	2.5
Total	**11.0**	**13.5**	**11.5**	**11.5**	**11.5**	**11.0**	**11.0**

Source: Company, Karvy Institutional Research, Scores: 1-3 where 3 is for the best

II. Leadership Position

We give highest ranking to ITC on account of >80% market share in the cigarette business. The ranking is followed by the HUL for leadership in Soaps, Detergent and Skin Care categories and Colgate for Oral Care categories.

Exhibit 40: Leadership Position and Contribution in Business

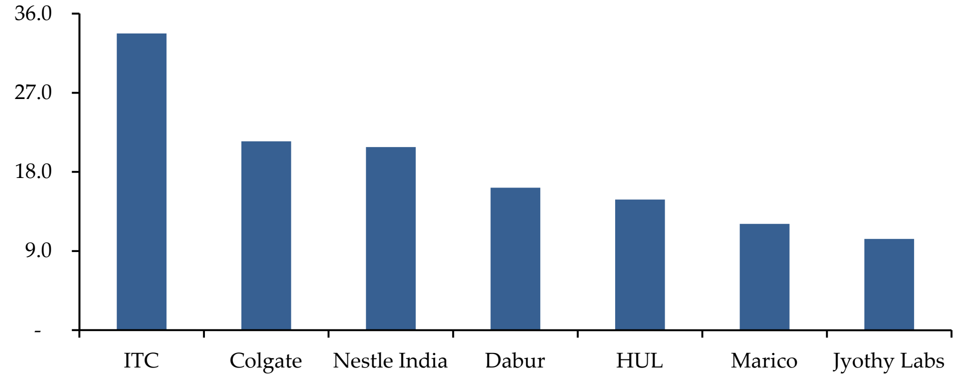
Companies	Leadership	Revenue Contribution (%)	EBITDA Contribution (%)
ITC	Cigarette	~45	~85
HUL	Soaps, Detergent and Skin Care	~55	~65
Nestle India	Noodles, Infant Foods	~48	~55
Dabur	Chywanprash, Hair Oil, Glucose	~20	~25
Colgate	Toothpaste	~78	~84
Marico	Hair Oil	~55	~70
Jyothy Labs	Whitener	~20	~47

Source: Company, Karvy Institutional Research

III. Operational Profitability

ITC enjoys robust operational profitability on account of its unarguable leadership the Cigarette business and low exposure to commodity prices. We give highest ranking to ITC which is followed by Nestle and Colgate who also have strong pricing power on their key brands.

Exhibit 41: EBITDA Margin Profile



Source: Company, Karvy Institutional Research

IV. Category Growth

We give highest ranking to HUL and Nestle on account of better outlook of those categories in which they have strong presence. HUL's Soap & Detergent categories are getting benefits of premiumisation while Skin care is more of higher consumption driven category. Nestle's Infant foods and Noodle category also persist high growth momentum.

Exhibit 42: Category Growth

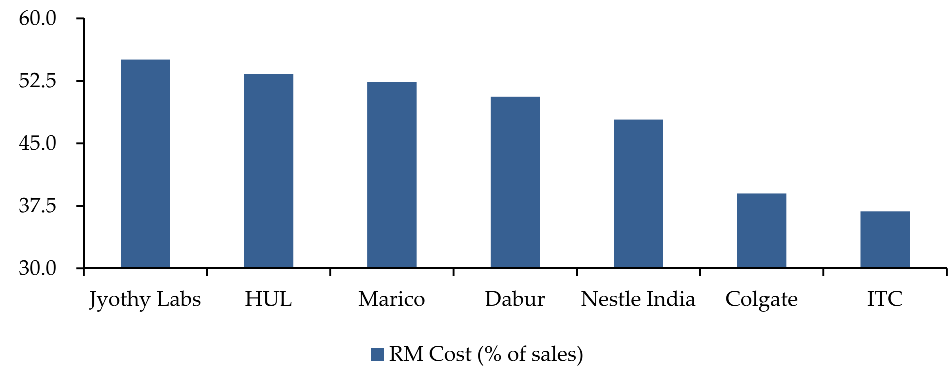
Companies	Key Category	Category Growth (%)	Ranking
ITC	Cigarette	Low single digit volume growth, large part of the growth comes from frequent price hike	9
HUL	Soaps, Detergent and Skin Care	Soaps & Detergent is largely price driven category while Skin care is having healthy mix of volume and price growth	13
Nestle India	Noodles, Infant Foods	Noodles is Healthy mix of volume and price growth while Infant food is largely price driven	13
Dabur	Chyawanprash, Hair Oil, Glucose	Healthy mix of volume and price growth	12
Colgate	Toothpaste	Healthy mix of volume and price growth	11
Marico	Hair Oil	Healthy mix of volume and price growth	12
Jyothy Labs	Whitener	Low single digit volume growth, large part of the growth comes from frequent price hike	11

Source: Company, Karvy Institutional Research

V. Commodity Exposure

We give highest ranking to ITC because of its low dependence on input prices. This low dependence is followed by Colgate and Nestle.

Exhibit 43: RM (% of sales)

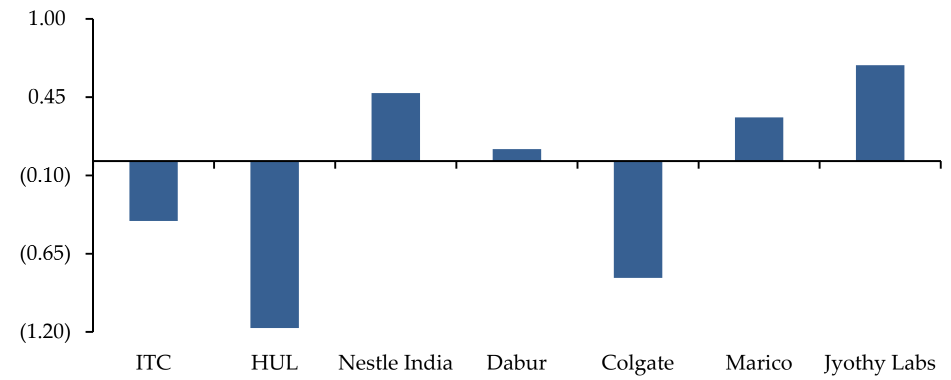


Source: Company, Karvy Institutional Research

VI. Net Debt Equity

ITC, HUL and Colgate is zero debt companies and having negative Net Debt to Equity. Hence they account for highest ranking from this fundamental factor.

Exhibit 44: Net Debt Equity



Source: Company, Karvy Institutional Research

VII. Valuation Comfort

Apart from the business fundamental, valuation comfort is also very critical for comparative analysis. We believe Jyothy Labs, Dabur and Marico are the best placed in term of valuation comfort.

Exhibit 45: Valuation Comfort

Companies	P/E (24-month Fwd EPS)	Ranking
ITC	23	10
HUL	30	8
Nestle India	32	4
Dabur	21	12
Colgate	24	8
Marico	21	11
Jyothy Labs	16	14

Source: Company, Karvy Institutional Research

Key Fundamental Triggers

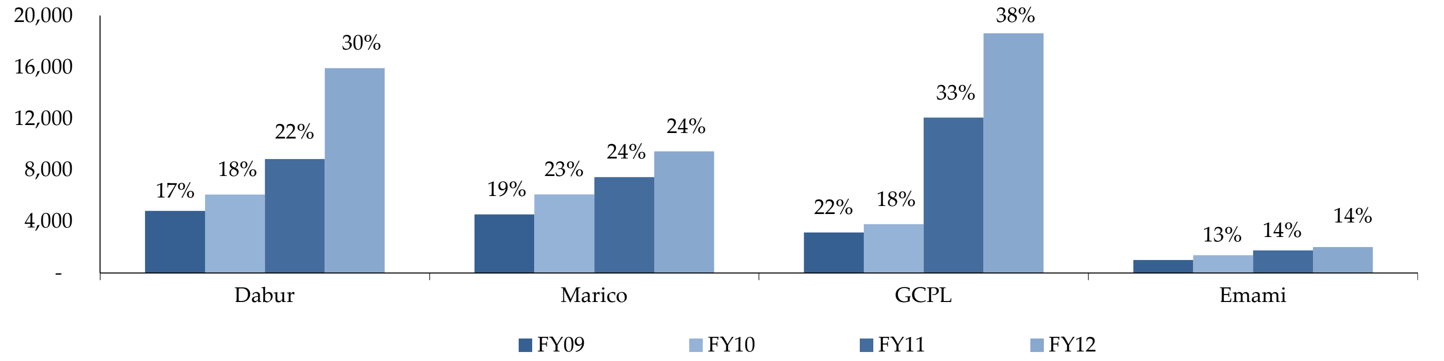
Evaluating the basic fundamentals, we expect this robust sales and profitability momentum to continue over the next two years:

I. Changing Business Fundamentals reflects Growth

A. Expanding International footprints a big positive divergence for the sector

The international business portfolio of most of the domestic FMCG companies specifically the mid-cap companies was at nascent stage in FY04 & FY05, has become critical for their robust growth now. Today, International businesses for domestic companies like Dabur, Marico, GCPL and Emami contributes 30%, 24%, 38% and 14% of their sales, respectively. We believe that unlike FY04 & FY05, the rising domestic competition won't affect the domestic FMCG players significantly, going forward.

Exhibit 46: International Business Contribution in Revenues



Source: Company, Karvy Institutional Research

Exhibit 47: Dabur's Geographical Revenue Mix

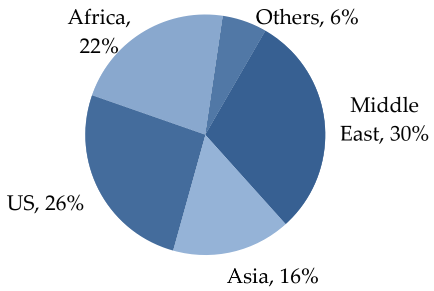


Exhibit 48: Marico's Geographical Revenue Mix

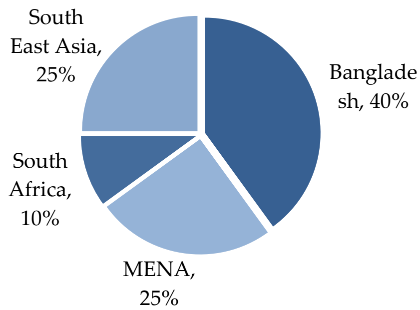
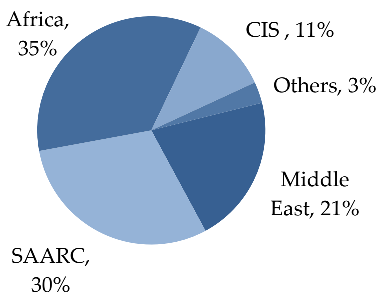
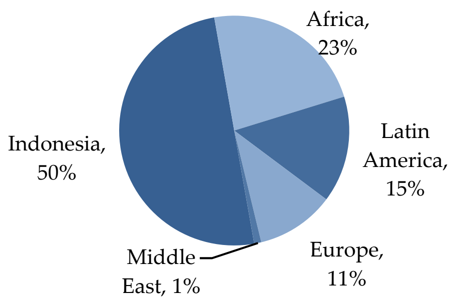


Exhibit 49: Emami's Geographical Revenue Mix



Source: Company, Karvy Institutional Research

Exhibit 50: GCPL's Geographical Revenue Mix

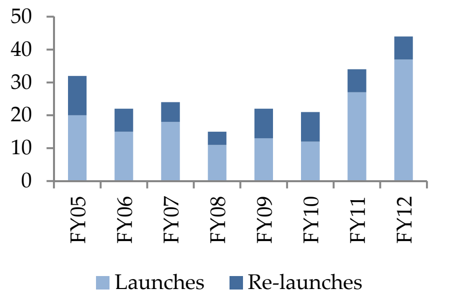


Source: Company, Karvy Institutional Research

B. Changing Product Mix and Range

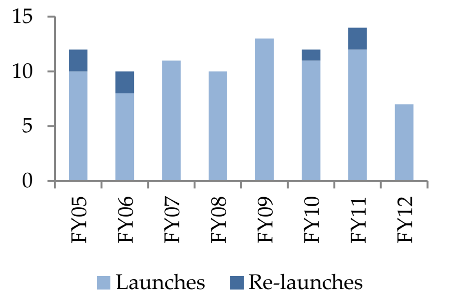
The FMCG companies have improved their product range in past few years and reduced their high dependence on few brands/SKUs. Consistent foray into new categories, launch of innovative products and extension of brands have considerably helped the FMCG companies, with which their current product portfolio becoming more balanced and the companies have multiple options to drive the business. Among the FMCG pack, HUL, Dabur and Colgate-Palmolive have increased portfolio size substantially in past two years. Leading the pack, HUL increased its portfolio size by 34 in FY11 (27 Launches & 7 Re-launches) & FY12 (37 Launches & 7 Re-launches).

Exhibit 51: HUL



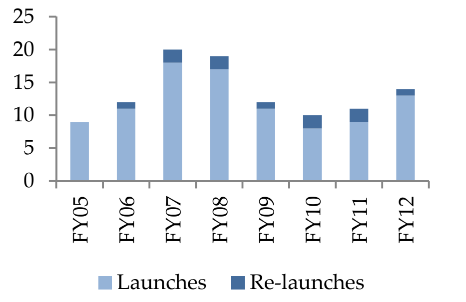
Source: Company, Karvy Institutional Research

Exhibit 52: Marico



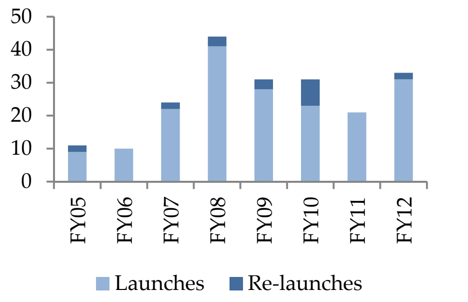
Source: Company, Karvy Institutional Research

Exhibit 53: Nestle



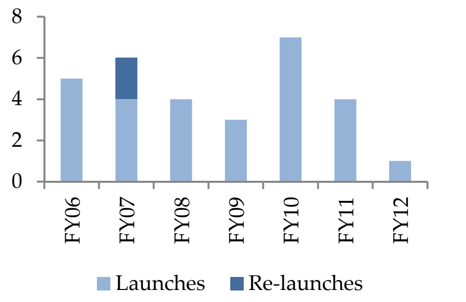
Source: Company, Karvy Institutional Research

Exhibit 54: Dabur India



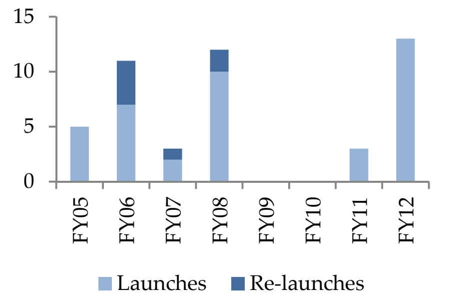
Source: Company, Karvy Institutional Research

Exhibit 55: Jyothy Labs



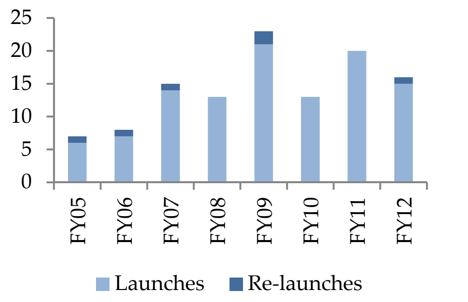
Source: Company, Karvy Institutional Research

Exhibit 56: Colgate-Palmolive



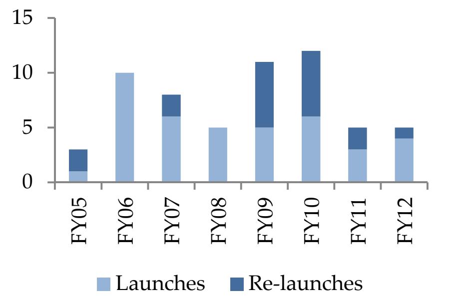
Source: Company, Karvy Institutional Research

Exhibit 57: ITC



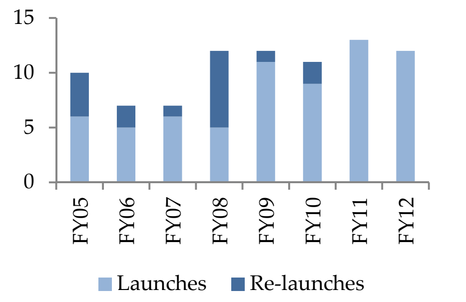
Source: Company, Karvy Institutional Research

Exhibit 58: Emami



Source: Company, Karvy Institutional Research

Exhibit 59: Britannia Industries

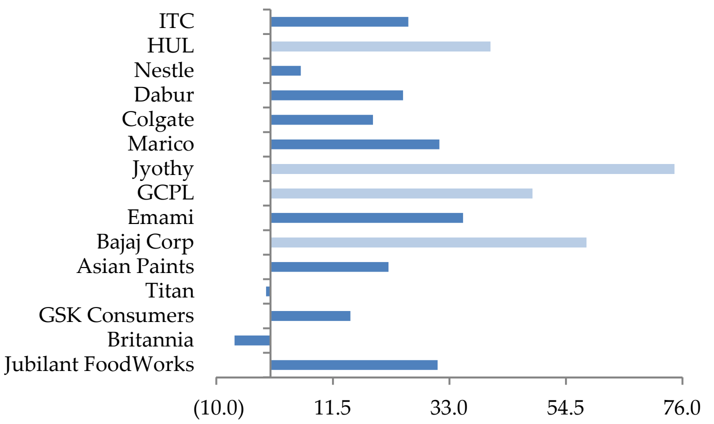


Source: Company, Karvy Institutional Research

C. Remarkable Improvement in Operational Performance

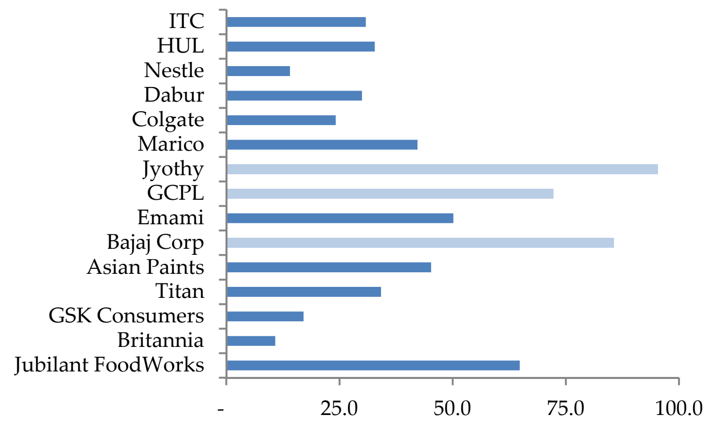
In our coverage universe, HUL, ITC, Marico and Jyothy Labs have shown strong earnings growth that resulted in outperformance. HUL has surprisingly reported high double-digit growth in past four quarters largely due to strong growth in Soaps & Detergent (S&D) segment. Marico is consistently growing with high double digit volume growth in past six-seven quarters with remarkable growth in Parachute franchise. Besides, Recovering from the phase marked with huge pressure post-acquisition of Henkel India (Henkel), Jyothy Labs has remarkably improved performance in past three quarters while boosting confidence on better visibility guidance that resulted in sharp uptick in the stock price.

Exhibit 60: 6M Stock Performance



Source: Bloomberg, Karvy Institutional Research

Exhibit 61: YTD Stock Performance



Source: Bloomberg, Karvy Institutional Research

Relative Chances of Positive Earnings Surprise

Companies	Sales Surprise	EBITDA Margin Surprise
ITC	Low	Low
HUL	Medium	Medium
Nestle India	Medium	Low
Dabur	Medium	Medium
Colgate	Medium	Low
Marico	Medium	Medium
Jyothy Labs	High	High

Source: Company, Karvy Institutional Research

Exhibit 62: Quarterly Net Sales Growth (%)

Companies	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
ITC	18.0	17.9	19.7	15.5	19.7	18.0	14.2	17.6	15.3
HUL*	6.7	9.7	11.5	14.0	15.3	19.8	17.2	20.4	17.6
Nestle India	20.2	27.8	26.5	23.1	20.9	20.7	16.7	13.7	13.7
Dabur	19.3	14.7	16.6	30.6	31.4	29.8	34.5	23.0	21.4
Colgate	13.0	13.2	13.8	12.6	15.6	19.1	20.0	17.9	20.5
Marico	13.4	12.5	22.1	29.2	32.0	25.1	29.4	18.4	21.8
Jyothy Labs	26.6	11.4	9.5	(17.7)	(18.5)	7.2	12.6	40.3	70.6
Emami	28.2	24.5	14.3	26.4	22.7	15.6	13.2	13.9	14.1
GCPL	62.9	67.1	89.4	96.3	39.6	23.3	37.1	32.4	39.2
Bajaj Corp	14.9	19.2	24.1	27.6	30.4	31.4	30.8	33.5	29.5
Pidilite Industries	20.3	13.7	26.4	22.4	20.9	18.6	16.4	14.3	18.1

*Source: Company, Karvy Institutional Research, * Domestic Business*

Exhibit 63: Quarterly EBITDA Margin Expansion (bps)

Companies	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
ITC	21	(17)	(41)	56	(32)	4	124	46	183
HUL	(192)	(169)	(308)	(58)	(44)	116	221	144	163
Nestle India	(131)	(90)	478	(7)	(40)	69	126	93	241
Dabur	16	9	(10)	(125)	(133)	(224)	(353)	(219)	39
Colgate	382	78	(758)	(334)	(753)	(341)	505	63	(4)
Marico	(45)	(102)	(256)	-	(118)	(78)	(68)	(176)	262
Jyothy Labs	(235)	20	(185)	(720)	(1,306)	(803)	500	513	304
Emami	(67)	(1,356)	(1,166)	(489)	(298)	(330)	54	516	(2)
GCPL	(127)	(171)	(215)	(273)	(381)	23	257	48	(22)
Bajaj Corp	358	(234)	18	(1,056)	(1,013)	(290)	(473)	(504)	321
Pidilite Industries	206	(213)	92	(110)	(390)	(261)	(252)	(36)	62

Source: Bloomberg, Karvy Institutional Research

D. FMCG Sector to Show ~16.4% Sales CAGR during FY12-15E

FMCG companies have shown robust sales growth of ~19.7% (largely price-driven) in FY12 v/s 15.9% CAGR in past 5 years. Most of the FMCG companies, during last year, passed on extra cost pressure through consistent price hike and their brand equity played key role in maintaining volume growth too. We anticipate slightly slower sales CAGR of ~16.4% during FY12-15E as we expect further price hike would be limited going forward. We expect ITC & HUL to show 16.4% & 15.7% CAGR in FY12-15E, while Nestle, Dabur, Colgate, Marico & Jyothy Labs should deliver 16.2%, 17.8%, 18.0%, 18.9% & 21.0% CAGR, respectively in FY12-15E.

Exhibit 64: Sales Growth Trend

Net Sales Gr. (%)	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
ITC	10.4	17.5	28.7	22.1	16.2	13.1	15.6	16.4	17.5	15.5	17.4	16.4
HUL	2.0	(1.9)	9.4	7.6	11.4	18.4	8.3	11.1	17.1	15.8	15.8	15.7
Nestle India	10.2	3.9	11.0	13.9	24.3	23.4	18.8	21.8	19.8	13.5	17.8	17.3
Dabur	(2.6)	18.1	24.9	9.6	15.8	18.8	20.8	20.3	29.5	18.3	17.7	17.7
Colgate	(1.5)	2.8	18.7	16.4	14.0	15.0	15.4	13.3	17.9	20.9	17.1	16.0
Marico	14.7	13.3	13.6	36.1	22.4	25.4	11.4	17.6	28.1	21.0	18.0	17.7
Jyothy Labs	3.9	12.8	14.9	19.3	4.7	28.5	23.5	3.3	81.4	22.2	21.0	19.8

Source: Company, Karvy Institutional Research

E. Expect EBITDA CAGR of 17.4% during FY12-15E

Softening key commodity prices, higher sales contribution by premium products and cost rationalisation initiatives would help companies to improve operational profitability. We expect EBITDA CAGR of 17.8% during FY12-15E. The EBITDA margin of ITC, HUL, Dabur, Marico and Jyothy Labs is expected to expand by 126 bps, 41 bps, 92 bps, 173 bps and 395 bps, respectively during FY12-15E.

Exhibit 65: Expect Better EBITDA growth then Sales Growth

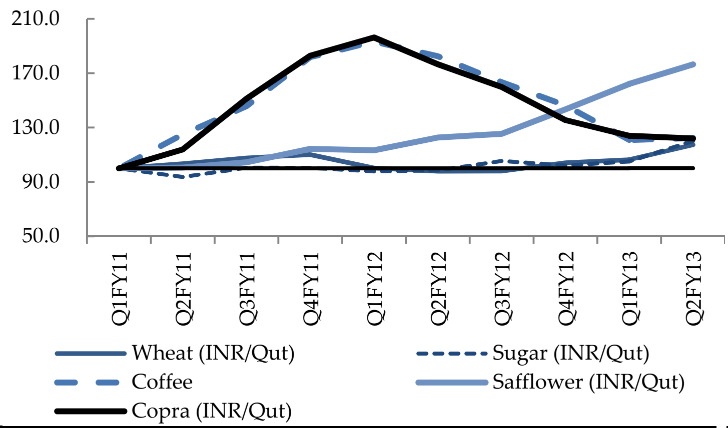
EBITDA Gr (%)	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
ITC	11.2	18.0	17.2	20.6	12.2	10.9	23.3	18.3	19.1	19.1	18.5	16.0
HUL	1.0	(22.9)	(0.8)	13.8	14.7	14.8	18.8	(4.7)	28.8	18.6	16.6	15.2
Nestle India	17.4	0.2	15.7	1.2	18.3	39.1	20.2	20.2	24.3	18.1	15.9	17.1
Dabur	0.1	32.8	32.2	25.5	19.0	15.4	32.9	18.2	14.0	23.0	18.1	19.2
Colgate	15.2	14.1	16.1	(4.0)	46.1	15.2	53.0	7.2	12.4	24.5	16.4	13.5
Marico	(1.8)	15.5	62.6	42.2	24.0	17.4	29.8	9.2	18.2	41.7	15.1	17.8
Jyothy Labs	(173.5)	(317.4)	54.6	20.5	13.3	7.8	40.8	(21.8)	59.9	59.9	28.0	19.5

Source: Company, Karvy Institutional Research

F. Softening Commodity Prices

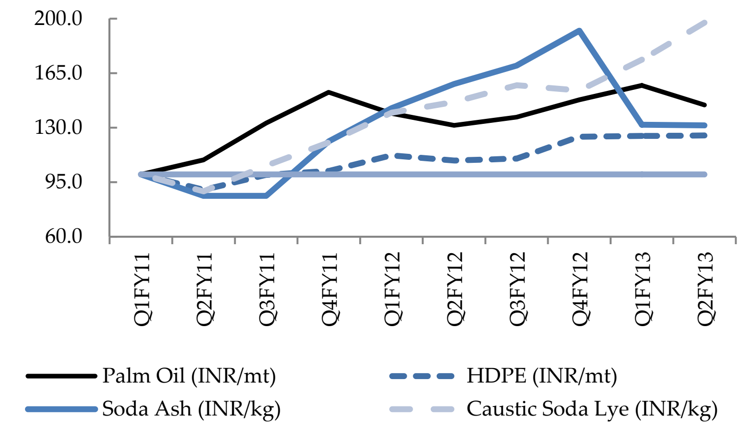
Many commodities have been softening from its peak level, which would help in improving the profitability of FMCG companies. Marico has been enjoying lower Copra prices (~40% of raw material cost) in past few quarters, while softening of Palm oil prices would likely to aid HUL and soap manufacturers in ensuing times.

Exhibit 66: Commodity Price Index



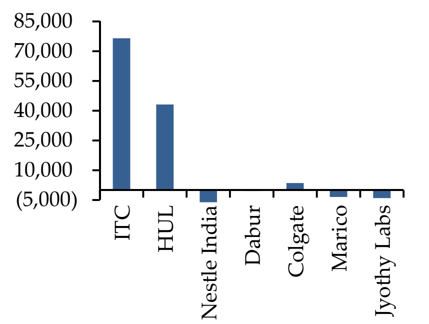
Source: Bloomberg, Capita-line, Karvy Institutional Research

Exhibit 67: Commodity Price Index



Source: Bloomberg, Capita-line, Karvy Institutional Research

Net Cash and Investment (Rs mn)

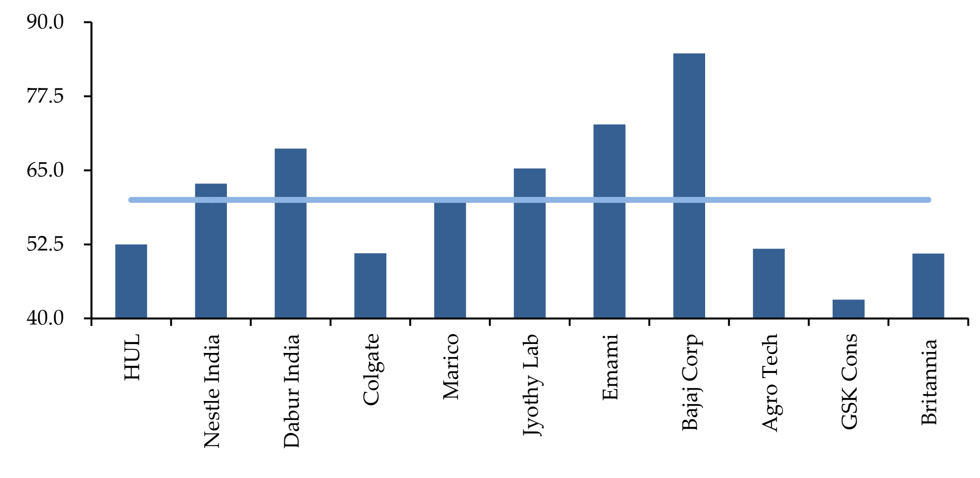


Source: Company, Karvy Institutional Research

G. Strong FCF will continue to be leveraged for acquisitions

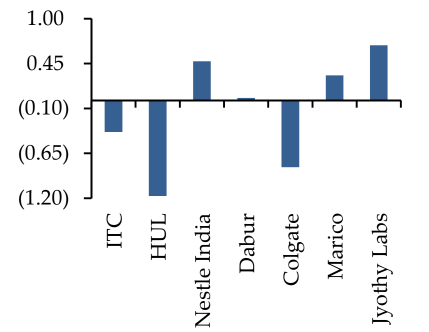
Unlike large cap consumer companies, mid-cap companies have been open to acquisitions to expand their revenue base. On an aggregate basis these companies have invested close to Rs.130 Bn on acquisitions. The gearing is still low and FCF from operations is still healthy we believe these acquisition strategies will continue. Dabur India, Jyothy Labs, Emami & Bajaj Corp are among the few FMCG companies having enough scope for further equity dilution in case of any likely acquisition opportunity. ITC, HUL and Colgate-Palmolive are even at negative net debt to equity. Hence, these companies have enough room for further acquisitions.

Exhibit 68: Promoter Holding (%)



Source: Company, Karvy Institutional Research

Net Debt/Equity



Source: Company, Karvy Institutional Research

Strategic Acquisitions (Past 12 Yrs)

Companies	Deal Amount (Rs mn)
Dabur	12,872
Marico	16,706
GCPL	25,131
HUL	52,670
ITC	10,844
Jyothy	7,506
Emami	3,513
Britannia	962

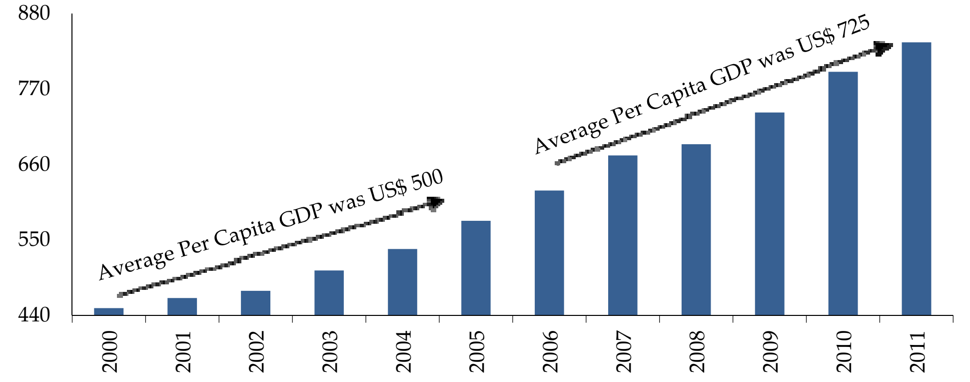
Source: Bloomberg

II. Several Socio-economic Factors Suggest Healthy Prospects

A. Substantial Change in Per Capita Income

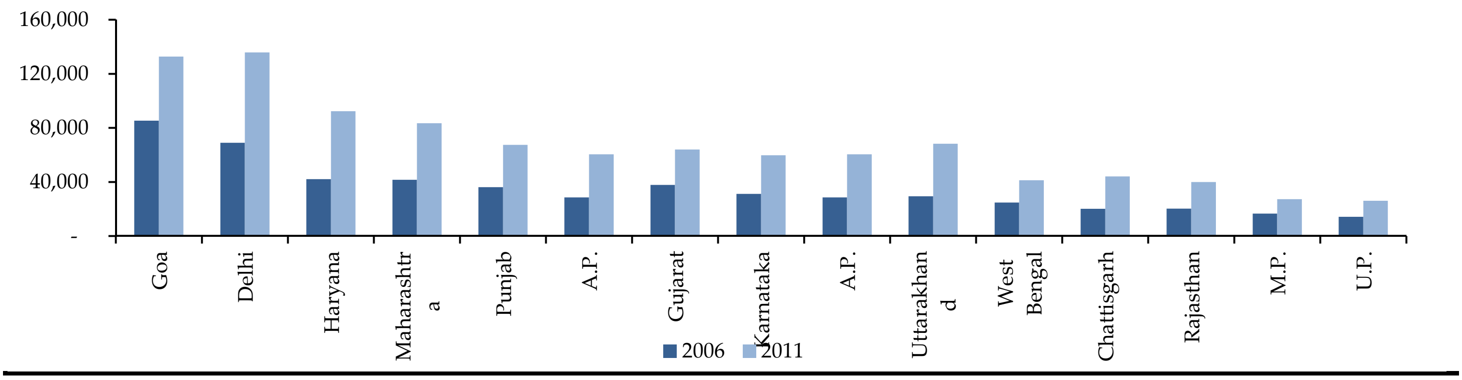
The average GDP growth for last five years recorded at ~8.6%, compared to ~5.5% in last five decades. We observed that key states namely Maharashtra, Uttar Pradesh, Andhra Pradesh, Tamil Nadu, West Bengal and Gujarat have significantly contributed for this robust growth. These six states contribute over 50% to India's GDP growth, with their contribution grew by >13% in past five years. The strong growth across states had helped the FMCG companies to deliver >15% growth in the past five years. ***We are positive on the sustainability of strong domestic FMCG growth for long period on account of rise in urban and rural disposable income, credit easing and low per capita consumption & lower penetration level of several categories.***

Exhibit 69: GDP Per Capita (Constant 2000 US$)



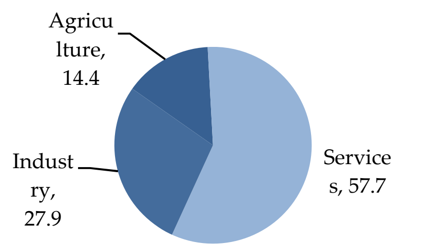
Source: World Bank Data, Karvy Institutional Research

Exhibit 70: Per Capita Net State Domestic Product at Current Price (Rs)



Source: Economic Survey 2011-12, Karvy Institutional Research

GDP Per Capita (Constant 2000 US$)

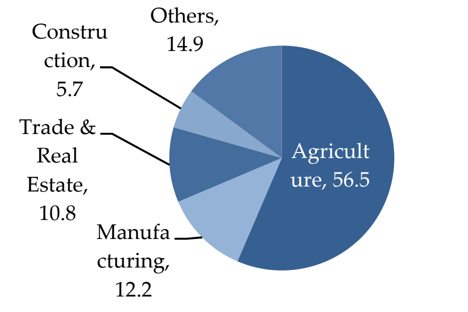


Source: CSO, Karvy Institutional Research

B. Lower Agriculture Dependency & Improved Monsoon Scenario

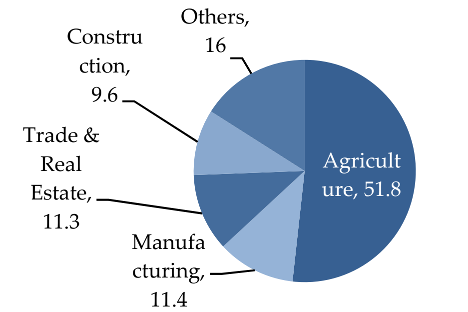
India's dependence on agriculture has been reducing gradually over the last several years. Agriculture's contribution in GDP and employment generation has declined to 14% and 52%, compared to 18% and 60% around 7-8 years back.

Exhibit 71: Sectoral Employment Mix in 2004 (%)



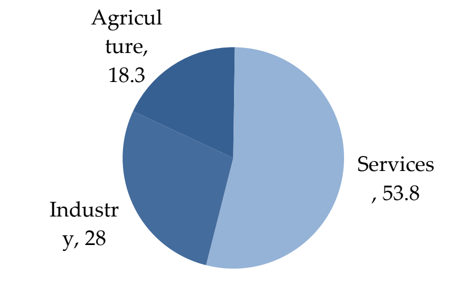
Source: CSO, Karvy Institutional Research

Exhibit 72: Sectoral Employment Mix in 2010 (%)



Source: CSO, Karvy Institutional Research

Exhibit 73: GDP Mix in 2005-06 (%)



Source: CSO, Karvy Institutional Research

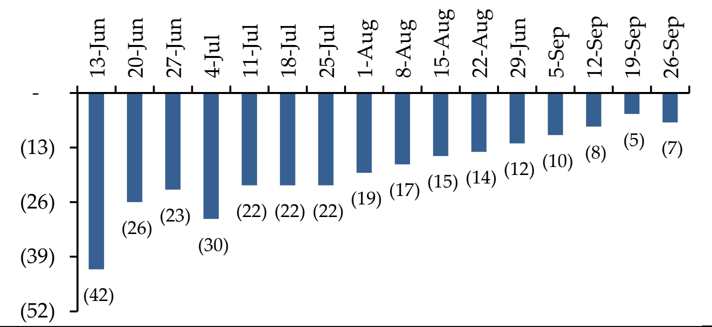
For the country as a whole, seasonal rainfall up to September 05, 2012 was 10% below the LPA, as against 12% by the end of last week ending August 29, 2012. Therefore, consistent improvement in the seasonal rainfall has changed the perception for the lower rural demand.

Exhibit 74: Seasonal Rainfall Scenario (1st Jun to 26th Sep)

	Actual Rainfall (mm)	Normal Rainfall (mm)	% Departure from LPA
Country as a whole	811	869	(7)
Northwest India	569	609	(7)
Central India	930	959	(3)
South Peninsula	620	691	(10)
East & northeast India	1,264	1,403	(10)

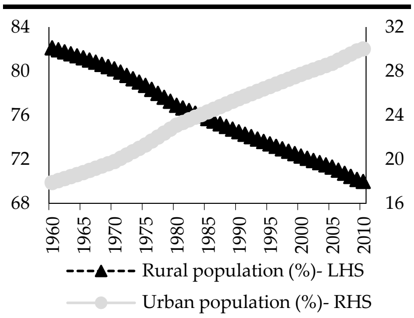
Source: IMD, Karvy Institutional Research

Exhibit 75: Week by Week Rainfall Departure (%) of LPA



Source: IMD, Karvy Institutional Research

Consistently Increase in Urban Population Mix (%)



Source: World Bank, Karvy Institutional Research

C. Favorable Urban-Rural Mix

Rising urban population is supporting urban demand for FMCG companies. Urban population mix was 18% in 1960, which rose to 28% in 2000 and then reached to 30% in 2010. The shift in the urban: rural mix has positively changed the dynamics for FMCG companies. Apart from change in population mix, the urban income distribution has also favourably changed over a period of time. The upper class in the urban income group has increased to ~36%, compared to 17% and 7% in 2002 and 1996, respectively. We believe that rise in urban population couple with improvement in urban income mix is positive for the FMCG companies under our coverage, as the urban market has higher appetite for premiumisation. Apart from the better value growth in the urban market, the FMCG companies also enjoy launching innovative premium products.

D. Sharp Rise in MSPs

Agriculture contributes ~50% of the employment in India hence any improvement in their income has significant role in the overall consumption pattern in India. The Government has taken sharp rise in Minimum Support Price (MSPs) of Kharif crops for 2012-13. The growth in MSP rates for most of the crops is highest in the past four years. HUL, Dabur and Jyothy Labs having ~50% revenue contribution from the rural markets, while Marico, Emami and Nestlé India clock 25-30% revenue contribution.

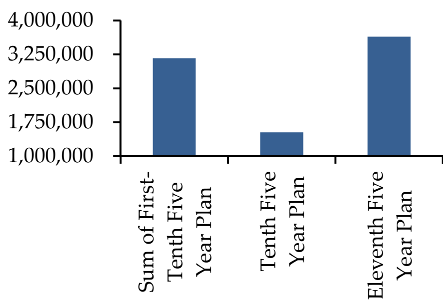
Exhibit 76: Strong MSP Rates Boost the Farm Income (Rs/quintal)

Kharif Crops	2012-13	YoY Gr%	CAGR % 2003-08	CAGR % 2008-13
Paddy (Grade A)	1,280	15%	4%	14%
Jowar (Hybrid)	1,500	53%	4%	20%
Bajra	1,175	20%	4%	14%
Maize	1,175	20%	5%	14%
Ragi	1,500	43%	4%	20%
Urad	4,300	30%	5%	20%
Cotton (H-4)	3,900	18%	2%	14%
Groundnut in shell	3,700	37%	3%	19%
Sunflower seed	3,700	32%	5%	20%
Soybean (Yellow)	2,240	33%	3%	16%
Sesamum	4,200	24%	2%	22%
Niger seed	3,600	24%	2%	24%
Rabi Crops	**2011-12**	**YoY Gr%**	**CAGR % 2002-07**	**CAGR % 2007-12**
Wheat	1,285	15%	4%	11%
Barley	980	26%	2%	12%
Gram	2,800	33%	4%	14%
Masur (Lentil)	2,800	24%	4%	13%
Rapeseed/Mustard	2,500	35%	6%	8%
Safflower	2,500	39%	4%	10%
Toria	2,425	40%	6%	0%
Other Crops				
Copra (Ball)	4,775	2%	2%	4%
Dehusked coconut	1,200	0%	na	na
Jute	1,600	0%	4%	10%
Sugarcane	139	29%	5%	12%

Source: Press Information Bureau, , Karvy Institutional Research

E. Robust 11th Five Year Plan Outlay

Five Year Plan Outlay (Rs Ten mn)



Source: Economic Survey 2011-12

The total outlay in the 11th Five Year Plan (FYP) was higher than the cumulative of the past 10 FYPs. The total plan outlay in 11th FYP (2007-12) was Rs. 36 trillion, 139% higher than Rs. 15 trillion in 10th FYP. Meanwhile, the cumulative outlay till 10th FYP was Rs. 32 trillion, lower than 11th FYP. We believe these initiatives have helped a lot to change the face of Indian economy. The average GDP growth in the past five years was highest in the past five decades. Therefore, these investments have helped in 6.5% increasing per capita income of India during the past five years. This has changed the Indian consumers' profile drastically and resulted into premiumisation in several FMCG categories.

F. Rise in Rural Income through Rural Reforms

The face of rural India has undergone significant changes due to mammoth investment by the governmental through several rural development initiatives/schemes – *Bharat Nirman, MNREGA and Sarva Shiksha Abhiyan* – having direct and indirect benefits for the rural development. Particularly, the government spending in these initiatives/schemes has increased by over three times in the last four years. We believe that the buoyancy in the rural economy is sustainable with increased allocation of funds.

Exhibit 77: Rural Reforms Through Higher Spending in Major Govt. Schemes

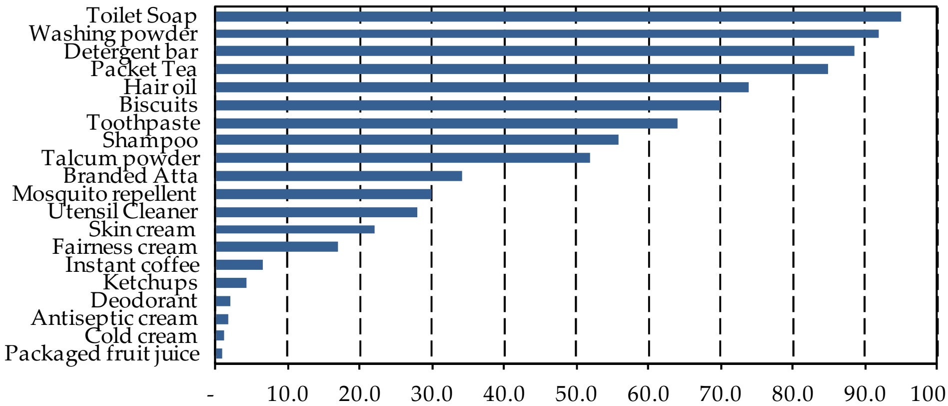
Highlights of Key Plans (Rs bn)	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	YoY Gr (%)
Bharat Nirman	-	313	454	480	580	674	16.2
Mahatma Gandhi NREGS	120	160	391	401	400	330	(17.5)
Indira Awaas Yojana (Rural Housing)	40	54	88	100	100	111	11.0
Pradhan Mantri Gram Sadak Yojana (PMGSY)	65	75	120	120	200	240	20.0
Sarva Shiksha Abhiyan (SSA)	107	131	131	150	210	256	21.9
National Rural Health Mission (NRHM)	110	119	139	154	181	208	14.9
Highways	117	107	116	167	133	209	57.1
NHDP / NHAI	65	70	86	95	103	115	11.7
IIFCL Cum. Disbursement target	-	-	90	200	250	-	-
National Rural Livelihood Mission	18	22	24	30	29	39	34.5
National Rural Drinking Water Programme	65	73	80	90	94	105	11.7
Rural Sanitation	11	12	12	16	17	35	105.9
Integrated Watershed Management Programme	11	18	19	25	25	31	24.0
National Programme of Mid Day Meals in Schools	73	80	80	94	104	119	14.4
Integrated Child Development Services	-	63	67	87	100	159	59.0
For Health Sector	-	37	44	56	57	-	-
Credit support to farmers	-	2,870	3,250	3,750	4,750	5,750	21.1
Rashtriya Krishi Vikas Yojana	-	-	-	-	78	92	17.9

Source: Economic Survey 2011-12, Karvy Institutional Research

III. Opportunity Galore in Under-penetrated & Low Consumption Segments

We see enormous opportunities in several categories on the back of low penetration level and low per capita consumption. Despite having high penetration level, we believe that the categories like detergent soap, personal soap and washing powder have low per capita consumption. Hence, any change in the consumption pattern will drive growth in these segments. Moreover, the segments like oral care, shampoo, skin cream, deodorant and packaged juice etc. – having low penetration level and per capita consumption as well – have huge opportunities, going ahead.

Exhibit 78: Penetration Level of Key Categories



Source: Industry, Emami Annual Report, Karvy Institutional Research

Our View: Several FMCG categories have huge opportunity to grow with growth in consumer base and change in consumption pattern.

Key Risks

1. Decline in Domestic Demand-Supply Scenario & Slowdown in Rural Demand

Any deceleration in the domestic demand-supply scenario may drag the estimated earnings of the companies under our coverage. Again, as the rural market has been consistently being critical for FMCG companies, any unexpected slower growth in the rural market can vary actual performance than our estimates.

2. Higher Input Cost

Any sharp increase in these commodities in global markets may lead to lower-than-estimated decline in earnings of the companies under our coverage.

3. Risk on Global Biz & Further Depreciation in INR

In the event of any disturbances in geo-political and further decline in socio-economic scenario can adversely affect our estimates. Again, any further depreciation in INR could also have major negative impact on companies under our coverage having global portfolio.

4. Impact of Packaging norms

The new packaging norms expected to be implemented in Nov'12, could largely impact the modern trade market where consumers get an opportunity to compare products. The FMCG companies with higher focus on mass segment would have to be more cautious for frequent price change. Post the implementation of this new rule, price increase would remain only alternative to protect profitability. Typically price change is more visible than reducing the grammage so volume would be more sensitive for any change.

5. Regulation Risk Remains for Cigarettes Biz

We can't rule out policy changes for the tobacco sector and announcements form the finance and health Ministry's would be critical to the performance of the sector.

6. Significance of Power Brands – Can Create Risks

The over dependence on a brand or few brands can create trouble for the Company in the long term. Here, we mention comparative analysis of dependence of power brands. We classified the companies based on their profitability dependence on power brands.

- High Dependence: Nestlé India & Marico
- Medium Dependence: Jyothy Labs & Colgate-Palmolive
- Low Dependence: HUL & Dabur

However, risk exposure would be higher for those companies where volume growth of power brand is slowing down.

KARVY STOCK BROKING

FMCG

October 18, 2012

Institutional Equities
India Research

ITC

INITIATION REPORT

Bloomberg: ITC IN
Reuters: ITC.BO

BUY

Safe Haven – Dominant Player in Cigarette Biz with Better Prospects in Non-cigarette Biz

ITC is a dominant player in cigarette business – *with >80% market share* – that accounts for ~44% of net sales and >80% of PBIT of the Company. The Company has maintained 16-18% growth in the cigarette business in the past several quarters despite pressure on volume on many occasions. We believe ITC would sustain similar growth trends in cigarette business going forward, unless there are some unfavourable governmental guidelines/policies on tobacco consumption. Meanwhile, the Company's non-cigarette business – *with ~70% contribution of FMCG & Agribusiness* – is expected to grow by 19% CAGR in FY12-15E in comparison to 17% CAGR recorded in FY09-12 period.

Cigarette Segment to Sustain Momentum: ITC's dominance in cigarette space would continue due to extensive portfolio, large distribution network, and brand loyalty amid suitable backward integration. Unless any unfavourable change in governmental policy towards tobacco consumption, strong pricing power coupled with foray into 64mm segment would aid ITC in maintaining healthy growth momentum, going forward. We believe that growth in cigarette business would drive ITC's overall profitability, with rise in PBIT/stick to 109 paisa by FY15E from ~80 paisa in FY12P owing to better revenue mix – *higher contribution from King Size cigarette* – and price growth.

Non-Cigarette Biz to grow at 19% CAGR in FY12-15E: We expect ITC's non-cigarette business to show 19.1% CAGR in FY12-15E v/s 16.7% CAGR in FY09-12. Its FMCG business – *which has grown 15x in last 8 years* – is likely to clock ~21% CAGR in FY12-15E owing to better foothold of the existing portfolio, consistent foray into newer segments and aggressive marketing strategy. Meanwhile, we expect ITC to clock 14% & 21% CAGR in Paperboard & Agribusiness segments, respectively in FY12-15E period. We expect non-cigarette business to contribute ~25% to ITC's total PBIT in FY15E, compared to 19% in FY12.

Outlook & Valuation

We use DCF methodology instead relative valuation, as relative valuation seems to be not feasible with no apparent comparison for ITC. Our DCF valuation assumes 18% and 16% FCF growth during first and second 5 years post FY15. We initiate coverage on ITC with **"BUY"** recommendation with target price of Rs. 312 per share having 8% upside potential.

Key Financials

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Revenue	222,737	261,795	302,334	355,033	413,141
EBITDA	74,208	88,376	105,234	124,721	144,659
Net Profits (Adj)	49,558	62,580	73,542	88,074	102,261
EPS (Rs)	6.3	8.0	9.4	11.3	13.1
PER (x)	45.3	35.9	30.5	25.5	21.9
P/BV (x)	13.6	11.5	10.0	8.6	7.4
EV/EBITDA (x)	29.3	24.5	20.6	17.1	14.5

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs288
Target Price:	Rs312
Upside (%)	8%

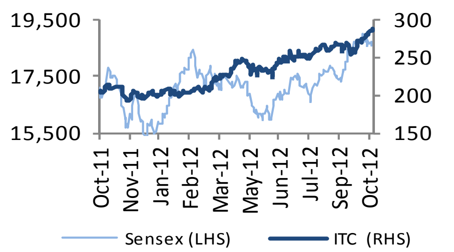
Stock Information

Market Cap. (Rs bn / US$ mn)	2,265/42,798
52-week High/Low (Rs)	289/189
3m ADV (Rs mn /US$ mn)	1,583/29.9
Beta	0.7
Sensex/ Nifty	18,611/5,660
Share outstanding (mn)	7,856

Stock Performance (%)

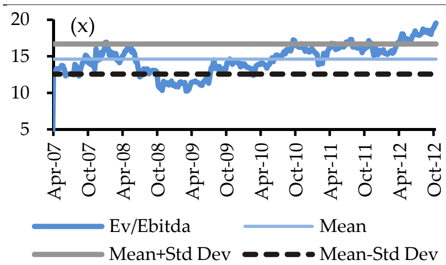
	1M	3M	12M	YTD
Absolute	13.7	12.8	40.1	43.2
Rel. to Sensex	13.3	3.7	28.2	18.9

Performance



Source: Bloomberg, Karvy Institutional Research

1 Year Forward EV/EBITDA



Source: Bloomberg, Karvy Institutional Research

Analysts Contact

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Company Financial Snapshot

Profit & loss

Rs mn	FY13E	FY14E	FY15E
Net sales	**302,334**	**355,033**	**413,141**
EBIDTA	105,234	124,721	144,659
Depreciation	8,241	8,716	9,366
Interest Expense	764	690	690
PBT	108,377	128,644	149,194
Tax	34,139	39,879	46,250
Adj. PAT	**73,542**	**88,074**	**102,261**
EPS (Rs)	9.4	11.3	13.1
DPS (Rs)	4.7	5.6	6.5
Profit and Loss Ratios			
EBIDTA Margin %	34.8	35.1	35.0
Adj Net Margin %	24.3	24.8	24.8
Valuation Multiples			
P/E (X)	30.5	25.5	21.9
EV/EBIDTA (X)	20.6	17.1	14.5

Company Background

ITC – *a well-diversified conglomerate* – was incorporated in 1910 under the name of Imperial Tobacco Company of India which was subsequently rechristened to India Tobacco Company in 1970 and ITC in 2001.

The Company continues to be a dominant player in cigarette business with considerable presence in FMCG, hotel, paperboard and agribusiness. However, despite having huge product basket, the cigarette segment still accounts for major chunks of ITC's profitability with over 80% share in PBIT.

Over the last 10 year, the stock has consistently outperformed benchmark Sensex. During this time, Sensex grew by 5x, while ITC grew by >8x. Even in the last one year, ITC's has outperformed Sensex by >25%.

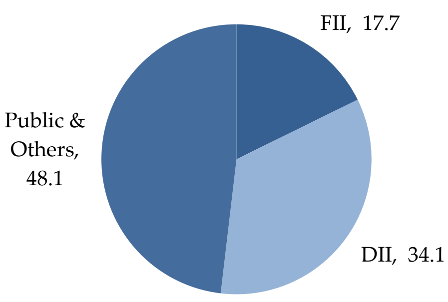
Balance Sheet

Rs mn	FY13E	FY14E	FY15E
Total Assets	**323,056**	**375,879**	**435,646**
Net Fixed Assets	132,832	141,216	148,951
Current Assets	137,394	178,283	226,765
Other Assets	52,830	56,380	59,930
Total Liabilities	**323,056**	**375,879**	**435,646**
Net worth	224,922	261,253	303,435
Debt	1,305	1,305	1,305
Current Liabilities	85,050	99,933	115,844
Deferred Tax	11,779	13,389	15,062
Balance Sheet Ratios			
RoE %	32.7	33.7	33.7
RoCE %	46.0	46.9	46.9
Net Debt/Equity	(0.1)	(0.2)	(0.3)
Equity/Total Assets	0.7	0.7	0.7

Cash Flow

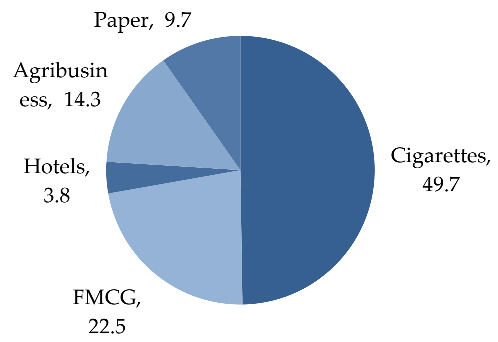
Rs mn	FY13E	FY14E	FY15E
PBT	108,377	128,644	149,194
Depreciation	8,241	8,716	9,366
Tax	(33,402)	(39,084)	(45,391)
Change in Wkg Cap	(26,038)	(116)	(1,804)
CF from Operations	**58,060**	**98,974**	**112,185**
Capex	(17,035)	(17,100)	(17,100)
Investments	(758)	(3,550)	(3,550)
CF from Investing	**(17,794)**	**(20,650)**	**(20,650)**
Change in Equity	-	-	-
Change in Debt	(280)	-	-
Dividends & others	(43,206)	(51,744)	(60,078)
CF from Financing	**(44,250)**	**(52,434)**	**(60,768)**
Change in Cash	(3,984)	25,890	30,767

Shareholding Pattern (%)



Source: BSE

Net Sales Mix (%)



Source: Company

Outlook & Valuation

We use DCF methodology instead relative valuation, as relative valuation seems to be not feasible with any apparent comparison for ITC. The Company's cigarette business is not comparable with any domestic or global players. Though we tried to compare ITC with few global players, we found that the comparison with any global players is also not appropriate as they are facing volume pressure and their profitability is also lower than ITC. Our strong cash flow assumption is based on ITC's robust past performance and low peer threat on its high margin cigarette business.

ITC dominate with 83% market share in the domestic cigarette market and its business model is far superior which is appropriately backward integrated. Therefore, apart from the disparity in sales, ITC's profitability is also not comparable with other domestic players.

Exhibit 1: Domestic Cigarette Player Comparison

Particulars	ITC	Godfrey Phillips	VST Industries
Net Sales (Rs mn)	123,241	19,105	6,801
EBITDA Margin (%)	60.6	20.6	30.2
Market Cap (Rs bn)	2,055	34	27

Source: Company, Karvy Institutional Research

Our DCF valuation assumes 18% and 16% FCF during first and second 5 years post the FY15. We initiate coverage on ITC with "BUY" recommendation with target price of Rs. 312 per share having 8% upside potential.

Exhibit 2: DCF Sensitivity

		Cost of Equity (%)				
		11.0%	11.5%	12.0%	12.5%	13.0%
Terminal Growth Rate (%)	3.0%	340	314	291	271	253
	3.5%	354	326	301	279	260
	4.0%	370	339	**312**	289	268
	4.5%	389	354	325	299	277
	5.0%	410	372	339	311	287

Source: Company, Karvy Institutional Research

Investment Rationale

Our investment argument is based on following premises:

1. Unparalleled Leader Cigarette Segment Ensuring Superior Profitability
2. Non-Cigarette Biz – Gearing for Profitability

1. Unparalleled Leader Cigarette Segment Ensuring Superior Profitability

ITC has so far been the unparalleled leader domestic cigarette segment. For ITC, the cigarette is not a volume driven business, as in the last five years, the volume CAGR stood at mere ~1% vs. cigarette sales CAGR of 12%. ITC has consistently increased the cigarette prices to pass on the extra tax burden and to improve the profitability. We consider ITC's cigarette business safer than any other FMCG categories due to the following factors:

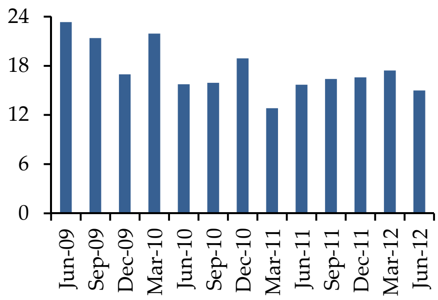
- Low Competitive Intensity,
- Cigarette's Addictive Nature,
- Low Raw Material Sensitivity, and
- Superior Business Model through Appropriate Backward Integration.

Exhibit 3: Peer Comparison – Cigarette

Companies	Net Sales (Rs mn)	EBITDA Margin (%)
ITC	123,241	60.6
Godfrey Phillips	19,105	20.6
VST Indus	6,801	30.2

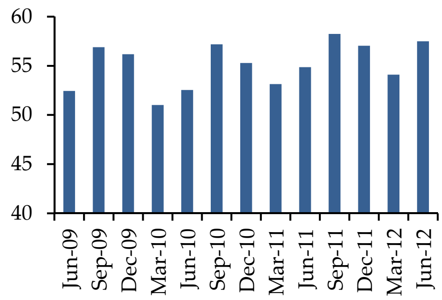
Source: Company, Karvy Institutional Research

Exhibit 4: Qtr Growth – Cigarette (%)



Source: Company, Karvy Institutional Research

Exhibit 5: Qtr PBIT Mrg – Cigarette (%)



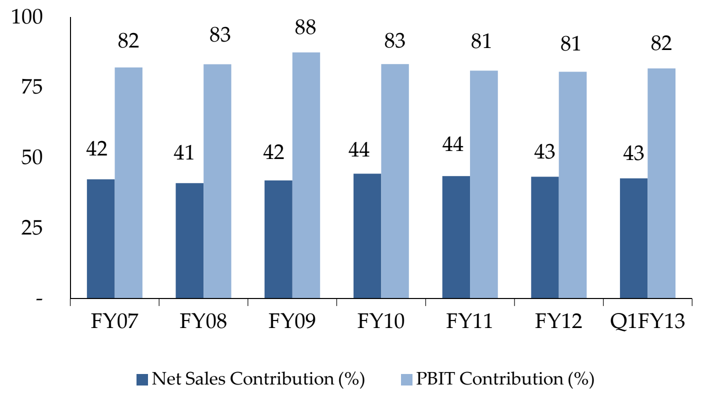
Source: Company, Karvy Institutional Research

Higher Incremental Demand Likely Despites Statutory Warning: The governmental policy is highly sensitive to cigarette business, as the Government tries to control the cigarette consumption through several means like: Hike in taxes (which accounts for ~50% of the MRP) and forewarning the consequences of smoking through actions like ban on smoking ban at public places, pictorial warnings on the package.

Although government intervention has high sensitivity for cigarette business, we have observed that ITC is more neutral than its peers and in most of the cases has appropriately passed on the extra tax burden. Again, such governmental health-related initiatives are still not very effective and we expect incremental demand through higher involvement of youth especially female smokers, which would maintain ITC's cigarette consumption level, going forward. Hence, we maintain our positive bias on ITC's cigarette business and its superior profitability would keep high to overall profitability for ITC.

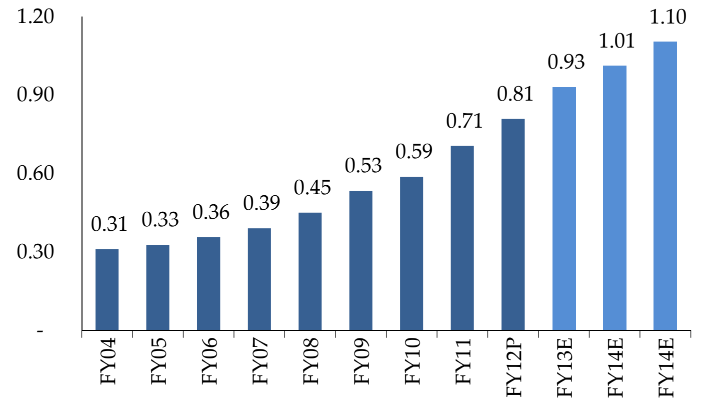
Our View: Cigarette PBIT per stick is likely to expand to 109 paisa by FY15E from ~80 paisa in FY12P owing to better cigarette revenue mix (higher contribution from King Size Cigarette) and price growth.

Exhibit 6: Cigarette Contribution in Sales & PBIT



Source: Company, Karvy Institutional Research

Exhibit 7: Expansion in PBIT/Cigarette (Rs/Stick)

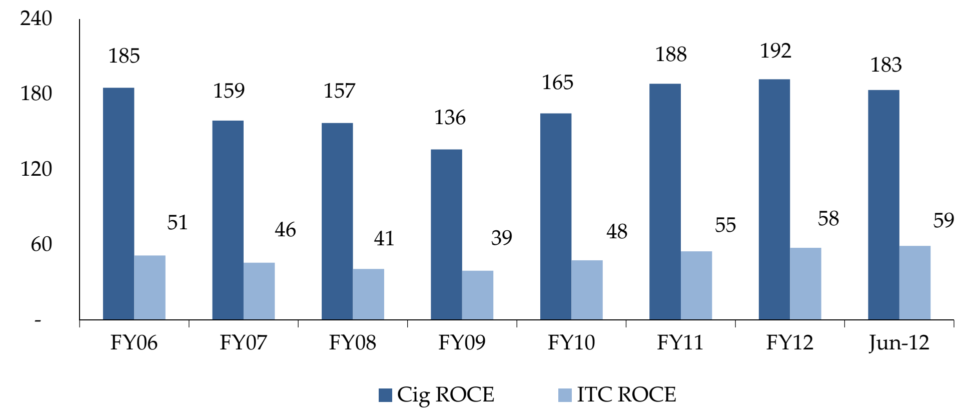


Source: Company, Karvy Institutional Research

A. High Cigarette ROCE: Historically, cigarette business ROCE ranges in 140-160% vs. depressed return profile of non-cigarette business, which ranges between 8-14%. Loss in FMCG segment and single digit ROCE in hotel business erased the benefits of strong ROCE in cigarette business.

Our View: ITC would remain its return profile, as the company is investing high for its non-cigarette businesses.

Exhibit 8: Wide Difference in Cigarette and ITC's ROCE (%)



Source: Company, Karvy Institutional Research

B. Opportunity in Small Size Cigarette: ITC is test-marketing a portfolio of new cigarette brands in 64mm cigarette i.e. Flake Deluxe, Scissors Deluxe, Bristol Deluxe, Gold Flake Superstar and Capstan Deluxe simultaneously to snatch business from the illegal market that accounts for ~20% of total cigarette market.

Our View: These new launches would start aiding ITC's cigarette volume growth from FY14 onwards.

2. Non-Cigarette Biz – Gearing for Profitability

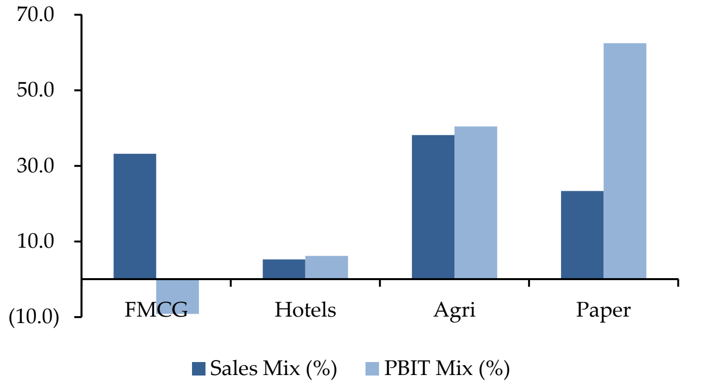
ITC has successfully reduced its overdependence on cigarette business through substantial growth in other businesses i.e. FMCG & Agri business. However, as the cigarette segment being very lucrative, ITC's profitability dependence on this segment is still not reduced substantially.

Exhibit 9: Change in Business Mix

	Sales Mix (%)		PBIT Mix (%)	
	FY03	FY12	FY03	FY12
Cigarette	74	58	91	81
FMCG	1	14	(6)	(2)
Hotels	2	3	1	3
Agri	14	15	4	8
Paper	10	11	11	11

Source: Company, Karvy Institutional Research

Exhibit 10: Non-Cigarette Sales and PBIT Mix



Source: Company, Karvy Institutional Research

A. FMCG Business: ITC's strong cash-flows from cigarette business resulted in better appetite for FMCG business. The Company has incurred >Rs. 20 bn operational loss to achieve 15x sales in last 8 years. ITC has been consistently entering into new segments and has now become a critical player in FMCG market too with its Aashirvaad Atta, Sunfeast Biscuit, Bingo – with combined contribution of >70% to FMCG sales – have been consistently performing well.

We believe that ITC's higher focus on product development, brand extension and strong marketing efforts would continue to augur well for these brands. Besides, we are encouraged by >300 bps decline in PBIT loss (% of sales) in FY12 to ~3.5% of sales, which further reduced to 2.6% in Q1FY13, especially amid pressure on input prices. In our view, sustaining high sales growth with reduction in operational loss is a remarkable achievement of the Company.

Our View: ITC's 'Branded Packaged Foods' & 'Stationery' businesses are profitable, while the losses in 'Lifestyle Retailing' & 'Personal Care' businesses are impacting its segmental profitability. We believe that ITC's FMCG segment would further reduce the losses and would achieve breakeven by FY13-end on the back of softening of input prices and better growth in the profitable businesses.

B. Agri Business: Agribusiness is a largely trading business that accounts for ~60% of ITC's total exports. Unmanufactured leaf tobacco is the largest product (~47% of total agribusiness) for the segment and fetches high margins. Though like any other commodity business, ITC's agribusiness is prone to high volatility, ITC's strong network with farmers has reduced volatility over a period of time. The 'e-Choupal' model created a significant two-way multi-dimensional channel between the farmers and the Company. Through 'e-Choupal', ITC is now connected with over 4 mn farmers in 40,000 villages in 10 states.

Our View: The profitability of agribusiness has improved substantially in last five years. PBIT margin expanded to 11% in FY12 from 4% in FY07. We expect ITC's Agribusiness to maintain its growth as well as profitability momentum, while further development of 'e-Choupal' and other agri initiatives would help the Company in expanding business, going forward.

C. Paper Business: This business was basically a strategic move for backward integration of the cigarette business. A big portion (~38% of the total gross sales) of this business is being consumed internally. ITC is focusing more on value-added products where the Company is already leader in the market. Value-added coated board growing at 15%, while the outlook of the business remains strong.

Our View: ITC has maintained profitability of this business with its PBIT margin has moved between 20%-25% in last five years. We expect higher contribution from the value-added products, which would further improve the margin profile of this business.

D. Hotels Business: ITC operates +100 Hotels in 90 locations in India through its four brands i.e. ITC Hotels, WelcomHotel, Fortune and WelcomHeritage which covers mix of luxury, heritage and mid segment. ITC's hotel business has high dependence on foreign visitors therefore slowdown in the developed countries has been impacting business since past two years.

Our View: We don't expect any significant change in the contribution of Hotel Business to ITC's overall sales and PBIT in the near-term.

Exhibit 11: ITC's Business Mix

Segments	Net Sales Mix (%)			Sales CAGR (%)		PBIT Margin (%)			PBIT Mix (%)			PBIT CAGR (%)	
	FY09	FY12	FY15E	FY09-12	FY12-15E	FY09	FY12	FY15E	FY09	FY12	FY15E	FY09-12	FY12-15E
Cigarettes	49.3	49.7	46.8	18.3	16.3	55.4	56.1	55.8	87.5	80.6	74.7	18.0	13.9
FMCG	20.4	22.5	24.6	17.3	14.4	(16.1)	(3.5)	6.0	(10.1)	(2.3)	4.2	na	na
Hotels	6.1	3.8	3.5	20.8	20.3	33.8	27.8	27.8	6.6	3.3	2.8	(4.0)	10.8
Agribusiness	14.2	14.3	16.0	(0.1)	13.8	6.7	11.3	12.0	5.4	7.5	8.2	35.5	20.2
Paper	10.1	9.7	9.1	17.2	21.1	19.2	23.9	24.0	10.6	10.9	10.2	22.3	14.4

Source: Company, Karvy Institutional Research

Exhibit 12: Key Assumptions

Key Assumptions	FY11	FY12	FY13E	FY14E	FY15E
Cig Volume Gr. (%)	(2.8)	4.5	(2.5)	5.8	5.5
Cig Gross Price Gr. (%)	18.0	8.3	16.5	8.6	7.4
Cig Gross Sales Gr. (%)	14.7	12.2	14.5	14.9	13.3
Cig Net Sales Gr. (%)	15.8	15.7	13.3	15.9	14.5
Cig Excise Gr. (%)	13.5	8.2	16.0	13.6	11.8
Cig VAT Rate (%)	14.9	19.4	19.8	19.8	19.8
Cig PBIT Gr.(%)	16.8	19.8	12.1	15.1	15.1
FMCG Gr. (%)	20.2	23.7	19.7	21.5	20.3
Agribusiness Gr. (%)	26.9	20.2	19.6	22.1	22.4
Paper Business Gr. (%)	12.4	11.1	13.1	13.4	16.7
Hotel Gr. (%)	8.3	1.2	11.8	13.3	16.6

Source: Company, Karvy Institutional Research

Financials-Consolidated

Exhibit 13: Profit & Loss Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Net Revenues	222,737	261,795	302,334	355,033	413,141
% Growth	16.4	17.5	15.5	17.4	16.4
Raw Material	81,184	96,453	106,207	123,619	143,951
Staff	17,319	19,443	22,844	26,499	30,739
Other Expenses	50,026	57,524	68,050	80,194	93,791
Total Expenditures	148,529	173,419	197,100	230,312	268,481
EBITDA	74,208	88,376	105,234	124,721	144,659
% Growth	18.3	19.1	19.1	18.5	16.0
EBITDA Margins (%)	33.3	33.8	34.8	35.1	35.0
Other Income	7,951	11,564	12,147	13,328	14,590
Interest	818	805	764	690	690
Depreciation	6,990	7,455	8,241	8,716	9,366
Profit Before Tax	74,351	91,680	108,377	128,644	149,194
Provision for tax	23,655	28,458	34,139	39,879	46,250
Effective tax rate (%)	31.8	31.0	31.5	31.0	31.0
Reported PAT	50,182	62,580	73,542	88,074	102,261
% Growth	22.3	24.7	17.5	19.8	16.1
Adjusted Net Profit	49,558	62,580	73,542	88,074	102,261
% Growth	20.5	26.3	17.5	19.8	16.1

Source: Company, Karvy Institutional Research

Exhibit 14: Balance Sheet

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Equity Share Capital	7,738	7,818	7,818	7,818	7,818
Reserves & surplus	157,161	186,767	217,104	253,434	295,617
Shareholders' funds	**164,899**	**194,586**	**224,922**	**261,253**	**303,435**
Minorities interests	1,408	1,571	2,385	3,199	4,013
Total Debt	1,439	1,587	1,305	1,305	1,305
Capital Employed	**167,746**	**197,744**	**228,612**	**265,756**	**308,753**
Net fixed assets	105,372	124,038	132,832	141,216	148,951
Cash & Cash Eq.	24,269	31,301	27,315	53,205	83,973
Net Other current assets	(2,597)	(1,009)	25,029	25,144	26,948
Investments	48,678	52,068	52,827	56,377	59,927
Net Deferred tax Assets	(7,958)	(8,658)	(9,394)	(10,190)	(11,049)
Total Assets	**167,746**	**197,744**	**228,612**	**265,756**	**308,753**

Source: Company, Karvy Institutional Research

Exhibit 15: Cash Flow Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
PBT	74,349	91,682	108,377	128,644	149,194
Depreciation	6,991	7,455	8,241	8,716	9,366
Tax	(22,784)	(24,153)	(33,402)	(39,084)	(45,391)
Change in Wkg Cap	807	(7,983)	(26,038)	(116)	(1,804)
CF from Operations	**55,087**	**59,771**	**58,060**	**98,974**	**112,185**
Capex	(14,894)	(24,090)	(17,035)	(17,100)	(17,100)
Investments	2,747	(1,044)	(758)	(3,550)	(3,550)
CF from Investing	**(8,713)**	**(19,772)**	**(17,794)**	**(20,650)**	**(20,650)**
Change in Equity	9,038	7,650	-	-	-
Change in Debt	(105)	48	(280)	-	-
Dividends & others	(44,564)	(40,671)	(43,206)	(51,744)	(60,078)
CF from Financing	**(35,797)**	**(33,167)**	**(44,250)**	**(52,434)**	**(60,768)**
Change in Cash	10,577	6,832	(3,984)	25,890	30,767

Source: Company, Karvy Institutional Research

Exhibit 16: Key Ratios

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Raw Material Cost/Sales (%)	36.4	36.8	35.1	34.8	34.8
Manpower Cost/Sales (%)	7.8	7.4	7.6	7.5	7.4
Operating & Other Cost/Sales (%)	22.5	22.0	22.5	22.6	22.7
Revenue Growth (%)	16.4	17.5	15.5	17.4	16.4
EBITDA Margins (%)	33.3	33.8	34.8	35.1	35.0
Net Income Margins (%)	22.2	23.9	24.3	24.8	24.8
ROCE (%)	44.2	44.7	46.0	46.9	46.9
ROE (%)	30.1	32.2	32.7	33.7	33.7

Source: Company, Karvy Institutional Research

Exhibit 17: Valuation Parameters

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
EPS (Rs.)	6.3	8.0	9.4	11.3	13.1
P/E (x)	45.3	35.9	30.5	25.5	21.9
BV (Rs)	21.1	24.9	28.8	33.4	38.8
P/BV (x)	13.6	11.5	10.0	8.6	7.4
EV/EBITDA (x)	29.3	24.5	20.6	17.1	14.5
Fixed assets turnover ratio (x)	2.1	2.1	2.3	2.5	2.8
Net Debt/Equity (x)	(0.1)	(0.2)	(0.1)	(0.2)	(0.3)
EV/Sales	9.8	8.3	7.2	6.0	5.1

Source: Company, Karvy Institutional Research

FMCG

October 18, 2012

Hindustan Unilever

INITIATION REPORT

Bloomberg: HUVR IN
Reuters: HLL.BO

HOLD

Performance to Sustain; Stock Fairly Valued

Hindustan Unilever (HUL) – India's largest FMCG manufacturer – is the classic case of change in DNA with its Sales growth, EBITDA margin and Valuation rising sharply as compared to the respective historical averages. Apart from showing robust performance in the past six-seven quarters, the counter has also improved visibility of its performance, going forward with the Company's Management becoming more aggressive. We expect HUL can sustain its current performance in ensuing period as well, on the back of several drivers i.e. multiple launches and re-launches, expansion of distribution channel, aggressive activities at field level, and vigorous foray into low-penetration and high-margin opportunities with a thrust on premium products.

Strong Sales Growth Momentum Likely to Continue: We expect HUL should clock 15.7% sales growth in FY12-15E period, higher than sales CAGR of 12% in FY09-12 period. We expect Soap & Detergent (S&D) segment would deliver 14.8% sales CAGR in FY12-15E period, higher than 10% sales CAGR seen in FY09-12 period. Its S&D segment reported average 24% growth in the past four quarters, which boosts our confidence of sustaining high growth momentum, going forward, while expansion of distribution channel, consistent launches and re-launches and premiumisation would augur well for HUL. In Personal Products (PP) segment, we expect HUL to maintain high sales growth momentum and should report 17.3% sales CAGR in FY12-15E period compared to 17.5% sales CAGR in FY09-12 period.

Profitability to Improve: We expect HUL's EBITDA margin would continue to be in the healthy range of 15.1-15.3% in FY12-15E period on account of better growth from premium segment, several cost-control initiatives and softening of prices of the key raw materials.

Outlook & Valuation

Consistent positive surprises that HUL has displayed in the past six-seven quarters and aggressive approach of the top management have lifted our confidence for better long-term prospects of the Company. We value HUL at P/E of 30x (1.8x PEG) on 24-month forward earnings, which is higher than its historical average P/E but lower than its past five years PEG of 2.4x. We initiate coverage on the Company with **"HOLD"** recommendation with target price of Rs. 576 per share having 1% upside potential.

Key Financials

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Revenue	200,185	234,363	271,308	314,168	363,374
EBITDA	27,045	34,837	41,312	48,175	55,490
Net Profits (Adj)	21,336	26,998	32,652	38,121	43,854
EPS (Rs)	9.9	12.5	15.1	17.6	20.3
PER (x)	58.2	46.0	38.1	32.6	28.3
P/BV (x)	45.4	33.8	28.1	23.8	20.4
EV/EBITDA (x)	44.8	34.4	28.9	24.6	21.1

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs573
Target Price:	Rs576
Upside (%)	1%

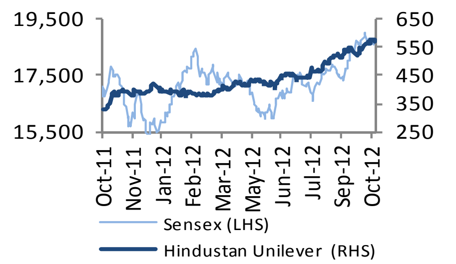
Stock Information

Market Cap. (Rs bn / US$ mn)	1,239/23,413
52-week High/Low (Rs)	580/325
3m ADV (Rs mn /US$ mn)	1,335/25.2
Beta	0.6
Sensex/ Nifty	18,611/5,660
Share outstanding (mn)	2,162

Stock Performance (%)

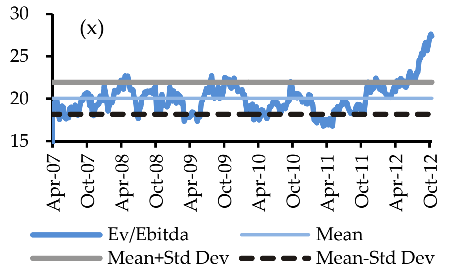
	1M	3M	12M	YTD
Absolute	7.7	29.0	71.6	40.7
Rel. to Sensex	7.4	18.6	57.0	16.8

Performance



Source: Bloomberg

1 Year Forward EV/EBITDA



Source: Karvy Institutional Research

Analysts Contact

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Company Financial Snapshot

Profit & loss

Rs mn	FY13E	FY14E	FY15E
Net sales	271,308	314,168	363,374
EBIDTA	41,312	48,175	55,490
Depreciation	2,316	2,540	2,736
Interest Expense	-	-	-
PBT	42,541	49,657	57,117
Tax	9,784	11,421	13,137
Adj. PAT	32,652	38,121	43,854
EPS (Rs)	15.1	17.6	20.3
DPS (Rs)	10.0	12.0	14.0
Profit and Loss Ratios			
EBIDTA Margin %	15.2	15.3	15.3
Adj. Net Margin %	12.0	12.1	12.1
Valuation Multiples			
P/E (X)	38.1	32.6	28.3
EV/EBIDTA (X)	28.9	24.6	21.1
EV/Sales (X)	3.9	3.3	2.9

Company Background

Hindustan Unilever (HUL) – the largest FMCG manufacturer in India – was formed in 1933 as Lever Brothers India.

In 1956, the Company was rechristened as Hindustan Lever (HLL) through a merger of Lever Brothers, Hindustan Vanaspasti Manufacturing Company and United Traders. Subsequently, in mid-2007, the Company was again rechristened to its present name.

HUL has presence in segments like Soaps, Detergents, Skin Care, Oral Care, Hair Care, Staple Foods and Beverages etc.

Hindustan Unilever is owned by Anglo-Dutch consumer goods giant Unilever that holds ~52% stake in the Company. HUL is one of the key scrip in the benchmark indices with ~4% weightage in Sensex.

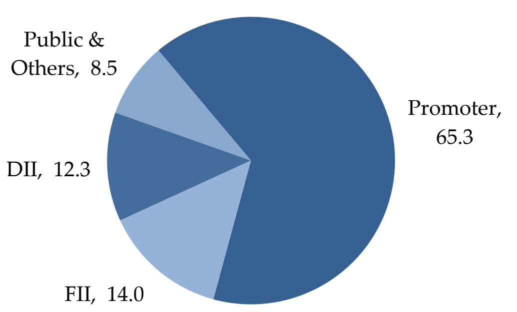
Balance Sheet

Rs mn	FY13E	FY14E	FY15E
Total Assets	**123,129**	**140,888**	**161,483**
Net Fixed Assets	25,589	26,548	27,312
Current Assets	72,521	86,821	104,151
Other Assets	25,019	27,519	30,019
Total Liabilities	123,129	140,888	161,483
Net worth	44,282	52,185	60,785
Debt	-	-	-
Current Liabilities	80,464	90,009	101,682
Deferred Tax & Minority Int	(1,617)	(1,307)	(984)
Balance Sheet Ratios			
RoE %	73.7	73.0	72.1
RoCE %	92.7	91.6	90.5
Net Debt/Equity	(0.5)	(0.6)	(0.7)
Equity/Total Assets	0.4	0.4	0.4
P/BV (X)	25.0	21.4	18.4

Cash Flow

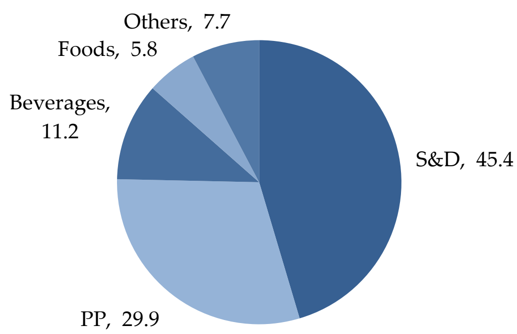
Rs mn	FY13E	FY14E	FY15E
PBT	42,541	49,657	57,117
Depreciation	2,316	2,540	2,736
Tax	(9,589)	(11,226)	(12,942)
Change in Wkg Cap	(1,850)	2,418	3,327
CF from Operations	**33,417**	**43,389**	**50,239**
Capex	(3,000)	(3,500)	(3,500)
Investments	(1,798)	(2,500)	(2,500)
CF from Investing	**(4,798)**	**(6,000)**	**(6,000)**
Change in Equity	-	-	-
Change in Debt	-	1	1
Dividends & others	(25,181)	(30,218)	(35,254)
CF from Financing	**(25,181)**	**(30,217)**	**(35,253)**
Change in Cash	3,438	7,172	8,986

Shareholding Pattern (%)



Source: BSE

Revenue Mix (%)

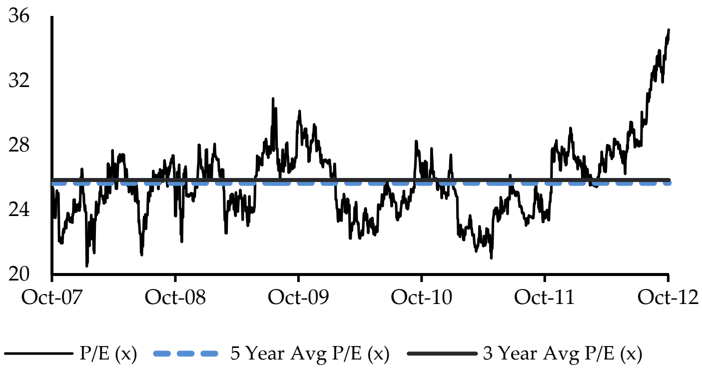


Source: Company

Outlook & Valuation

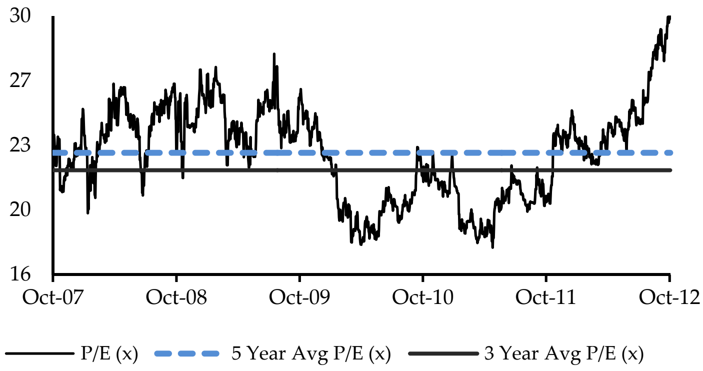
Consistent positive surprises that HUL has displayed in the past six-seven quarters and aggressive approach of the top management have lifted our confidence for better long-term prospects of the Company. We value HUL at P/E of 30x (1.7x PEG) on 24-month forward earnings, which is higher than its historical average P/E but lower than its past five years PEG of 2.4x. We initiate coverage on the Company with **"HOLD"** recommendation with target price of Rs. 576 per share having 1% upside potential.

Exhibit 1: HUL P/E Band (12-month Fwd Earnings)



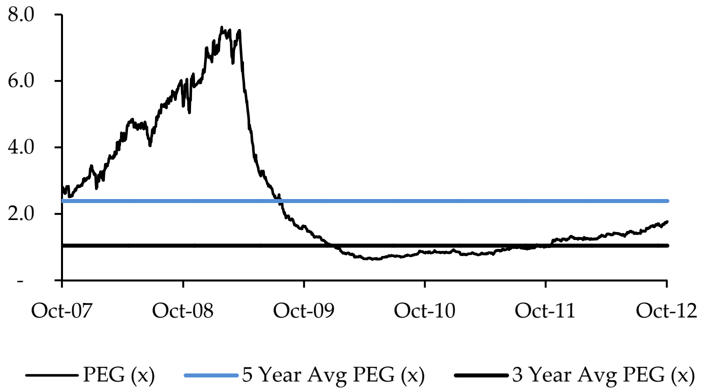
Source: Bloomberg, Karvy Institutional Research

Exhibit 2: HUL P/E Band (24-month Fwd Earnings)



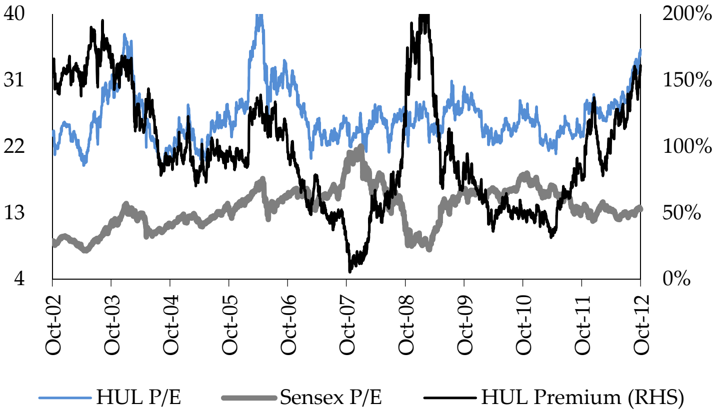
Source: Bloomberg, Karvy Institutional Research

Exhibit 3: HUL's Past 5 Year PEG (x)



Source: Company, Karvy Institutional Research

Exhibit 4: HUL and Sensex Valuation Comparison



Source: Company, Karvy Institutional Research

Rationale for "HOLD" Recommendation

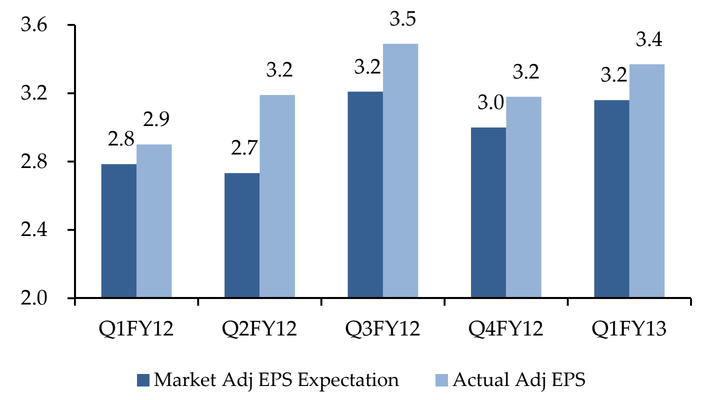
Our investment argument is based on following premises:

1. Multiple Factors to Drive Business – HUL to Sustain Current Performance
2. Growth Momentum to Continue in S&D Segment
3. Operational Consistency in Personal Products Segment

1. Multiple Factors to Drive Business – HUL to Sustain Current Performance

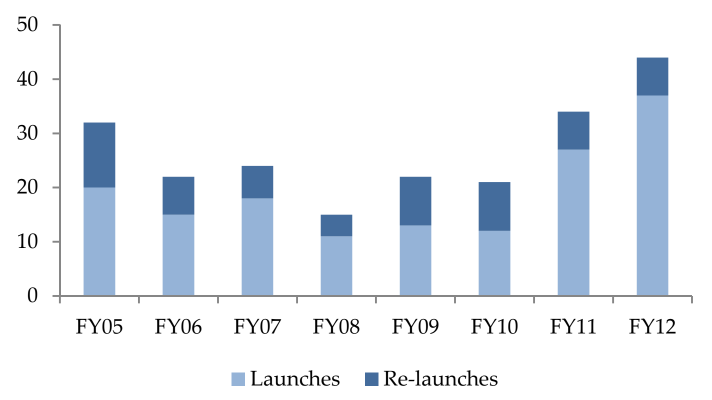
Hindustan Unilever (HUL) is the classic case of change in DNA with its sales growth, EBITDAM and valuation rising sharply as compared to the respective historical averages. Apart from showing robust performance in the past six-seven quarters, the counter has also improved visibility of its performance, going forward with the Company's Management becoming more aggressive.

Exhibit 5: HUL Consistently Surpassed Expectation



Source: Bloomberg, Karvy Institutional Research

Exhibit 6: Aggressive Launches & Re-launches



Source: Company, Karvy Institutional Research

Our View: HUL can sustain its current performance in ensuing period on the back of several drivers i.e. multiple launches/re-launches, expansion of distribution channel, aggressive activities at field level, and vigorous foray into low-penetration and high-margin opportunities with a thrust on premium products.

2. Growth Momentum to Continue in S&D Segment

HUL surprisingly reported strong sales growth in S&D segment in the past four-five quarters, primarily driven by premiumisation, with better soaps growth in FY12 – *although relatively slower than its competitors i.e. GCPL, Wipro and Reckitt Benckiser* – surpassing the growth recorded in the previous two fiscals, due to strong regional grip. In the detergent segment, HUL has shown sharp 29% growth in FY12 – far ahead of single digit growth recorded in FY10 & FY11. We believe that this growth was a good mix of volume and price, with the price growth ahead of volume growth.

Our View: Despite higher penetration level of S&D segment, rise in consumption-level amid rising consumers' preference for branded products would aid HUL in registering healthy volume growth, going forward.

Exhibit 7: Soap Players' Performance

Soaps	FY08	FY09	FY10	FY11	FY12
HUL	8.3	13.2	8.3	5.7	9.2
Reckitt Benckiser	25.0	36.1	29.8	22.5	14.1
Nirma	(3.4)	6.5	1.8	(2.4)	na
GCPL	19.3	26.0	16.1	(3.9)	27.6
Wipro	25.6	26.4	17.8	12.4	30.8
Jyothy Labs (Inc Henkel India)	(4.9)	13.9	7.0	(0.1)	7.4

Source: Company, Karvy Institutional Research

Exhibit 8: Detergent Players' Performance

Detergent	FY08	FY09	FY10	FY11	FY12
HUL	17.8	32.9	(0.4)	6.4	29.2
Nirma	12.6	22.0	(19.6)	(11.2)	na
P&G	29.2	31.5	7.2	24.0	na
Rohit Surfactants	42.0	24.4	20.2	na	na
Jyothy Labs (Inc Henkel India)	34.4	14.0	8.7	(1.3)	0.4

Source: Company, Karvy Institutional Research

Exhibit 9: S&D Quarterly Performance

Particulars	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Revenue (Rs mn)	22,115	20,037	20,719	19,785	22,645	21,294	21,929	22,048	25,550	25,926	26,460	28,344	31,631
Revenue growth YoY (%)	9.5	0.9	(2.4)	(1.7)	2.4	6.3	5.8	11.4	12.8	21.8	20.7	28.6	23.8
Revenue Mix (%)	48.8	46.9	45.2	45.2	46.6	44.8	42.8	44.5	45.8	46.3	44.5	49.2	49.7
PBIT Margin (%)	17.2	13.6	13.4	12.8	11.0	11.7	7.7	7.5	9.2	12.4	13.5	11.3	12.2
PBIT Mix (%)	52.4	39.9	35.3	41.7	36.6	37.5	23.0	25.4	30.9	38.4	36.4	38.1	39.5

Source: Company, Karvy Institutional Research

3. Operational Consistency in Personal Products Segment

Hindustan Unilever (HUL) has wide range of products in Personal Products (PP) segment covering Skin Care, Oral Care, Hair Care and Personal Care products etc. This is the most critical segment for HUL accounting for ~30 of sales and ~50% of profitability of the Company. HUL has consistently maintained its superior operational performance despite stiff competition from the domestic and MNC players i.e. Dabur, Marico, Emami, L'Oreal, Johnson & Johnson, P&G and Beiersdorf AG (Nivea) etc. though focus on premium segment, consistent new launches, brand extension. HUL's Skin care sub-segment – *contributing ~50% to the segment's EBITDA* – looks to be more promising with tremendous growth potential owing to higher consumption. We believe that the PP segment would continue aid HUL on profitability front, going forward, as the change in consumers' life style will result in higher consumption.

Our View: Bulky product portfolio in each sub-segment would make HUL more competitive. Strong growth in skin care sub-segment would annul profitability pressure in other sub-segments i.e. shampoo and oral care, while enabling HUL to maintain better profitability in the segment as a whole.

Exhibit 10: Brand Extension

Brand	Presence
Dove	Shampoo, Soap, Body Lotion, Deodorant, Conditioner, Hair Care
Vaseline	Petroleum Jelly, Lip care, Body Lotion
Pears	Soap, Face wash, Hand wash
Pond's	Skin Care, Talc, Face wash
Liril	Soap, Talc
Lux	Soap, Shampoo
Sunsilk	Shampoo, Conditioner
Rexona	Soap, Deodorant
Lakme	Skin Care, Color Cosmetics

Source: Company, Karvy Institutional Research

Exhibit 11: Our Estimate for PP Business Mix

Categories	Sales Mix (%)	EBITDA Mix (%)
Skin Care	~38%	~48%
Shampoo	~24%	~16%
Oral Care	~15%	~10%
Color Cosmetics	~9%	~11%
Deodorant	~4%	~10%
Others	~10%	~6%

Source: Company, Karvy Institutional Research

Exhibit 12: PP Quarterly Performance

Particulars	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Revenue (Rs mn)	12,255	11,902	13,770	12,552	13,655	13,648	16,547	14,591	16,307	16,126	18,862	17,109	18,471
Revenue growth YoY (%)	14.7	13.4	15.5	20.9	11.4	14.7	20.2	16.2	19.4	18.2	14.0	17.3	13.3
Revenue Mix (%)	27.0	27.8	30.0	28.7	28.1	28.7	32.3	29.4	29.2	28.8	31.7	29.7	29.0
PBIT Margin (%)	22.0	26.3	31.9	21.8	24.8	23.0	28.8	25.0	25.3	24.4	25.9	26.3	25.8
PBIT Mix (%)	37.0	45.8	55.9	45.2	49.9	47.0	64.9	55.9	54.1	47.2	49.9	53.4	48.7

Source: Company, Karvy Institutional Research

Exhibit 13: HUL Business Snapshot

Business Mix	Sales Mix (%)			Sales CAGR (%)		PBIT Margin (%)			PBIT Mix (%)			PBIT CAGR (%)	
	FY09	FY12	FY15E	FY09-12	FY12-15E	FY09	FY12	FY15E	FY09	FY12	FY15E	FY09-12	FY12-15E
Soaps and Detergents	47.4	45.4	44.5	10.3	14.8	15.0	11.6	11.0	45.8	35.0	33.1	1.3	12.9
Personal Products	25.8	29.9	31.3	17.5	17.5	26.6	24.9	25.0	44.2	49.5	52.9	14.9	17.7
Beverages	11.0	11.2	10.3	12.4	12.7	13.4	14.0	15.0	9.5	10.4	10.5	14.0	15.4
Foods	5.0	5.8	6.7	17.4	21.2	1.0	1.8	3.1	0.3	0.7	1.4	43.4	45.2

Source: Company, Karvy Institutional Research

Exhibit 14: Key Assumptions

Key Assumptions	FY11	FY12E	FY13E	FY14E	FY15E
Soaps Sales Growth (%)	5.7	9.2	10.3	11.3	11.7
Detergents Sales Growth (%)	6.4	29.2	19.5	16.7	15.7
Personal Care Sales Growth (%)	16.0	9.8	25.7	18.0	17.8
Beverages Sales Growth (%)	9.4	11.7	13.1	12.6	12.6
Food Sales Growth (%)	23.5	11.4	21.2	21.2	21.2
EBITDA Change (bps)	(223.1)	135.4	36.3	10.7	(6.3)
Effective Tax Rate (%)	21.6	23.4	23.0	23.0	23.0

Source: Company, Karvy Institutional Research

Financials - Consolidated

Exhibit 15: Profit and Loss Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Net Revenues	200,185	234,363	271,308	314,168	363,374
% Growth	11.1	17.1	15.8	15.8	15.7
Raw Material	102,387	125,017	140,195	160,589	185,394
Staff	10,120	12,009	13,717	15,911	18,457
Other Expenses	60,634	62,502	76,084	89,493	104,032
Total Expenditures	173,140	199,527	229,995	265,993	307,883
EBITDA	27,045	34,837	41,312	48,175	55,490
% Growth	(4.7)	28.8	18.6	16.6	15.2
EBITDA Margins (%)	13.5	14.9	15.2	15.3	15.3
Other Income	2,618	2,596	3,545	4,023	4,363
Interest	10	17	-	-	-
Depreciation	2,293	2,335	2,316	2,540	2,736
Profit Before Tax	27,360	35,081	42,541	49,657	57,117
Provision for tax	5,919	8,215	9,784	11,421	13,137
Effective tax rate (%)	21.6	23.4	23.0	23.0	23.0
Reported PAT	22,960	27,908	37,188	38,121	43,854
% Growth	6.5	21.5	33.3	2.5	15.0
Adjusted Net Profit	21,336	26,998	32,652	38,121	43,854
% Growth	1.7	26.5	20.9	16.7	15.0

Source: Company, Karvy Institutional Research

Exhibit 16: Balance Sheet

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Equity Share Capital	2,160	2,162	2,162	2,162	2,162
Reserves & surplus	25,190	34,649	42,120	50,024	58,624
Shareholders' funds	**27,350**	**36,811**	**44,282**	**52,185**	**60,785**
Minorities interests	149	183	287	403	531
Total Debt	-	-	-	-	-
Capital Employed	**27,499**	**36,994**	**44,569**	**52,588**	**61,316**
Net fixed assets	25,126	24,905	25,589	26,548	27,312
Cash & Cash Eq.	17,757	19,964	23,403	30,575	39,561
Net Other current assets	(29,343)	(33,196)	(31,346)	(33,764)	(37,091)
Investments	11,885	23,222	25,019	27,519	30,019
Net Deferred tax Assets	2,074	2,100	1,905	1,710	1,515
Total Assets	**27,499**	**36,994**	**44,569**	**52,588**	**61,316**

Source: Company, Karvy Institutional Research

Exhibit 17: Cash Flow Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
PBT	27,360	35,080	42,541	49,657	57,117
Depreciation	2,293	2,335	2,316	2,540	2,736
Tax	(6,710)	(6,948)	(9,589)	(11,226)	(12,942)
Change in Wkg Cap	(1,473)	(7,545)	(1,850)	2,418	3,327
CF from Operations	**19,235**	**20,502**	**33,417**	**43,389**	**50,239**
Capex	(3,227)	(2,734)	(3,000)	(3,500)	(3,500)
Investments	(4,109)	(5,789)	(1,798)	(2,500)	(2,500)
CF from Investing	**(3,272)**	**(5,129)**	**(4,798)**	**(6,000)**	**(6,000)**
Change in Equity	-	-	-	-	-
Change in Debt	-	-	-	1	1
Dividends & others	(22,832)	(8,442)	(25,181)	(30,218)	(35,254)
CF from Financing	**(22,842)**	**(8,459)**	**(25,181)**	**(30,217)**	**(35,253)**
Change in Cash	(6,879)	6,914	3,438	7,172	8,986

Source: Company, Karvy Institutional Research

Exhibit 18: Key Ratios

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Raw Material Cost/Sales (%)	51.1	53.3	51.7	51.1	51.0
Manpower Cost/Sales (%)	5.1	5.1	5.1	5.1	5.1
Operating & Other Cost/Sales (%)	30.3	26.7	28.0	28.5	28.6
Revenue Growth (%)	11.1	17.1	15.8	15.8	15.7
EBITDA Margins (%)	13.5	14.9	15.2	15.3	15.3
Net Income Margins (%)	10.7	11.5	12.0	12.1	12.1
ROCE (%)	98.4	94.2	92.7	91.6	90.5
ROE (%)	78.0	73.3	73.7	73.0	72.1

Source: Company, Karvy Institutional Research

Exhibit 19: Valuation Parameters

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
EPS (Rs.)	9.9	12.5	15.1	17.6	20.3
P/E (x)	58.2	46.0	38.1	32.6	28.3
BV (Rs)	12.7	17.0	20.5	24.1	28.1
P/BV (x)	45.4	33.8	28.1	23.8	20.4
EV/EBITDA (x)	44.8	34.4	28.9	24.6	21.1
Fixed assets turnover ratio (x)	8.0	9.4	10.6	11.8	13.3
Net Debt/Equity (x)	(0.6)	(0.5)	(0.5)	(0.6)	(0.7)
EV/Sales	6.1	5.1	4.4	3.8	3.2

Source: Company, Karvy Institutional Research

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FMCG October 18, 2012

Nestle India

INITIATION REPORT

Bloomberg: NEST IN
Reuters: NEST.BO

SELL

Seeking Volume Growth

In the last few quarters, Nestlé India has been witnessing pressure on volume front owing to consistent price hike, lower discretionary spend by the consumers and rising competition in most of the segments. On account of sluggish performance, the Company has underperformed BSE FMCG Index by ~30% in the past 12-month period.

Volume Growth Concern: Consistent price hike, low discretionary spending by consumers along with the rising competition in most of the categories has been impacting Nestlé India's volume growth in the last few quarters. Nestlé India has focused more towards high-value segments with higher profitability in H1CY12. However, the Company lost the momentum in the low-value segment. Hence, Nestlé India expanded the EBITDA margin even in the high inflationary scenario but could not maintain the volume growth momentum.

Limited Scope for Expansion in EBITDA margin: Nestlé has already expanded EBITDA margin in last 3-4 quarters by implementing steep price hike in most of the brands and change in revenue mix towards products with better margin. Hence, we see limited scope of improvement in the EBITDA margin, going forward. As Nestlé India would have to focus more on volume front, its pricing power on key brands is expected to come under pressure, which would limit the further expansion in EBITDA margin. Hence, we expect Nestlé India to maintain EBITDA margin at ~21% in CY12E to CY14E.

Pressure on Return Ratios: Higher capex on expanding manufacturing capacities and lower incremental demand has given significant pressure on Nestlé India return profile. The Company's RoCE & RoE are expected to be 67% and 65% by CY12-end, compared to 140% & 96% in CY10.

Outlook & Valuation

Nestlé India has been the laggard in the FMCG space in last 12 months owing to slow volume growth and pressure on return ratios. The Company couldn't sustain its high valuations due to performance issue hence its valuations premium has declined to 25% vs. 40% a year back. Assuming 31x (PEG of 1.9x) multiple on 24-month forward earnings, we initiate coverage on the Company with **"SELL"** recommendation with a target price at Rs4,564 having 4% downside potential.

Key Financials

Y/E Mar (Rs mn)	CY10	CY11	CY12E	CY13E	CY14E
Revenue	62,609	74,994	85,126	100,262	117,610
EBITDA	12,559	15,614	18,447	21,381	25,030
Net Profits (Adj)	8,188	9,616	10,608	12,203	14,594
EPS (Rs)	84.9	99.7	110.0	126.6	151.4
PER (x)	56.1	47.7	43.3	37.6	31.4
P/BV (x)	53.7	36.0	27.7	24.3	22.1
EV/EBITDA (x)	36.2	29.8	25.4	21.9	18.4

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs4,760
Target Price:	Rs4,564
Downside (%)	4%

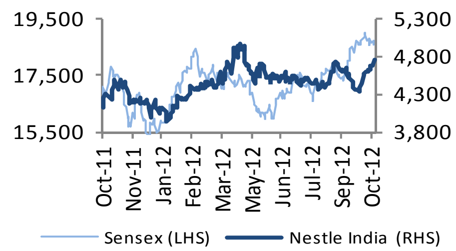
Stock Information

Market Cap. (Rs bn / US$ mn)	459/8,674
52-week High/Low (Rs)	5,429/3,925
3m ADV (Rs mn /US$ mn)	147/2.8
Beta	0.5
Sensex/ Nifty	18,611/5,660
Share outstanding (mn)	96

Stock Performance (%)

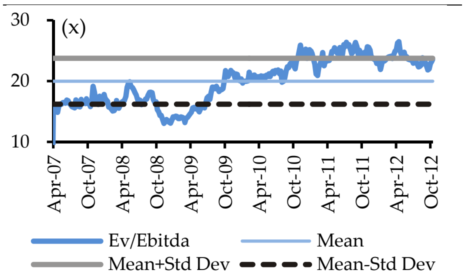
	1M	3M	12M	YTD
Absolute	6.7	5.8	14.6	16.2
Rel. to Sensex	6.3	(2.7)	4.8	(3.5)

Performance



Source: Bloomberg, Karvy Institutional Research

1 Year Forward EV/EBITDA



Source: Bloomberg, Karvy Institutional Research

Analysts Contact

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Company Financial Snapshot

Profit & loss

Particulars (Rs mn)	CY12E	CY13E	CY14E
Net sales	85,126	100,262	117,610
EBIDTA	18,447	21,381	25,030
Depreciation	2,504	3,560	3,900
Interest Expense	538	807	792
PBT	15,374	17,187	20,555
Tax	4,766	4,984	5,961
Adj. PAT	10,608	12,203	14,594
EPS (Rs)	110.0	126.6	151.4
DPS (Rs)	60.5	72.6	90.8
Profit and Loss Ratios			
EBIDTA Margin %	21.7	21.3	21.3
Adj Net Margin %	12.5	12.2	12.4
Valuation Multiples			
P/E (X)	43.3	37.6	31.4
EV/EBIDTA (X)	25.4	21.9	18.4
EV/Sales (X)	5.5	4.7	3.9

Company Background

Nestlé India – *a subsidiary of Nestle SA* – has been operating in India for around nine decades making it one of the oldest and the biggest players in the domestic FMCG segment.

The Company has a wide array of products and its key brands are: "Milk", "Natural Dahi", "Everyday" dairy whitener, "Maggi" noodles, "Nescafe" coffee, "Sunrise" coffee, "Iced Tea", "Kit Kat", "Polo", "Milky Bar", and "Bar-one" etc.

With an eye over the changes lifestyle of people in India, Nestlé India has continuously been focusing on innovating new products, renovating the existing products, while offering high-quality products at affordable prices.

Nestlé India is implementing huge capex programme to expand manufacturing capacities domestically, which suggests its parent company's high focus in the emerging market.

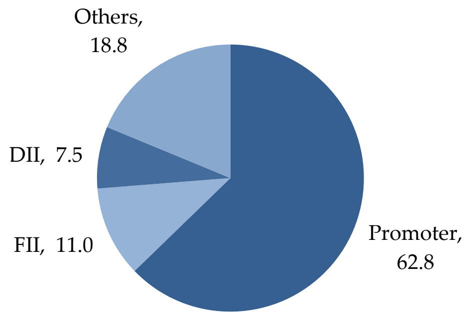
Balance Sheet

Rsmn	CY10	CY11E	CY12E
Total Assets	**51,506**	**58,647**	**62,382**
Net Fixed Assets	36,440	39,880	35,980
Current Assets	13,562	17,263	24,897
Other Assets	1,505	1,505	1,505
Total Liabilities	**51,507**	**58,648**	**62,382**
Net worth	16,573	18,856	20,740
Debt	12,708	14,208	12,208
Current Liabilities	21,666	24,899	28,624
Deferred Tax & Minority Int.	560	685	810
Balance Sheet Ratios			
RoE %	64.0	64.7	70.4
RoCE %	63.0	64.7	76.0
Net Debt/Equity	0.7	0.6	0.2
Equity/Total Assets	0.6	0.6	0.6
P/BV (X)	27.7	24.3	22.1

Cash Flow

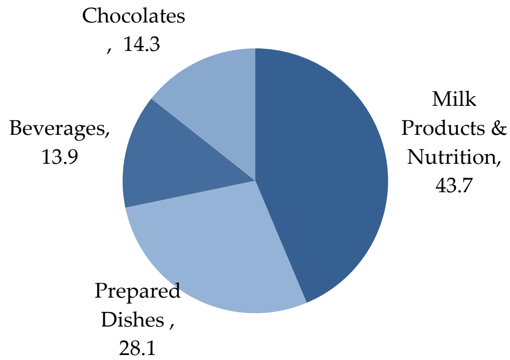
Rs mn	CY12E	CY13E	CY14E
PBT	15,374	17,187	20,555
Depreciation	2,504	3,560	3,900
Tax	(4,641)	(4,859)	(5,836)
Change in Wkg Cap	(677)	1,134	1,345
CF from Operations	13,098	17,830	20,756
Capex	(9,000)	(7,000)	-
Investments	(161)	-	-
CF from Investing	(9,161)	(7,000)	-
Change in Equity	-	-	-
Change in Debt	3,000	1,500	(2,000)
Dividends & others	(5,835)	(8,542)	(10,945)
CF from Financing	(4,313)	(9,227)	(15,503)
Change in Cash	**-376**	**1603**	**5254**

Shareholding Pattern (%)



Source: BSE

Revenue Mix (%)

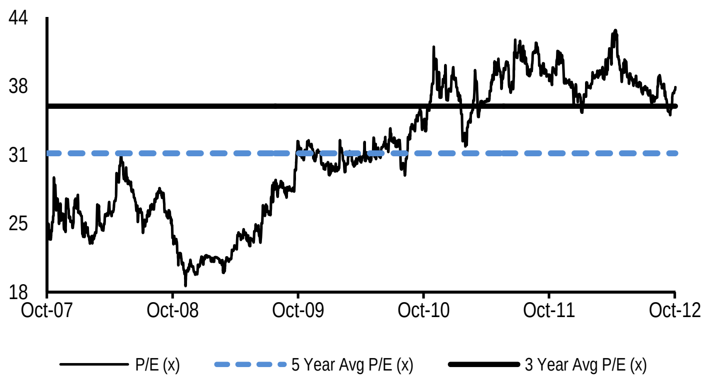


Source: Company

Outlook & Valuation

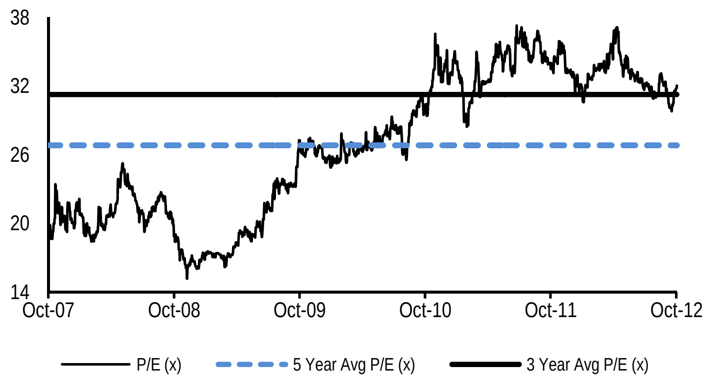
Nestlé India is among the least performers in the FMCG space in last 12 months owing to slow volume growth and pressure on return rations. The Company couldn't sustain its high valuations due to performance issue hence its valuations premium has declined to 25% vs. 40% a year back. Assuming 31x(PEG of 1.9x) multiple on 24-month forward earnings, we initiate coverage on the Company with **"SELL"** recommendation with a target price at Rs4,564 having 4% downside potential.

Exhibit 1: Nestle P/E Band (12-month Fwd)



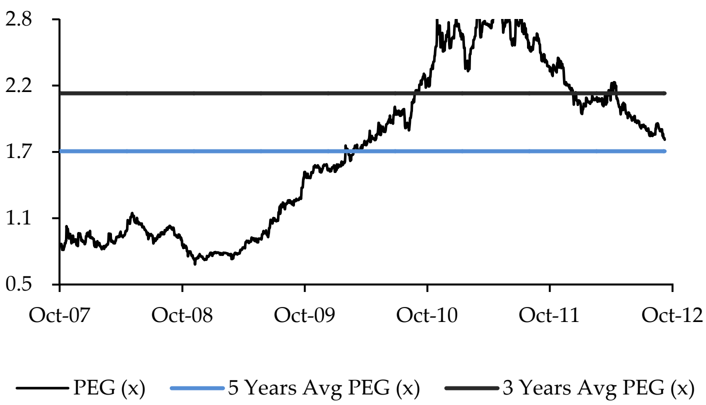
Source: Bloomberg, Karvy Institutional Research

Exhibit 2: Nestle P/E Band (24-month Fwd)



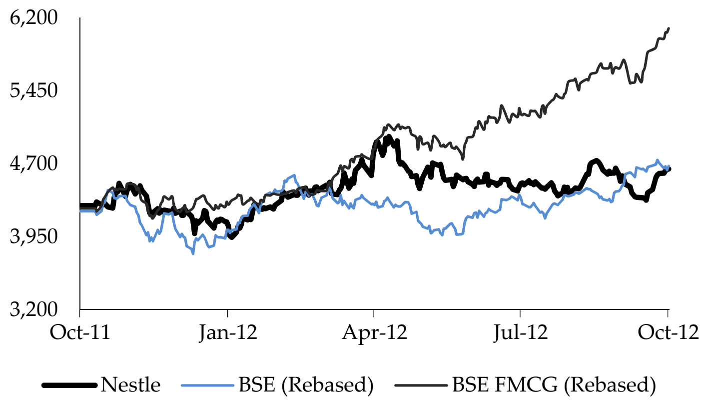
Source: Bloomberg, Karvy Institutional Research

Exhibit 3: PEG (x) Band



Source: Company, Karvy Institutional Research

Exhibit 4: Relative Stock Return



Source: Company, Karvy Institutional Research

Rationale for "SELL" Recommendation

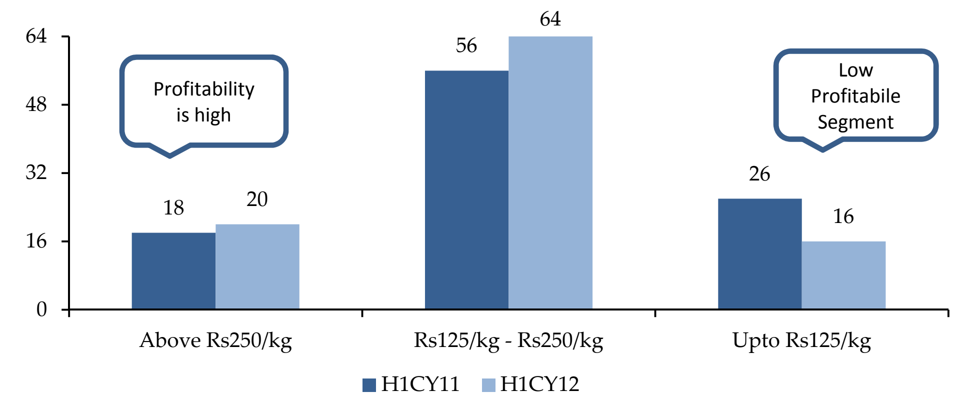
Our investment argument is based on following premises:

1. Uneven Revenue Mix – Low-Value Segment Drags Overall Volume
2. Restricted Scope of Further Expansion in EBITDA Margin
3. Pressure on Return Ratios – Marginal Improvement Likely in CY14E

1. Change in Revenue Mix – Low-Value Segment Drags Overall Volume

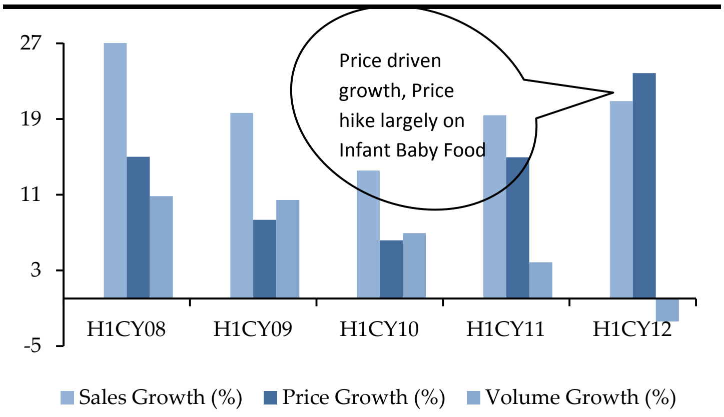
Consistent price hike, low discretionary spending by consumers along with the rising competition in most of the categories has been impacting Nestlé India's volume growth in the last few quarters. Nestlé India has focused more towards high-value segments with higher profitability in H1CY12. However, the Company lost the momentum in the low-value segment. Hence, Nestlé India expanded the EBITDA margin even in the high inflationary scenario but could not maintain the volume growth momentum.

Exhibit 5: Revenue Mix Skewed towards Profitable Segment



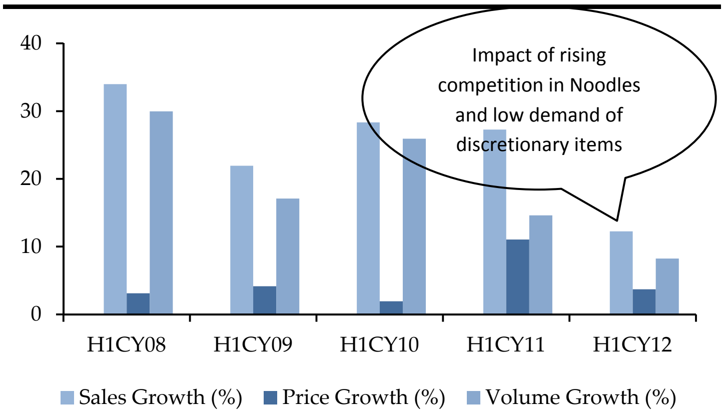
Source: Company, Karvy Institutional Research

Exhibit 6: Performance of Milk Products & Nutrition



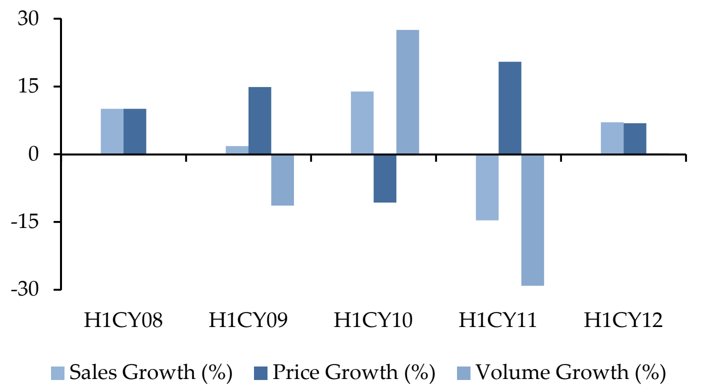
Source: Company, Karvy Institutional Research

Exhibit 7: Performance of Prepared Dishes & Cooking



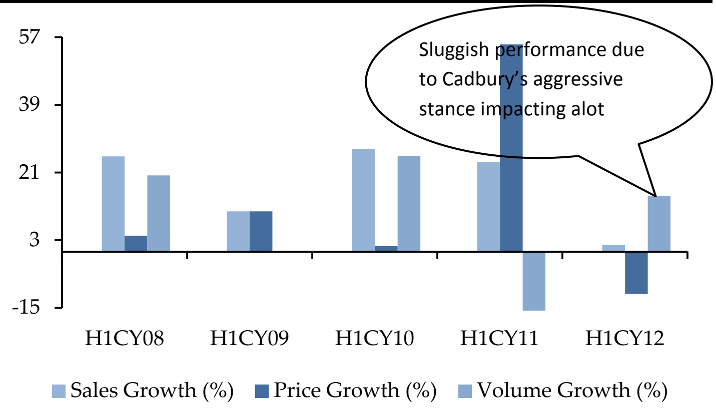
Source: Company, Karvy Institutional Research

Exhibit 8: Beverages Performance



Source: Company, Karvy Institutional Research

Exhibit 9: Chocolates & Confectionary Performance



Source: Company, Karvy Institutional Research

Initiatives to Check the Pressure on Volume

Nestlé India has undertaken few initiatives including aggressive launches/promotional campaigns with a view to boosting volume especially to tap the rural market.

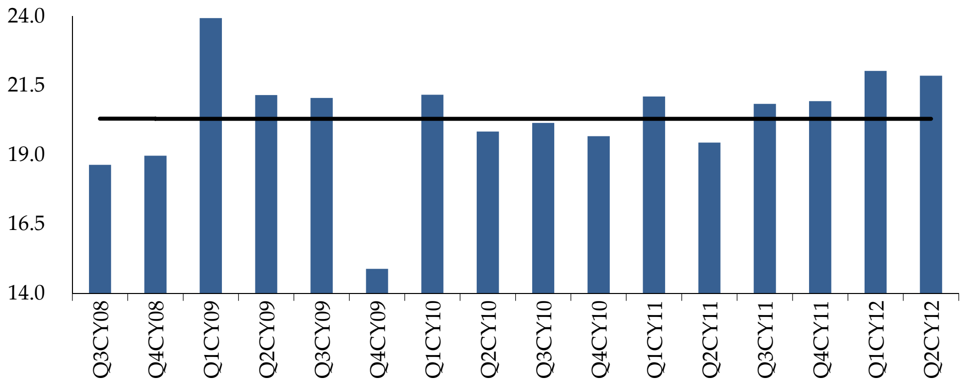
- Launch of Rs. 5 pack of Maggi and promoting it through Amitabh Bachchan,
- Launch of new chocolates under Dark Chocolate, and
- Expansion of Kit Kat portfolio.

Our View: Though new launches along with higher focus on rural market would help Nestlé India in recording better volume growth in coming quarters, the Company is not likely to achieve its long-term average volume growth of ~15% in the near to medium-term.

2. Restricted Scope of Further Expansion in EBITDA Margin

Nestlé India has already expanded EBITDA margin in the last 3-4 quarters by implementing steep price hike in most of the brands and change in the revenue mix towards products with better margin. Hence, we see limited scope of improvement in the EBITDA margin, going forward.

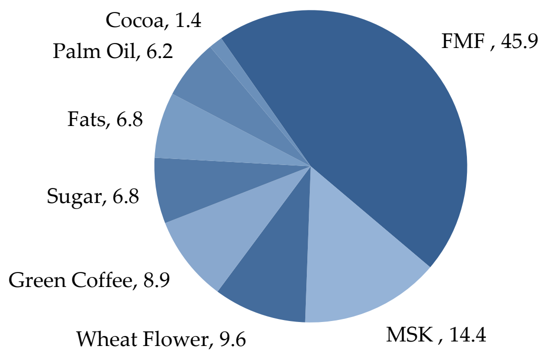
Exhibit 10: EBITDA Margin Trend (%)



Source: Company, Karvy Institutional Research

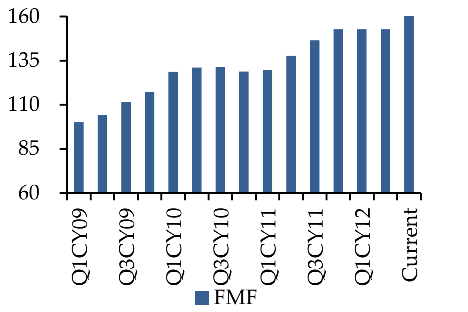
As the prices of key inputs are rising at slower pace compared to previous quarters, the gross profitability can be improved with marginal hike in the prices. However, we believe that higher marketing efforts to ensure volume growth would offset the improved profitability.

Exhibit 11: Raw Material Mix (%)



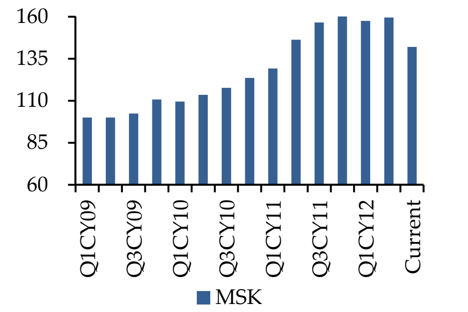
Source: Company, Karvy Institutional Research

Exhibit 12: FMF Prices



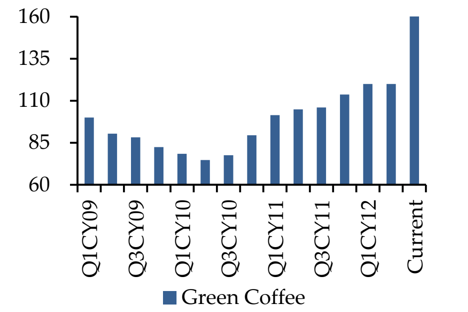
Source: Company, Karvy Institutional Research

Exhibit 13: MSK Prices



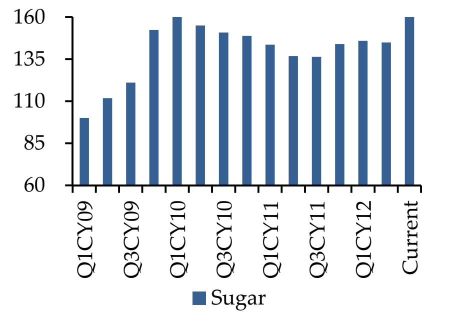
Source: Company, Karvy Institutional Research

Exhibit 14: Green Coffee Prices



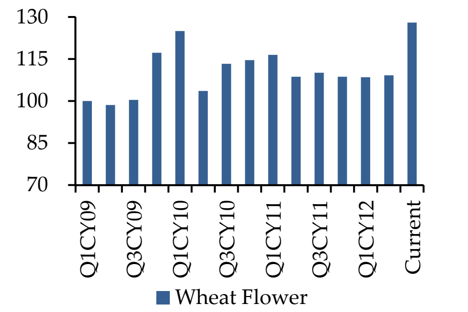
Source: Company, Karvy Institutional Research

Exhibit 15: Sugar Prices



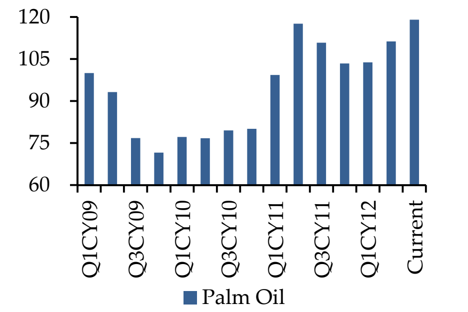
Source: Company, Karvy Institutional Research

Exhibit 16: Wheat Prices



Source: Company, Karvy Institutional Research

Exhibit 17: Palm Oil Prices



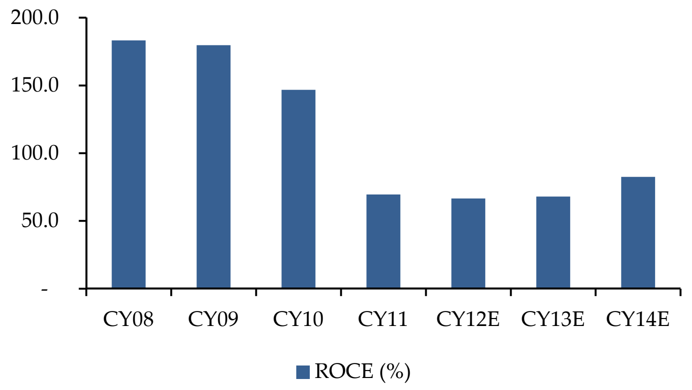
Source: Company, Karvy Institutional Research

Our View: As Nestlé India would have to focus more on volume front, its pricing power on key brands is expected to come under pressure, which would limit the further expansion in EBITDA margin. Hence, we expect Nestlé India to maintain EBITDA margin at ~21% in CY12E to CY14E.

3. Pressure on Return Ratios – Marginal Improvement Likely in CY14E

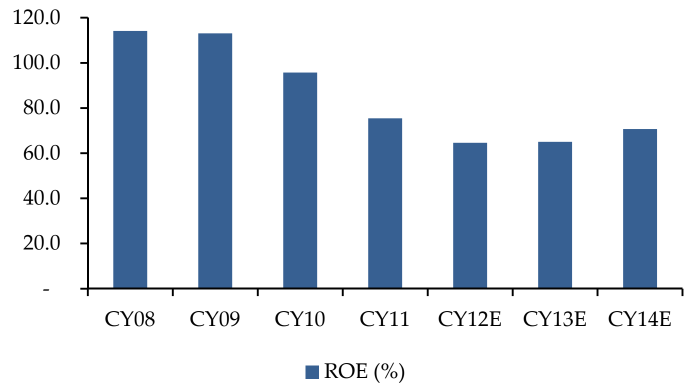
Higher capex on expanding manufacturing capacities and lower incremental demand has given significant pressure on Nestlé India return profile. The Company's RoCE & RoE are expected to be 67% and 65% by CY12-end, compared to 140% & 96% in CY10.

Exhibit 18: ROCE Trend and Expectation



Source: Company, Karvy Institutional Research

Exhibit 19: ROE Trend and Expectation



Source: Company, Karvy Institutional Research

Our View: Though higher focus on volume growth and better discretionary spend by the consumers would marginally improve Nestlé India's return profile in CY14E, it would be far to reach CY10 levels.

Exhibit 20: Key Assumptions

Key Assumptions	CY10	CY11	CY12E	CY13E	CY14E
Sales Growth (%)	21.8	19.8	13.5	17.8	17.3
Volume Growth (%)	17.0	6.8	12.7	12.9	13.2
Gross Margin (%)	51.2	52.1	54.2	53.9	53.9
SG&A (% of net Sales)	17.0	16.3	16.8	17.0	17.0
EBITDA Margin (%)	20.1	20.8	21.7	21.3	21.3
Effective tax rate (%)	28.5	30.7	31.0	29.0	29.0
DPS (Rs)	48.5	48.5	60.5	72.6	90.8

Source: Company, Karvy Institutional Research

Financials

Exhibit 21: Profit and Loss Statement

Y/E Dec (Rs mn)	CY10	CY11	CY12E	CY13E	CY14E
Net Revenues	62,609	74,994	85,126	100,262	117,610
% Growth	21.8	19.8	13.5	17.8	17.3
Raw Material	30,555	35,894	39,030	46,217	54,257
Staff	4,334	5,465	6,545	7,723	9,113
Other Expenses	15,160	18,021	21,105	24,941	29,211
Total Expenditures	50,050	59,380	66,679	78,881	92,581
EBITDA	12,559	15,614	18,447	21,381	25,030
% Growth	20.2	24.3	18.1	15.9	17.1
EBITDA Margins (%)	20.1	20.8	21.7	21.3	21.3
Other Income	365	422	542	747	790
Interest	11	51	538	807	792
Depreciation	1,278	1,533	2,504	3,560	3,900
Profit Before Tax	11,452	13,879	15,374	17,187	20,555
Provision for tax	3,264	4,264	4,766	4,984	5,961
Effective tax rate (%)	28.5	30.7	31.0	29.0	29.0
Reported PAT	8,188	9,616	10,608	12,203	14,594
% Growth	25.0	17.4	10.3	15.0	19.6
Adjusted Net Profit	8,188	9,616	10,608	12,203	14,594
% Growth	24.5	17.4	10.3	15.0	19.6

Source: Company, Karvy Institutional Research

Exhibit 22: Balance Sheet

Y/E Dec (Rs mn)	CY10	CY11	CY12E	CY13E	CY14E
Equity Share Capital	964	964	964	964	964
Reserves & surplus	7,590	11,775	15,608	17,892	19,776
Shareholders' funds	**8,554**	**12,740**	**16,573**	**18,856**	**20,740**
Total Debt	-	9,708	12,708	14,208	12,208
Capital Employed	**8,554**	**22,448**	**29,281**	**33,064**	**32,948**
Net fixed assets	13,616	29,943	36,440	39,880	35,980
Cash & Cash Eq.	2,553	2,271	1,895	3,498	8,751
Net Other current assets	(8,789)	(10,676)	(9,999)	(11,133)	(12,479)
Investments	1,505	1,344	1,505	1,505	1,505
Misc Exp not written off	-	-	-	-	-
Net Deferred tax Assets	(333)	(435)	(560)	(685)	(810)
Total Assets	**8,554**	**22,448**	**29,281**	**33,064**	**32,948**

Source: Company, Karvy Institutional Research

Exhibit 23: Cash Flow Statement

Y/E Dec (Rs mn)	CY10	CY11	CY12E	CY13E	CY14E
PBT	11,451	13,879	15,374	17,187	20,555
Depreciation	1,278	1,533	2,504	3,560	3,900
Tax	(3,207)	(3,640)	(4,641)	(4,859)	(5,836)
Change in Wkg Cap	756	(164)	(677)	1,134	1,345
CF from Operations	10,368	11,876	13,098	17,830	20,756
Capex	(4,459)	(15,552)	(9,000)	(7,000)	-
Investments	526	-	(161)	-	-
CF from Investing	(3,933)	(15,552)	(9,161)	(7,000)	-
Change in Equity	-	-	-	-	-
Change in Debt	-	8,652	3,000	1,500	(2,000)
Dividends & others	(4,654)	(4,649)	(5,835)	(8,542)	(10,945)
CF from Financing	(5,438)	3,232	(4,313)	(9,227)	(15,503)
Change in Cash	**997**	**(444)**	**(376)**	**1,603**	**5,254**

Source: Company, Karvy Institutional Research

Exhibit 24: Key Ratios

Y/E Dec	CY10	CY11	CY12E	CY13E	CY14E
Raw Material Cost/Sales (%)	48.8	47.9	45.8	46.1	46.1
Manpower Cost/Sales (%)	6.9	7.3	7.7	7.7	7.7
Operating & Other Cost/Sales (%)	24.2	24.0	24.8	24.9	24.8
Revenue Growth (%)	21.8	19.8	13.5	17.8	17.3
EBITDA Margins (%)	20.1	20.8	21.7	21.3	21.3
Net Income Margins (%)	13.1	12.8	12.5	12.2	12.4
ROCE (%)	146.8	69.6	63.0	64.7	76.0
ROE (%)	95.7	75.5	64.0	64.7	70.4

Source: Company, Karvy Institutional Research

Exhibit 25: Valuation Parameters

Y/E Dec	CY10	CY11	CY12E	CY13E	CY14E
EPS (Rs.)	84.9	99.7	110.0	126.6	151.4
P/E (x)	56.1	47.7	43.3	37.6	31.4
BV (Rs)	88.7	132.1	171.9	195.6	215.1
P/BV (x)	53.7	36.0	27.7	24.3	22.1
EV/EBITDA (x)	36.2	29.8	25.4	21.9	18.4
Fixed assets turnover ratio (x)	4.6	2.5	2.3	2.5	3.3
Net Debt/Equity (x)	(0.3)	0.6	0.7	0.6	0.2
EV/Sales	7.3	6.2	5.5	4.7	3.9

Source: Company, Karvy Institutional Research

Dabur India

Institutional Equities
India Research

INITIATION REPORT

Bloomberg: DABUR IN
Reuters: DABU.BO

BUY

Better Operational Performance Likely

Large domestic product-portfolio and regular foray into newer geographies have enabled Dabur India in clocking 21% sales CAGR and 20% EBITDA CAGR in past five years. We believe that several business drivers would aid the Company in maintaining strong performance in coming years as well. We anticipate 18% and 20% Sales and EBITDA CAGR in FY12-15E.

Multiple Business Sales Drivers: We believe that Dabur India is set to maintain its strong sales growth in coming years too on the back of multiple growth drivers. We expect the Company to clock 18% sales CAGR in FY12-15E owing to 16% sales CAGR in domestic business and 19% sales CAGR in global business. The Company's domestic business has shown slower growth in last few quarters largely due to muted performance of its rural business. However, with the roll-out of rural distribution initiative in ten states, we expect the Company to report better sales growth in rural business in coming period.

Significant Contribution from Recent Acquisitions: Dabur's global business has been consistently showing higher double-digit growth due to regular foray into newer geographies and overseas acquisitions. Its recent acquisitions – *Hobi Kozmetic (Hobi) & Namaste Group (Namaste)* – have been integrated completely and their portfolios are being extended across geographies. We expect Hobi & Namaste would jointly contribute ~13% of sales and ~11% of EBITDA in FY15E.

Expect 20% EBITDA CAGR in FY12-FY15E: We are optimistic for better operational show by Dabur India going forward on the back of expected softening of key raw material prices and better EBITDA Margin from global business portfolio of especially of Hobi & Namaste. We expect the Company's EBITDA would rise by 20% CAGR in FY12-FY15E.

Outlook & Valuation

Strong domestic presence, robust product portfolio, and regular foray into newer geographies have Dabur India in maintaining high revenue growth momentum. Valuing the stock on 24xP/E (PEG of 1.1x) on 24-month forward earnings, we initiate coverage on the Company with **"BUY"** recommendation with target price of Rs. 150 per share having 14% upside potential.

Key Financials

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Revenue	40,962	53,054	62,750	73,844	86,881
EBITDA	7,544	8,598	10,572	12,490	14,883
Net Profits (Adj)	5,545	6,449	7,896	9,662	11,716
EPS (Rs)	3.2	3.7	4.5	5.5	6.7
PER (x)	41.4	35.7	29.1	23.8	19.6
P/BV (x)	16.5	13.4	10.0	7.5	5.7
EV/EBITDA (x)	30.9	26.9	21.5	17.8	14.5

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs132
Target Price:	Rs150
Upside (%)	14%

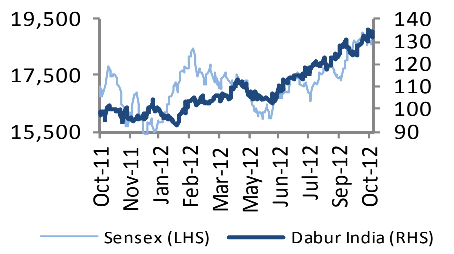
Stock Information

Market Cap. (Rs bn / US$ mn)	230/4,351
52-week High/Low (Rs)	139/92
3m ADV (Rs mn /US$ mn)	166/3.1
Beta	0.5
Sensex/ Nifty	18,611/5,660
Share outstanding (mn)	1,743

Stock Performance (%)

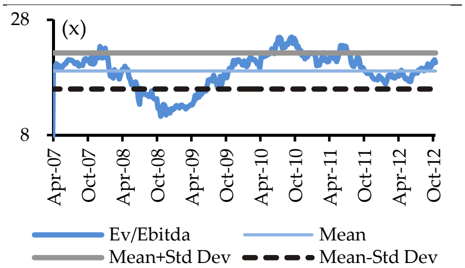
	1M	3M	12M	YTD
Absolute	6.2	14.4	32.8	32.8
Rel. to Sensex	5.8	5.2	21.5	10.3

Performance



Source: Bloomberg, Karvy Institutional Research

1 Year Forward EV/EBITDA



Source: Bloomberg, Karvy Institutional Research

Analysts Contact

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Company Financial Snapshot

Profit & Loss

Rs mn	FY13E	FY14E	FY15E
Net sales	62,750	73,844	86,881
EBIDTA	10,572	12,490	14,883
Depreciation	834	933	1,032
Interest Expense	677	469	326
PBT	9,860	12,068	14,635
Tax	1,972	2,414	2,927
Adj. PAT	7,896	9,662	11,716
EPS (Rs)	4.5	5.5	6.7
DPS (Rs)	1.0	1.0	1.0
Profit and Loss Ratios			
EBIDTA Margin %	16.8	16.9	17.1
Adj Net Margin %	12.6	13.1	13.5
Valuation Multiples			
P/E (X)	29.8	24.3	20.1
EV/EBIDTA (X)	22.0	18.3	14.9
EV/Sales (X)	3.7	3.1	2.6

Company Background

Dabur India – one of the leading FMCG companies in India – is popular for products like Chyawanprash, Honey, Glucose, Red Toothpaste, Babool, Vatika hair oil, Hajmola, Fem beauty products, etc.

Over the years, the Company acquired Balsara's Hygiene & Home products businesses, Fem Care Pharma, Hobi Kozmetik Group and Namaste Laboratories.

It has significant global presence in countries like Middle East, Africa, US, Europe, Nepal and Bangladesh.

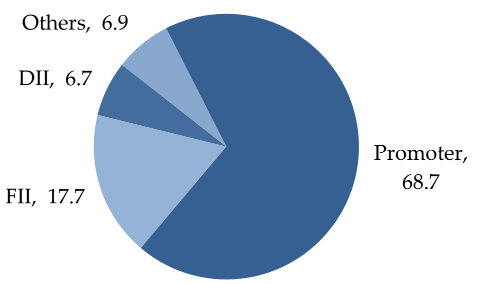
Balance Sheet

Rs mn	FY13E	FY14E	FY15E
Total Assets	**52,519**	**61,276**	**72,717**
Net Fixed Assets	17,696	18,613	19,431
Current Assets	29,279	37,119	47,741
Other Assets	5,544	5,544	5,544
Total Liabilities	**52,519**	**61,276**	**72,717**
Net worth	23,027	30,651	40,328
Debt	9,143	8,043	6,943
Current Liabilities	20,050	22,291	25,162
Deferred Tax & Minority Int.	299	291	284
Balance Sheet Ratios			
RoE %	34.3	31.5	29.1
RoCE %	32.7	32.4	31.6
Net Debt/Equity	0.1	(0.1)	(0.2)
Equity/Total Assets	0.4	0.5	0.6
P/BV (X)	10.2	7.7	5.8

Cash Flow

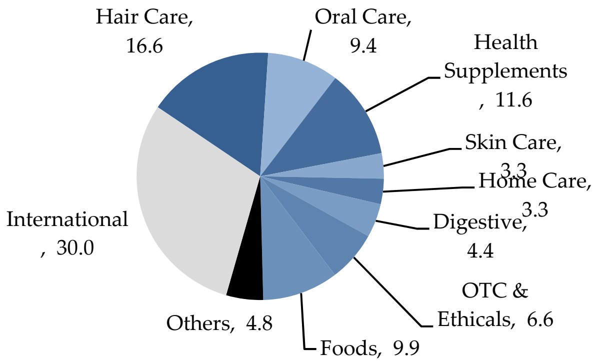
Rs mn	FY13E	FY14E	FY15E
PBT	9,860	12,068	14,635
Depreciation	834	933	1,032
Tax	(1,972)	(2,414)	(2,927)
Change in Wkg Cap	(816)	(2,182)	(2,457)
CF from Operations	**7,906**	**8,405**	**10,282**
Capex	(1,850)	(1,850)	(1,850)
Investments	-	-	-
CF from Investing	**(1,850)**	**(1,850)**	**(1,850)**
Change in Equity	(0)	0	(0)
Change in Debt	(1,600)	(1,100)	(1,100)
Dividends & others	(2,038)	(2,038)	(2,038)
CF from Financing	**(3,638)**	**(3,138)**	**(3,138)**
Change in Cash	2,418	3,417	5,294

Shareholding Pattern (%)



Source: BSE

Revenue Mix (%)

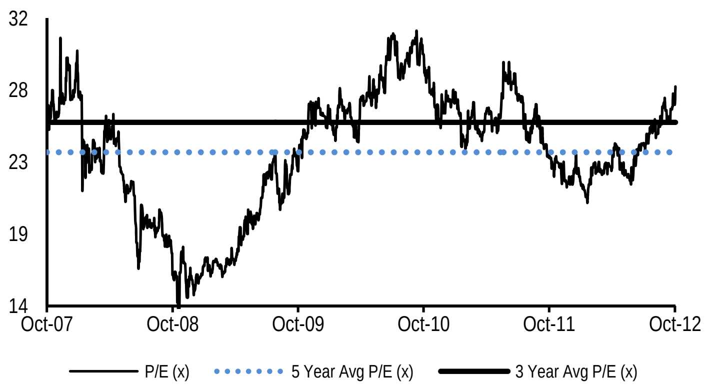


Source: Company

Outlook & Valuation

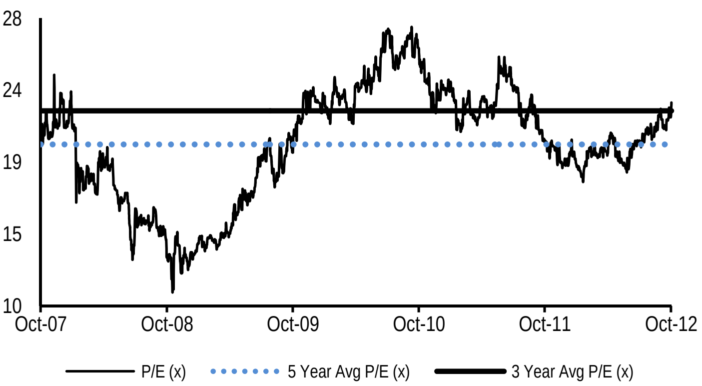
Strong domestic presence, robust product portfolio, and regular foray into newer geographies have Dabur India in maintaining high revenue growth momentum. Valuing the stock on 24xP/E (PEG of 1.1x) on 24-month forward earnings, we initiate coverage on the Company with **"BUY"** recommendation with target price of Rs. 150 per share having 14% upside potential.

Exhibit 1: Dabur P/E Band (12-month Fwd)



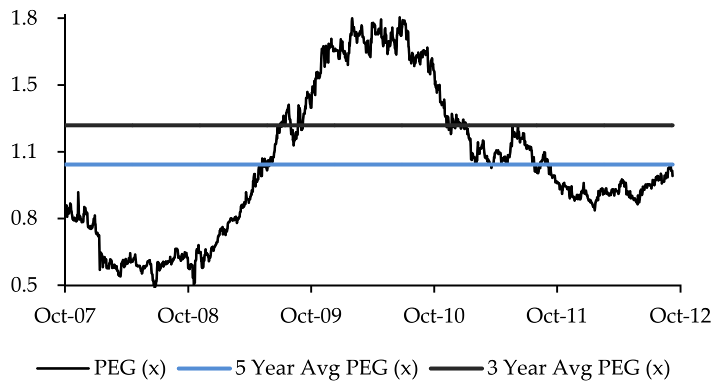
Source: Bloomberg, Karvy Institutional Research

Exhibit 2: Dabur P/E Band (24-month Fwd)



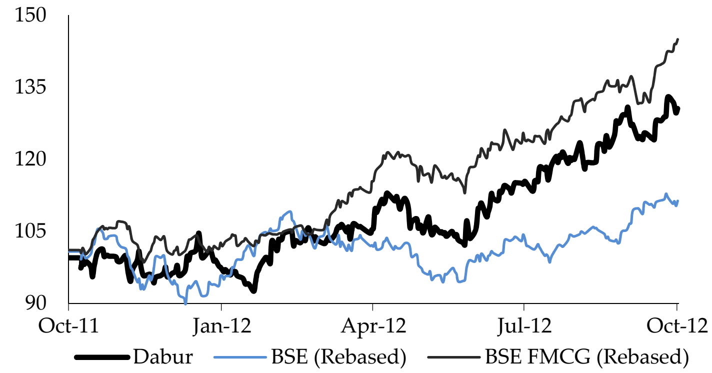
Source: Bloomberg, Karvy Institutional Research

Exhibit 3: Dabur PEG (x) Band



Source: Bloomberg, Karvy Institutional Research

Exhibit 4: Relative Stock Return



Source: Bloomberg, Karvy Institutional Research

Investment Rationale

Our investment argument is based on following premises:

1. Multiple Business Sales Drivers
2. Significant Contribution from Recent Acquisitions
3. Expect 19% EBITDA CAGR in FY12-FY15E

1. Multiple Business Sales Drivers

We believe that Dabur India is set to maintain its strong sales growth in coming years too on the back of multiple growth drivers. We expect the Company to clock 18% sales CAGR in FY12-15E owing to 16% sales CAGR in domestic business and 19% sales CAGR in global business. Dabur's domestic business has shown slower growth in last few quarters largely due to muted performance of its rural business. However, with improved Monsoon and the roll-out of rural distribution initiative in ten states, we expect the Company to report better sales growth in rural business in coming period.

Exhibit 5: Dabur's Business Mix

Categories	Revenue Mix (%)	Sales CAGR (FY09-12)	Sales Gr. (%) FY12	Sales Gr. (%) Q1FY13	Sales CAGR (%) (FY12-15E)	Comments
Domestic	**70.0**		**14.7**	**16.1**		
(A) Consumer Care	**55.2**		**11.4**	**13.0**		
Hair Care	16.6	11.2	16.0	10.4	14.8	Dabur maintaining strong growth in the Hair Oils and has shown average >20% growth in the past 4-5 quarters. Vatika franchise was affected in Q1FY13 due to price cuts by the competitors. We assume slower growth of Vatika in FY13 which would result in ~14% growth in Hair Oils in FY13E. But in the next three years, we expect 15.5% CAGR in Hair Oils. Shampoo biz was affected in FY12, while we expect Dabur should report good growth in FY13 due to corrective action taken to manage the rise in competition and lower base of FY12. We expect 21% growth of Shampoo in FY13Em while expect ~14.5% CAGR in FY12-15E.
Oral Care	9.4	10.8	9.4	8.1	11.9	Historically also, Dabur has not been able to show healthy growth in oral care due to stiff competition from Colgate & HUL. Likely price growth can result into marginally better growth in coming years.
Health Supp.	11.6	16.4	9.4	18.0	16.2	Expect it to maintain growth momentum of previous years.
Skin Care	3.3	21.9	8.9	13.3	15.7	Gulabari franchise was under severe pressure in FY12 due to strong local competition. Strong outlook of skin care category would also help Dabur in accelerating growth in coming years.
Home Care	3.3	15.5	14.3	14.4	16.2	Expect it to maintain growth momentum of previous years.
Digestive	4.4	9.8	9.9	9.8	10.6	Expect it to maintain growth momentum of previous years.
OTC & Ethical	6.6	11.8	8.2	12.7	12.2	Expect it to maintain growth momentum of previous years.
(B) Foods	**9.9**	**24.0**	**26.5**	**34.5**	**25.7**	Real & Active have been witnessing strong performance in the past several quarters. Better consumption of branded foods makes us optimistic for maintaining this high growth momentum, going forward.
(C) Others	**4.8**					
International	**30.0**	**48.4**	**27.2**	**24.0**	**19.3**	Regular foray into newer geographies and better growth prospect of Hobi & Namaste would maintain growth momentum in global business in coming years.

Source: Company, Karvy Institutional Research

2. Significant Contribution from Recent Acquisitions

Dabur's global business has been consistently showing higher double-digit growth due to regular foray into newer geographies and overseas acquisitions. Its recent acquisitions – Hobi Kozmetic (Hobi) & Namaste Group (Namaste) – have been integrated completely and their portfolios are being extended across geographies. We expect Hobi & Namaste would jointly contribute ~13% of sales and ~11% of EBITDA in FY15E.

Exhibit 6: Exhibit: Benefits through Hobi Kozmetic and Namaste Group

Particular (Rs mn)	FY13E	FY14E	FY15E
Revenue			
Sales Ex Hobi & Namaste	54,894	64,591	75,889
YoY Gr%	*18.3*	*17.7*	*17.5*
Hobi Sales (Rs mn)	1,632	1,890	2,230
YoY Gr%	*12.8*	*15.8*	*18.0*
Namaste (Rs mn)	6,225	7,363	8,762
YoY Gr%	*18.0*	*18.3*	*19.0*
Total Sales	**62,750**	**73,844**	**86,884**
YoY Gr%	*18.3*	*17.7*	*17.7*
Operational Performance			
EBITDA (Ex Hobi & Namaste)	9,536	11,238	13,337
EBITDA Margin % (Ex Hobi & Namaste)	*17.4*	*17.4*	*17.6*
Hobi EBITDA	174	211	263
EBITDA Margin %	*10.6*	*11.1*	*11.8*
Namaste EBITDA	863	1,041	1,283
EBITDA Margin %	*13.9*	*14.1*	*14.6*
Total EBITDA	**10,572**	**12,490**	**14,883**
Consolidated EBITDA Margin %	*16.8*	*16.9*	*17.1*
Sales contribution by Hobi and Namaste %	*12.5*	*12.6*	*12.7*
EBITDA contribution by Hobi and Namaste %	*9.8*	*10.0*	*10.4*

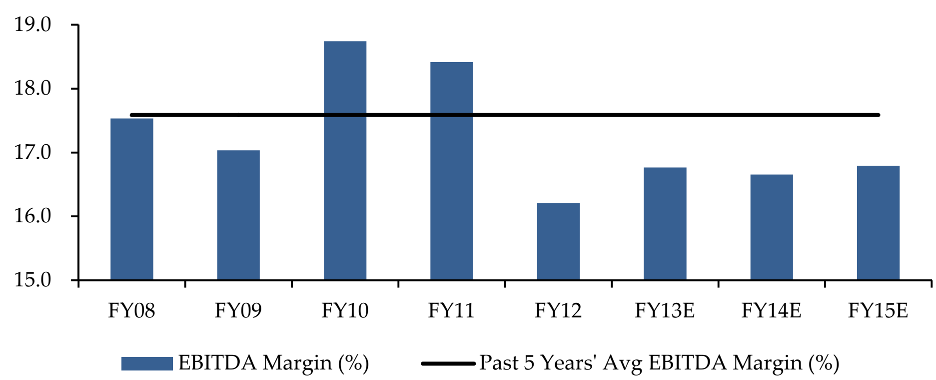
Source: Company, Karvy Institutional Research

3. Expect 20% EBITDA CAGR in FY12-FY15E

Our View: High EBITDA margin of ~17-19% that Dabur witnessed in FY07-FY11 won't be repeated in coming years, as we expect higher contribution from the low EBITDA margin global business would cap the EBITDA margin at ~17% in FY12-15E.

Dabur India's EBITDA margins were under pressure in the last few quarters on account of inflated input prices, acquisition of low EBITDA margin business and higher marketing spending for global operations. We are optimistic for better operational show by Dabur India going forward on the back of expected softening of key raw material prices and better EBITDAM from global business portfolio of especially of Hobi & Namaste. We expect the Company's EBITDA & Sales would rise by 20% CAGR & 18% CAGR in FY12-FY15E.

Exhibit 7: Dabur's EBITDA Margin



Source: Company, Karvy Institutional Research

Exhibit 8: Key Assumptions

Key Assumptions	FY11	FY12	FY13E	FY14E	FY15E
Sales Growth (%)	20.3	29.5	18.3	17.7	17.7
Hair Oil Sales Growth (%)	15.0	21.0	14.0	15.5	15.5
Shampoo Sales Growth (%)	(23.0)	(12.0)	21.0	14.0	14.0
Oral Care Sales Growth (%)	11.2	10.0	12.0	13.0	12.0
Health Supplments Sales Growth (%)	20.0	10.0	17.0	16.5	16.5
SkinCare Sales Growth (%)	15.5	6.3	15.9	16.0	16.1
Foods Sales Growth (%)	27.0	26.0	29.0	25.0	24.0
EBITDA margin expansion	-33bps	-221bps	64bps	7bps	22bps
Effective tax rate (%)	20.0	18.5	20.0	20.0	20.0

Source: Company, Karvy Institutional Research

Financials-Consolidated

Exhibit 9: Profit and Loss Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Net Revenues	40,962	53,054	62,750	73,844	86,881
% Growth	20.3	29.5	18.3	17.7	17.7
Raw Material	19,053	26,852	30,332	35,733	42,490
Staff	2,986	3,745	4,645	5,481	6,467
Other Expenses	11,379	13,859	17,201	20,141	23,040
Total Expenditures	33,418	44,456	52,178	61,354	71,998
EBITDA	7,544	8,598	10,572	12,490	14,883
% Growth	18.2	14.0	23.0	18.1	19.2
EBITDA Margins (%)	18.4	16.2	16.8	16.9	17.1
Other Income	322	574	799	980	1,109
Interest	303	538	677	469	326
Depreciation	624	729	834	933	1,032
Profit Before Tax	6,938	7,905	9,860	12,068	14,635
Provision for tax	1,390	1,464	1,972	2,414	2,927
Effective tax rate (%)	20.0	18.5	20.0	20.0	20.0
Reported PAT	5,545	6,449	7,896	9,662	11,716
% Growth	10.6	16.3	22.4	22.4	21.3
Adjusted Net Profit	5,545	6,449	7,896	9,662	11,716
% Growth	13.1	16.3	22.4	22.4	21.3

Source: Company, Karvy Institutional Research

Exhibit 10: Balance Sheet

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Equity capital	1,741	1,742	1,742	1,742	1,742
Reserves & surplus	12,170	15,427	21,285	28,909	38,586
Shareholders' funds	**13,911**	**17,169**	**23,027**	**30,651**	**40,328**
Minorities interests	41	33	25	17	10
Total Debt	10,207	10,743	9,143	8,043	6,943
Capital Employed	**24,159**	**27,945**	**32,195**	**38,711**	**47,281**
Net fixed assets	15,311	16,680	17,696	18,613	19,431
Cash & Cash Eq.	2,805	4,484	6,903	10,319	15,614
Net other Current Assets	1,032	1,511	2,327	4,509	6,966
Investments	4,197	4,825	4,825	4,825	4,825
Net Deferred Tax Assets	(190)	(274)	(274)	(274)	(274)
Total assets	**24,159**	**27,945**	**32,195**	**38,711**	**47,281**

Source: Company, Karvy Institutional Research

Exhibit 11: Cash Flow Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
PBT	7,079	7,905	9,860	12,068	14,635
Depreciation	624	729	834	933	1,032
Tax	(1,250)	(1,357)	(1,972)	(2,414)	(2,927)
Change in Wkg Cap	(1,353)	(761)	(816)	(2,182)	(2,457)
CF from Operations	**5,311**	**6,204**	**7,906**	**8,405**	**10,282**
Capex	(9,260)	(2,242)	(1,850)	(1,850)	(1,850)
Investments	(1,458)	(550)	-	-	-
CF from Investing	**(10,559)**	**(2,305)**	**(1,850)**	**(1,850)**	**(1,850)**
Change in Equity	1	1	(0)	0	(0)
Change in Debt	8,705	726	(1,600)	(1,100)	(1,100)
Dividends & others	(2,577)	(2,946)	(2,038)	(2,038)	(2,038)
CF from Financing	**6,130**	**(2,219)**	**(3,638)**	**(3,138)**	**(3,138)**
Change in Cash	882	1,680	2,418	3,417	5,294

Source: Company, Karvy Institutional Research

Exhibit 12: Key Ratios

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Raw Material Cost/Sales (%)	46.6	50.7	48.4	48.5	49.0
Manpower Cost/Sales (%)	7.3	7.1	7.4	7.4	7.4
Operating & Other Cost/Sales (%)	27.7	26.1	27.3	27.2	26.5
Revenue Growth (%)	20.3	29.5	18.3	17.7	17.7
EBITDA Margins (%)	18.4	16.2	16.8	16.9	17.1
Net Income Margins (%)	13.5	12.2	12.6	13.1	13.5
ROCE (%)	30.0	30.2	32.7	32.4	31.6
ROE (%)	39.9	37.6	34.3	31.5	29.1

Source: Company, Karvy Institutional Research

Exhibit 13: Valuation Parameters

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
EPS (Rs.)	3.2	3.7	4.5	5.5	6.7
P/E (x)	41.4	35.7	29.1	23.8	19.6
BV (Rs)	8.0	9.9	13.2	17.6	23.1
P/BV (x)	16.5	13.4	10.0	7.5	5.7
EV/EBITDA (x)	30.9	26.9	21.5	17.8	14.5
Fixed assets turnover ratio (x)	5.5	6.0	6.4	6.8	7.5
Net Debt/Equity (x)	0.5	0.4	0.1	(0.1)	(0.2)
EV/Sales	5.7	4.4	3.6	3.0	2.5

Source: Company, Karvy Institutional Research

Institutional Equities
India Research

Colgate Palmolive (India)

INITIATION REPORT

Bloomberg: CLGT IN
Reuters: COLG.BO

HOLD

Premium Play

Colgate-Palmolive (India) is focusing on new launches – *largely in the premium segment* – which would help the Company in sustaining healthy sales growth, while protecting its high profitability in the long-run. However, we believe that the stock has factored in most of the positives, as the counter has run up by 24% in the past 12 month with 21% in initial 6 months.

Volume Growth to Sustain – Premiumisation to Aid Price Growth: The Company has consistently maintained 12% volume growth in past several quarters despite undertaking ~10% price hike in last three quarters. Despite having higher sales base, the Company's growth rate was consistently higher than its peers, which led to expansion of its market share. However, we believe that the Company would sustain this volume growth rate, going forward primarily due to regular product launches, higher rural focus and continued dental awareness programmes. Besides, premiumisation in the oral care industry is helping the Company in registering better sales growth. We believe that Colgate would sustain 18% Sales CAGR in FY12-FY15E compared to 15.3% Sales CAGR in FY09-12.

Robust Pricing Power to Protect Profitability: Being a leader in the oral care segment, Colgate enjoys robust pricing power to maintain its EBITDA margin, going forward. It is observed that the Company has consistently been expanding its EBITDA margin by means of successive hike and foray into premium segment. In the last three year, its margins were >22% vis-à-vis 17-18% range previously. We believe that Colgate has to invest high on A&P going forward to face the stiff competition, which would partially set off gross level profitability – *through better price growth and higher contribution from premium segment* – and cap the EBITDA margin at ~21% in FY12-15E.

Outlook & Valuation

As oral care industry is set for premiumisation we expect better realization growth in ensuing years. We believe that Colgate would sustain volume growth going ahead, owing to regular product launches, higher rural focus and continued dental awareness programmes, albeit with higher promotional spending in FY13E & FY14E. We value Colgate on 26x P/E (~1.5x PEG) on 24-month forward earnings and derive target price of Rs. 1,322 apiece. We initiate coverage Colgate with **"HOLD"** rating.

Key Financials

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Revenue	22,847	26,932	32,572	38,150	44,244
EBITDA	5,148	5,785	7,201	8,380	9,512
Net Profits (Adj)	4,026	4,465	5,367	6,357	7,310
EPS (Rs)	29.6	32.8	39.5	46.7	53.8
PER (x)	41.8	37.6	31.3	26.4	23.0
P/BV (x)	43.8	38.6	31.9	25.1	15.5
EV/EBITDA (x)	31.8	28.4	22.8	19.4	16.6

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs1,236
Target Price:	Rs1,322
Upside (%)	7%

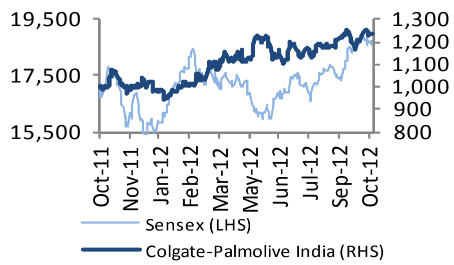
Stock Information

Market Cap. (Rs bn / US$ mn)	168/3,177
52-week High/Low (Rs)	1,288/932
3m ADV (Rs mn /US$ mn)	88/1.7
Beta	0.6
Sensex/ Nifty	18,611/5,660
Share outstanding (mn)	136

Stock Performance (%)

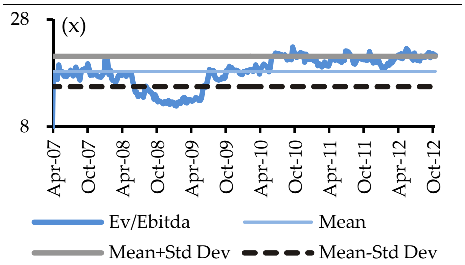
	1M	3M	12M	YTD
Absolute	1.8	7.8	23.6	24.8
Rel. to Sensex	1.4	(0.9)	13.1	3.6

Performance



Source: Bloomberg

1 Year Forward EV/EBITDA



Source: Karvy Institutional Research

Analysts Contact

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naveen.trivedi@karvy.com

Company Financial Snapshot

Profit & loss

Rs mn	FY13E	FY14E	FY15E
Net sales	32,572	38,150	44,244
EBIDTA	7,201	8,380	9,512
Depreciation	508	569	543
PBT	7,252	8,476	9,747
Tax	1,886	2,119	2,437
Adj. PAT	5,367	6,357	7,310
EPS (Rs)	39.5	46.7	53.8
DPS (Rs)	28.0	31.0	20.0
Profit and Loss Ratios			
EBIDTA Margin %	22.1	22.0	21.5
Adj Net Margin %	16.5	16.7	16.5
Valuation Multiples			
P/E (X)	31.3	26.4	23.0
EV/EBIDTA (X)	22.8	19.4	16.6
EV/Sales (X)	5.0	4.3	3.6

Company Background

Colgate-Palmolive India (Colgate) – incorporated in 1937 – is an undisputed leader in oral care business category through its product basket consisting of toothpaste, toothbrush, toothpowder and mouthwash. The Company enjoys ~54% and ~38% market share in the domestic toothpaste and toothbrush categories.

Through several field level programmes and partnering with the dentist fraternity, the Company has consistently been strengthening its foothold in the domestic oral care market.

Besides, Colgate also has presence in the personal care category through its Palmolive brand which covers Soaps, Shampoo and Body wash segment.

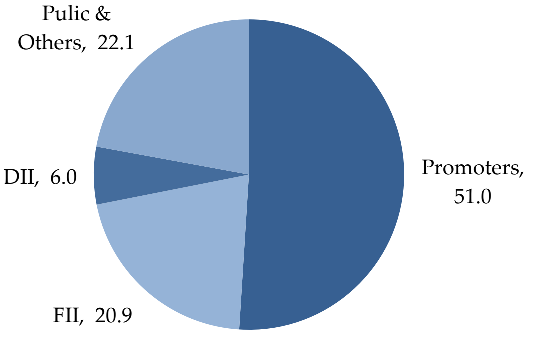
Balance Sheet

Rs mn	FY13E	FY14E	FY15E
Total Assets	**12,484**	**14,819**	**19,973**
Net Fixed Assets	4,110	3,767	3,374
Current Assets	7,403	9,580	14,628
Other Assets	971	1,471	1,971
Total Liabilities	**12,484**	**14,819**	**19,973**
Net worth	5,265	6,690	10,818
Current Liabilities	7,340	8,250	9,276
Deferred Tax & Minority Int	(121)	(121)	(121)
Balance Sheet Ratios			
RoE %	101.9	95.0	67.6
RoCE %	136.8	125.3	87.9
Net Debt/Equity	(0.5)	(0.6)	(0.8)
Equity/Total Assets	0.4	0.5	0.5
P/BV (X)	31.9	25.1	15.5

Cash Flow

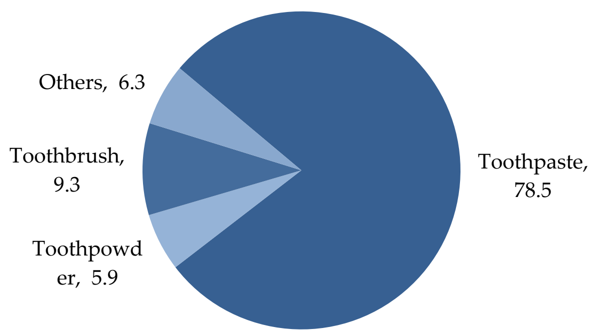
Rs mn	FY13E	FY14E	FY15E
PBT	7,252	8,476	9,747
Depreciation	508	569	543
Tax	(1,886)	(2,119)	(2,437)
Change in Wkg Cap	61	115	163
CF from Operations	**5,936**	**7,041**	**8,016**
Capex	(1,380)	(226)	(150)
Investments	(500)	(500)	(500)
CF from Investing	**(1,880)**	**(726)**	**(650)**
Change in Equity	-	-	-
Change in Debt	-	-	-
Dividends & others	(4,455)	(4,932)	(3,182)
CF from Financing	**(4,455)**	**(4,932)**	**(3,182)**
Change in Cash	(399)	1,383	4,184

Shareholding Pattern (%)



Source: BSE

Revenue Mix (%)

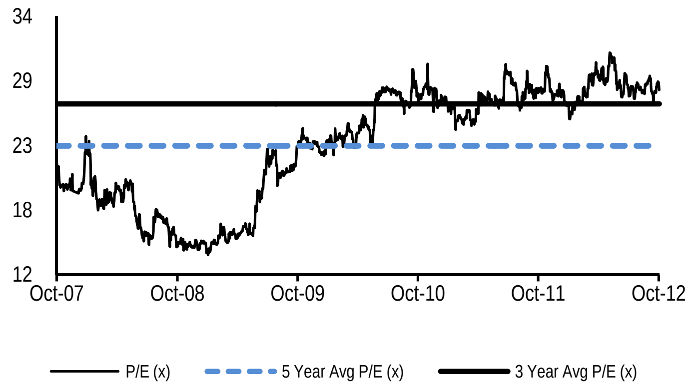


Source: Company

Outlook & Valuation

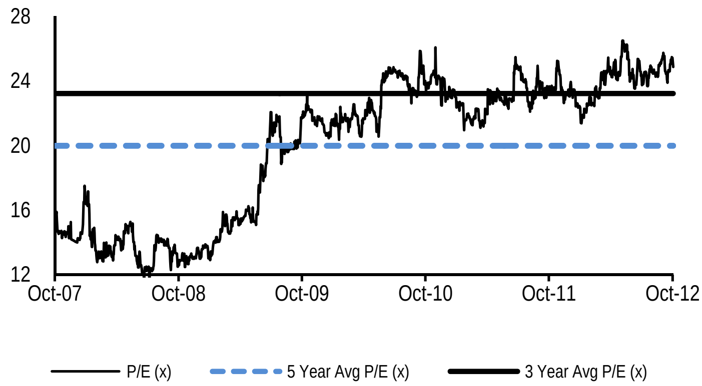
We believe that the domestic oral care segment is set for premiumisation while better realization growth is likely in the coming years. We believe that Colgate would sustain volume growth going forward owing to regular product launches, higher rural focus and continued dental awareness programmes. However, we believe that Colgate's A&P spending would continue to be high in FY13 & FY14 in order to maintain the healthy volume growth. Assuming 26x P/E (~1.6x PEG) on 1-year forward earnings, we initiate coverage on the Company with **"HOLD"** recommendation with target price of Rs. 1,322 per share having 7% upside potential.

Exhibit 1: Colgate P/E Band (12-month Fwd Earnings)



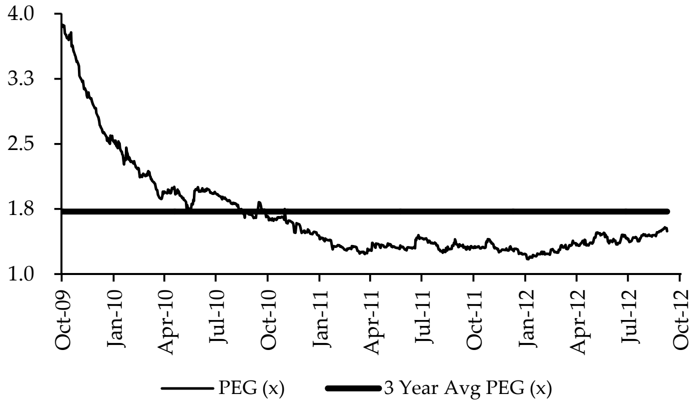
Source: Bloomberg, Karvy Institutional Research

Exhibit 2: Colgate P/E Band (24-month Fwd Earnings)



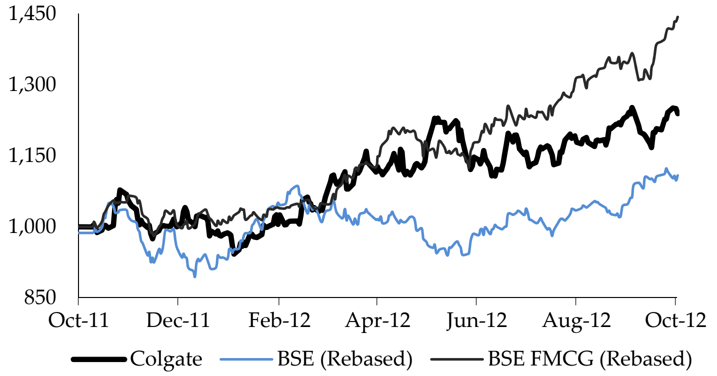
Source: Bloomberg, Karvy Institutional Research

Exhibit 3: Colgate's Past 3 Years PEG (x)



Source: Bloomberg, Karvy Institutional Research

Exhibit 4: Relative Stock Return



Source: Bloomberg, Karvy Institutional Research

Rationale for "HOLD" Recommendation

Our investment argument is based on following premises:

1. Volume growth sustainable; Premiumisation helping price growth
2. Enough Pricing Power to Protect Profitability
3. New launches ensures better prospects

1. Volume Growth to Sustain – Premiumisation to Aid Price Growth

Colgate has consistently maintained 12% volume growth in past several quarters despite undertaking ~10% price hike in last three quarters. Despite having higher sales base, the Company's growth rate was consistently higher than its peers, which led to expansion of its market share.

Our View: The Company would sustain 17.3% sales growth in FY12-FY15E compared to 15.3% sales CAGR in FY09-12.

Meanwhile, the oral care portfolio of both Dabur & HUL remained under pressure in the past few quarters due to rise in competitive intensity especially in the economy segment.

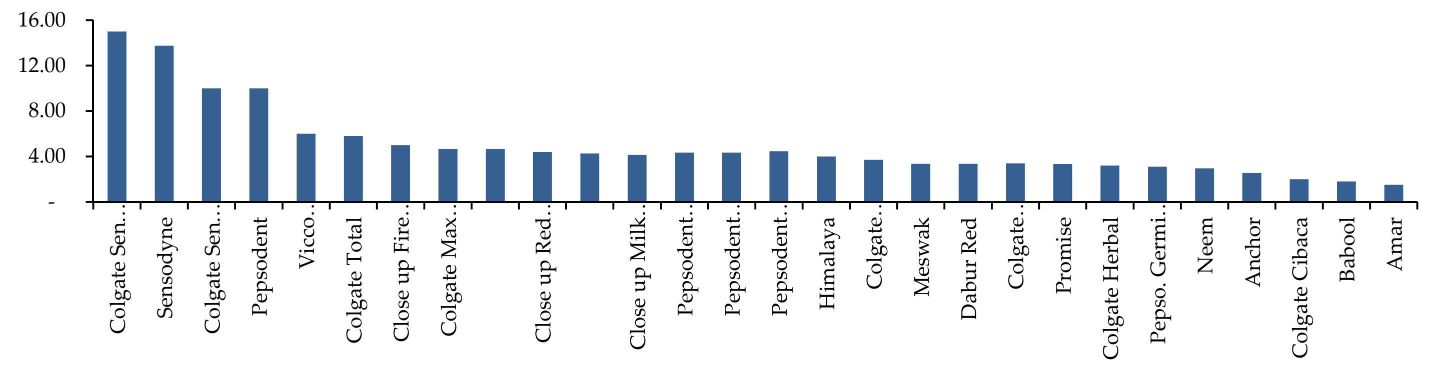
Besides, premiumisation in the oral care industry is helping the Company in registering better sales growth. We expect toothpaste price growth to remain healthy and would help in posting goods sales growth in the coming years.

Exhibit 5: Colgate Consistently Strengthening its Position in the Oral Care Industry

Particular	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
Colgate									
Sales Growth (%)	13.0	13.2	13.8	12.6	15.6	19.1	20.0	17.9	20.5
Volume Growth (%)	13.0	13.0	12.0	12.0	12.0	13.0	12.0	12.0	11.0
Price Growth (%)	(0.0)	0.2	1.8	0.6	3.6	6.1	8.0	5.9	9.5
Market Share (%)	53.2	53.3	53.4	52.2	53.0	52.6	52.5	54.0	54.5
Dabur									
Sales Growth (%)	20.2	11.0	9.4	5.3	12.7	6.0	11.6	7.7	8.1

Source: Company, Karvy Institutional Research

Exhibit 6: Colgate's Toothpaste brands cover almost all the price points in the Toothpaste Category (Rs/10gm)

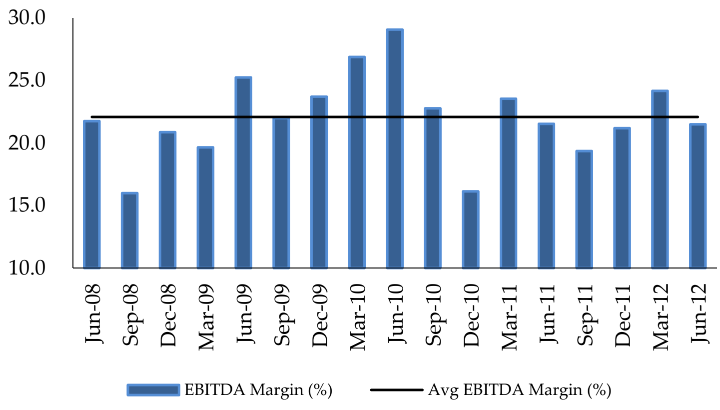


Source: Karvy Institutional Research

2. Strong Pricing Power to Protect Profitability

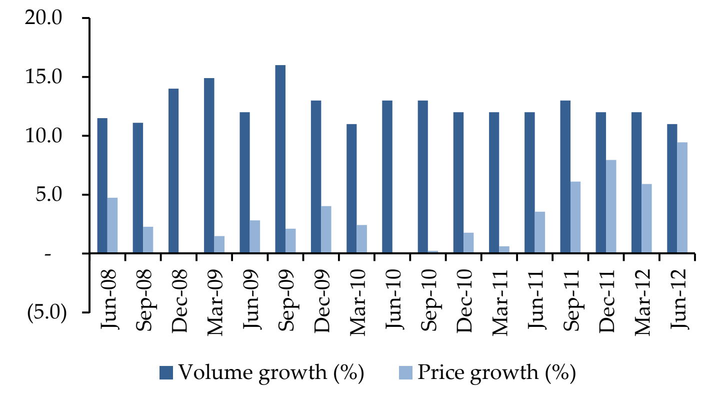
Colgate – *being a leader in the oral care segment* – enjoys robust pricing power to maintain its EBITDA margin, going forward. It is observed that the Company has consistently been expanding its EBITDA margin by means of successive hike and foray into premium segment. In the last three year, its margins were >22% vis-à-vis 17-18% range previously.

Exhibit 7: Colgate maintaining EBITDA margin at ~20% in the past several quarters owing to strong pricing power of its brands



Source: Company, Karvy Institutional Research

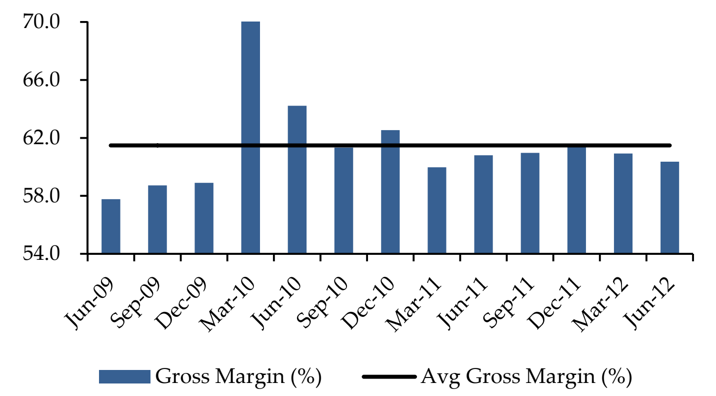
Exhibit 8: Colgate consistently clock ~12% volume in the past several quarters despite it took price hike in some of the quarters



Source: Company, Karvy Institutional Research

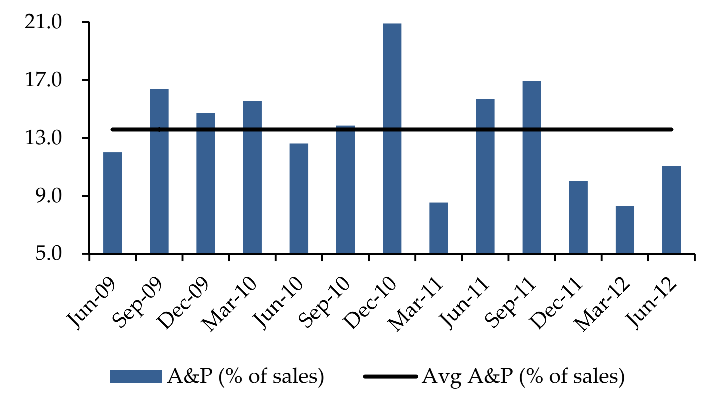
Rise in Gross Margin to Offset Higher Promotional Spending: Colgate's promotional expenditure has been lower on in the last three quarters to protect the EBITDA margin. We believe that Colgate has to invest high on A&P going forward to face the stiff competition, which would set off gross level profitability – *through better price growth and higher contribution from premium segment* – to some extent and would cap the EBITDA margin at ~21-22% in FY12-15E.

Exhibit 9: Gross margin in the past two quarters are slightly lower than average



Source: Company, Karvy Institutional Research

Exhibit 10: A&P spending (% of sales) in the last three quarters are lower than the average spend



Source: Company, Karvy Institutional Research

3. New Launches Suggest Better Prospects

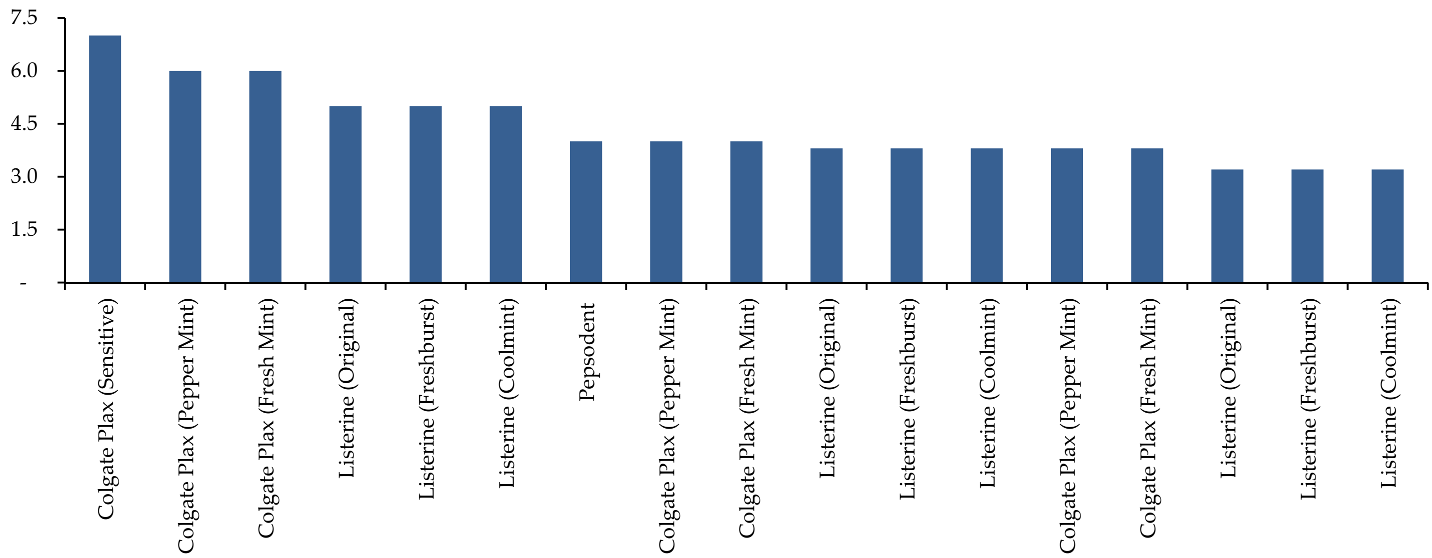
Colgate's consistent focus on new launches provides us the better business visibility, going forward. It is observed that most of these launches are in the premium segment, wherein the competition is also low and profitability is high. Colgate has aggressively launched toothpaste in the *"Sensitive"* segment wherein it already had toothbrush also. Meanwhile, we are also bullish on Colgate's incremental focus on Mouthwash & Body-wash category.

Exhibit 11: Launches in the past one year

Toothbrush	Toothpaste	Mouthwash	Body Wash
Colgate Super Shine Toothbrush	Colgate Sensitive Pro-Relief Toothpaste	Colgate Plax Fresh Tea	Palmolive Aroma Body Wash
Colgate 360 degree sonic Power Toothbrush	Colgate Plax Complete Care Mouthwash	Colgate Plax Sensitive Mouthwash	Palmolive Thermal Spa Body Wash
Colgate Zig-Zag Anti-Germ Toothbrush			
Colgate Barbie Toothbrush			
Colgate Spiderman Toothbrush			
Colgate 360 degree Surround Toothbrush			
Colgate 360 Sensitive Pro-relief Toothbrush			
Colgate Max Fresh Toothbrush			

Source: Company, Karvy Institutional Research

Exhibit 12: Mouthwash Price Comparison (Rs/10ml)



Source: Karvy Institutional Research

Our View: Thrust on new launches in less-competitive and high-margin premium segment with incremental focus on niche on other categories will drive sales growth of the Company.

Exhibit 13: Key Assumptions

Key Assumptions	FY11	FY12	FY13E	FY14E	FY15E
Net Sales Growth (%)	13.2	18.2	20.8	17.1	16.0
Toothpaste Volume Growth (%)	12.0	13.8	12.0	12.0	11.0
Gross Profit Margin %	61.8	61.0	62.1	62.0	62.1
Advertisement Expense (% of sales)	9.9	9.8	10.5	10.5	11.0
EBITDA Margin %	22.5	21.5	22.1	22.0	21.5
Effective Tax Rate (%)	22.6	24.1	26.0	25.0	25.0

Source: Company, Karvy Institutional Research

Financials

Exhibit 14: Profit & Loss Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Net Revenues	22,847	26,932	32,572	38,150	44,244
% Growth	13.3	17.9	20.9	17.1	16.0
Raw Material	8,720	10,502	12,331	14,509	16,775
Staff	1,932	2,156	2,661	3,117	3,615
Other Expenses	7,047	8,489	10,379	12,143	14,342
Total Expenditures	17,699	21,147	25,371	29,769	34,732
EBITDA	5,148	5,785	7,201	8,380	9,512
% Growth	7.2	12.4	24.5	16.4	13.5
EBITDA Margins (%)	22.5	21.5	22.1	22.0	21.5
Other Income	427	507	560	664	778
Interest	33	15	-	-	-
Depreciation	343	393	508	569	543
Profit Before Tax	5,199	5,884	7,252	8,476	9,747
Provision for tax	1,174	1,419	1,886	2,119	2,437
Effective tax rate (%)	22.6	24.1	26.0	25.0	25.0
Reported PAT	4,026	4,465	5,367	6,357	7,310
% Growth	(4.9)	10.9	20.2	18.4	15.0
Adjusted Net Profit	4,026	4,465	5,367	6,357	7,310
% Growth	(0.3)	10.9	20.2	18.4	15.0

Source: Company, Karvy Institutional Research

Exhibit 15: Balance Sheet

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Equity Share Capital	136	136	136	136	136
Reserves & surplus	3,705	4,218	5,129	6,554	10,682
Shareholders' funds	**3,841**	**4,354**	**5,265**	**6,690**	**10,818**
Minorities interests	-	-	-	-	-
Total Debt	1	-	-	-	-
Capital Employed	3,841	4,354	5,265	6,690	10,818
Net fixed assets	2,632	3,238	4,110	3,767	3,374
Cash & Cash Eq.	3,951	3,098	2,696	4,079	8,263
Net Other current assets	(3,344)	(2,571)	(2,632)	(2,748)	(2,911)
Investments	291	471	971	1,471	1,971
Net Deferred tax Assets	310	118	121	121	121
Total Assets	**3,841**	**4,354**	**5,265**	**6,690**	**10,818**

Source: Company, Karvy Institutional Research

Exhibit 16: Cash Flow Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
PBT	5,199	5,884	7,252	8,476	9,747
Depreciation	342	393	508	569	543
Tax	(1,042)	(911)	(1,886)	(2,119)	(2,437)
Change in Wkg Cap	(321)	(940)	61	115	163
CF from Operations	**3,916**	**4,040**	**5,936**	**7,041**	**8,016**
Capex	(409)	(1,016)	(1,380)	(226)	(150)
Investments	264	914	(500)	(500)	(500)
CF from Investing	**(145)**	**(102)**	**(1,880)**	**(726)**	**(650)**
Change in Equity	-	-	-	-	-
Change in Debt	(45)	(1)	-	-	-
Dividends & others	(3,185)	(3,980)	(4,455)	(4,932)	(3,182)
CF from Financing	**(3,230)**	**(3,981)**	**(4,455)**	**(4,932)**	**(3,182)**
Change in Cash	541	(44)	(399)	1,383	4,184

Source: Company, Karvy Institutional Research

Exhibit 17: Key Ratios

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Raw Material Cost/Sales (%)	38.2	39.0	37.9	38.0	37.9
Manpower Cost/Sales (%)	8.5	8.0	8.2	8.2	8.2
Operating & Other Cost/Sales (%)	30.8	31.5	31.9	31.8	32.4
Revenue Growth (%)	13.3	17.9	20.9	17.1	16.0
EBITDA Margins (%)	22.5	21.5	22.1	22.0	21.5
Net Income Margins (%)	17.6	16.6	16.5	16.7	16.5
ROCE (%)	134.0	132.9	136.8	125.3	87.9
ROE (%)	104.8	102.5	101.9	95.0	67.6

Source: Company, Karvy Institutional Research

Exhibit 18: Valuation Parameters

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
EPS (Rs.)	29.6	32.8	39.5	46.7	53.8
P/E (x)	41.8	37.6	31.3	26.4	23.0
BV (Rs)	28.2	32.0	38.7	49.2	79.5
P/BV (x)	43.8	38.6	31.9	25.1	15.5
EV/EBITDA (x)	31.8	28.4	22.8	19.4	16.6
Fixed assets turnover ratio (x)	8.7	8.3	7.9	10.1	13.1
Net Debt/Equity (x)	(1.0)	(0.7)	(0.5)	(0.6)	(0.8)
EV/Sales	7.2	6.1	5.0	4.3	3.6

Source: Company, Karvy Institutional Research

Institutional Equities
India Research

Marico

INITIATION REPORT

Bloomberg: MRCO IN
Reuters: MRCO.BO

BUY

Adequate Scope for Improving Operational Profitability

Apart from being leader in the domestic coconut oil market through Parachute brand, Marico has also balanced its revenue stream through setting up Saffola, Nihar, Hair & Care and Kaya brands over the past few years. The recently acquired personal care business of Paras Pharma would further strengthen its position in the personal care category. Besides, its global business – accounting for ~22% of sales – has become critical over the years through regular foray into newer geographies. With multiple drivers to run the business, we believe that Marico has enough scope to improve the operational profitability, going forward. We expect Marico to show 18.9% and 24% Sales and EBITDA CAGR in FY12-15E, compared to 18.5% and 18.6% CAGR in FY09-12, respectively.

Robust Sales Growth Momentum to Continue: Marico has displayed robust performance in the last four-five quarters on the back of robust volume growth performance by Parachute hair oil. Parachute volume growth in the past few quarters was even higher than the past 16 quarters average growth owing to consumers shift towards the branded oil from loose oil. We believe that this robust sales growth momentum would continue and Marico should report 19% CAGR in net sales in FY12-15E.

Expect Better Operational Profitability: We expect Marico's operational profitability would improve on account of softening of key raw material prices, acquisition of high-margin personal care business of Paras Pharma, and better operational excellence in the international business. We expect Marico can show 24% EBITDA CAGR in FY12-15E as compared to 19% CAGR in FY09-12.

Outlook & Valuation

Consistent addition of products/categories and focus on all brands have enabled Marico to reduce high dependence on Parachute franchise. Assuming 24xP/E (at PEG of 1x which is average of past 5 years) on 24-month forward earnings, we initiate coverage on the Company with **"BUY"** recommendation with a target price at Rs. 231 per share having 13% upside potential.

Key Financials

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Revenue	31,283	40,083	48,494	57,230	67,343
EBITDA	4,098	4,844	6,862	7,898	9,306
Net Profits (Adj)	2,668	3,175	4,533	5,455	6,760
EPS (Rs)	4.3	5.2	7.0	8.4	10.5
PER (x)	47.2	39.7	29.2	24.3	19.6
P/BV (x)	13.8	11.0	6.4	5.3	4.3
EV/EBITDA (x)	31.9	26.7	19.7	16.7	13.6

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs204
Target Price:	Rs231
Upside (%)	13%

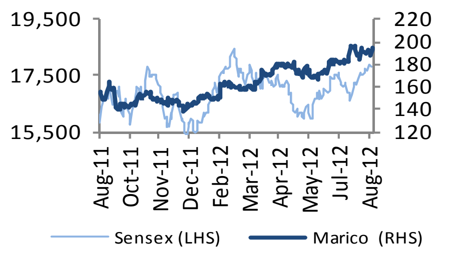
Stock Information

Market Cap. (Rs bn / US$ mn)	131/2,485
52-week High/Low (Rs)	211/134
3m ADV (Rs mn /US$ mn)	65/1.2
Beta	0.5
Sensex/ Nifty	18,611/5,660
Share outstanding (mn)	645

Stock Performance (%)

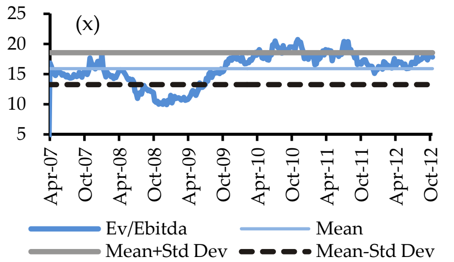
	1M	3M	12M	YTD
Absolute	4.0	10.4	32.1	40.4
Rel. to Sensex	3.6	1.5	20.9	16.6

Performance



Source: Bloomberg, Karvy Institutional Research

1 Year Forward EV/EBITDA



Source: Bloomberg, Karvy Institutional Research

Analysts Contact

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naveen.trivedi@karvy.com

Company Financial Snapshot

Profit & loss

Rs mn	FY13E	FY14E	FY15E
Net sales	**48,494**	**57,230**	**67,343**
EBIDTA	**6,862**	**7,898**	**9,306**
Depreciation	944	1,000	1,055
Interest Expense	502	345	187
PBT	5,767	6,930	8,575
Tax	1,182	1,421	1,758
Adj. PAT	**4,533**	**5,455**	**6,760**
EPS (Rs)	7.0	8.4	10.5
DPS (Rs)	0.9	1.1	1.4
Profit and Loss Ratios			
EBIDTA Margin %	14.2	13.8	13.8
Adj Net Margin %	9.3	9.5	10.0
Valuation Multiples			
P/E (X)	29.2	24.3	19.6
EV/EBIDTA (X)	19.7	16.7	13.6

Company Background

Marico – one of India's leading FMCG companies – has a vast range of products under its portfolio. It tries to reach out to every part of the society with its variation and innovation of its products.

"Parachute" hair oil, "Saffola", "Hair & Care", "Nihar", and "Revive" are some of its well-known brands. The Company has brands like "Livon", "Set Wet" and "Zatak" in the personal care.

The Company has presence in over 25 countries spread across Asia, Middle-east and African subcontinent. It has some popular international brands like "Fiancée", "Haircode", "Camelia", "Aromatic", "Caivil", "Hercules", "BlackChic", "Code 10" and "Ingwe".

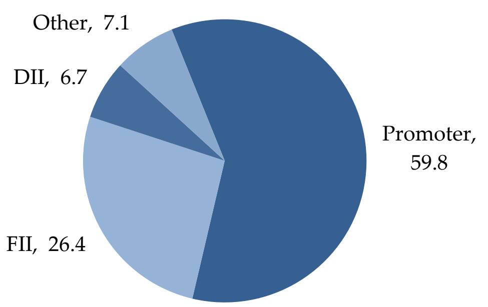
Balance Sheet

Rs mn	FY13E	FY14E	FY15E
Total Assets	**35,027**	**36,681**	**43,086**
Net Fixed Assets	16,530	16,130	15,675
Current Assets	15,541	17,595	24,455
Other Assets	2,957	2,957	2,957
Total Liabilities			
Net worth	20,529	25,158	30,885
Debt	7,398	3,214	2,528
Current Liabilities	7,022	8,177	9,483
Deferred Tax & Minority Int	78	132	189
Balance Sheet Ratios			
RoE %	22.1	21.7	21.9
RoCE %	24.3	27.5	27.5
Net Debt/Equity	0.3	0.1	(0.1)
Equity/Total Assets	0.6	0.7	0.7
P/BV (X)	6.4	5.3	4.3

Cash Flow

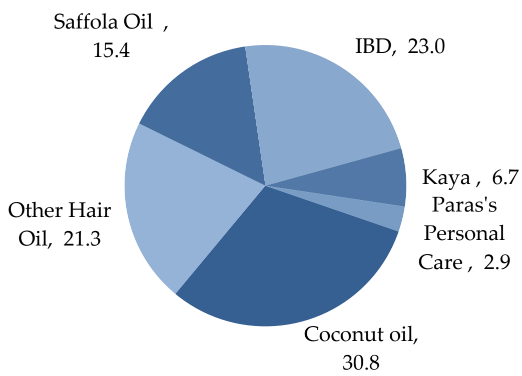
Rs mn	FY13E	FY14E	FY15E
PBT	5,767	6,930	8,575
Depreciation	944	1,000	1,055
Tax	(1,182)	(1,421)	(1,758)
Change in Wkg Cap	(2,658)	(1,105)	(1,521)
CF from Operations	3,373	5,749	6,539
Capex	(8,500)	(600)	(600)
Investments	-	-	-
CF from Investing	(8,500)	(600)	(600)
Change in Equity	5,227	-	-
Change in Debt	(650)	(4,185)	(686)
Dividends & others	(661)	(826)	(1,033)
CF from Financing	3,415	(5,356)	(1,905)
Change in Cash	(1,713)	(207)	4,034

Shareholding Pattern (%)



Source: BSE

Revenue Mix in FY13E (%)

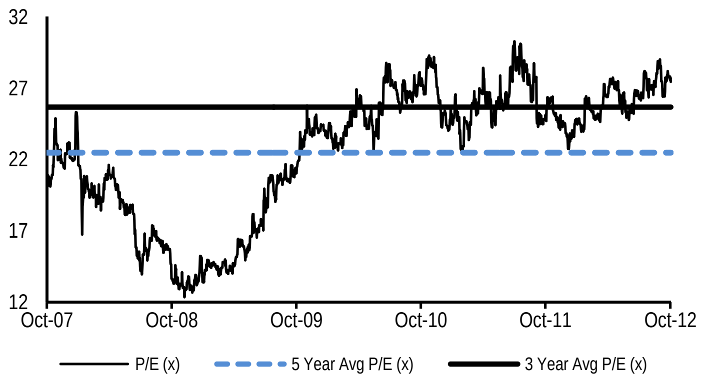


Source: Company

Outlook & Valuation

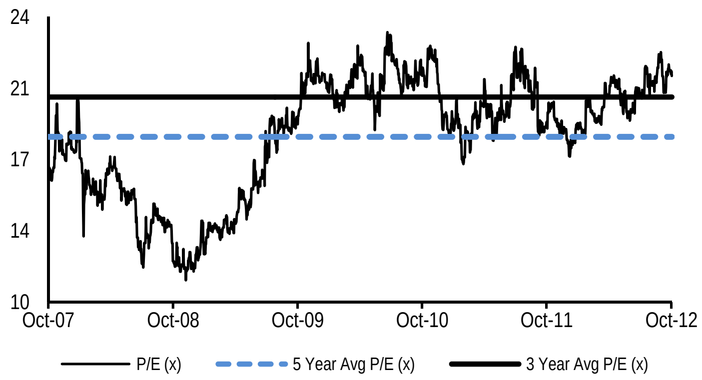
Consistent addition of products/categories and focus on all brands have enabled Marico to reduce high dependence on Parachute franchise. Assuming 24xP/E (at PEG of 1x which is average of past 5 years) on 24-month forward earnings, we initiate coverage on the Company with **"BUY"** recommendation with a target price at Rs. 231 per share having 13% upside potential.

Exhibit 1: Marico P/E Band (12-month Fwd)



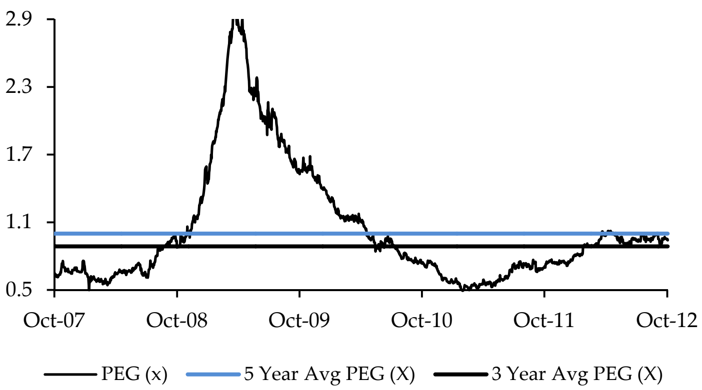
Source: Bloomberg, Karvy Institutional Research

Exhibit 2: Marico P/E Band (24-month Fwd)



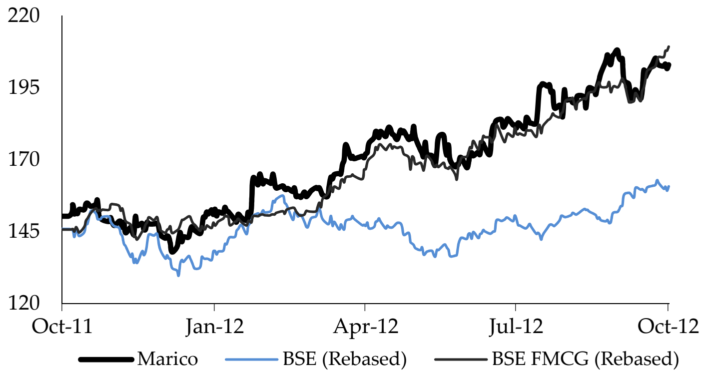
Source: Bloomberg, Karvy Institutional Research

Exhibit 3: Marico PEG Band (24-month Fwd)



Source: Bloomberg, Karvy Institutional Research

Exhibit 4: Relative Stock Return



Source: Bloomberg, Karvy Institutional Research

Investment Rationale

Our investment argument is based on following premises:

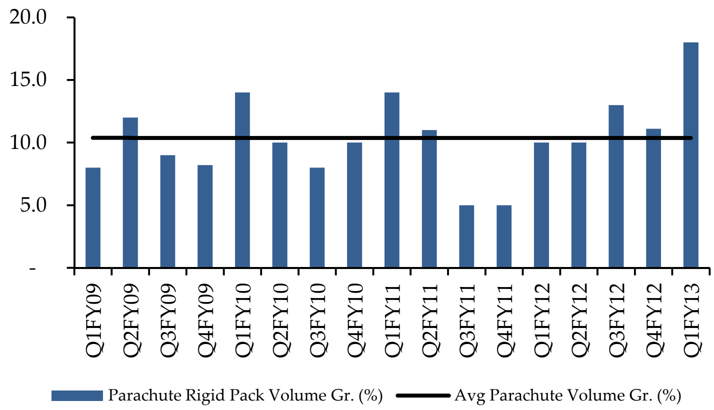
1. Robust Sales Growth Momentum to Continue
2. Expect Better Operational Profitability
3. Kaya Business- Breakeven is awaited

1. Robust Sales Growth Momentum to Continue

Our View: Robust sales growth momentum is expected to continue, going forward and Marico would report 19% CAGR in net sales in FY12-15E.

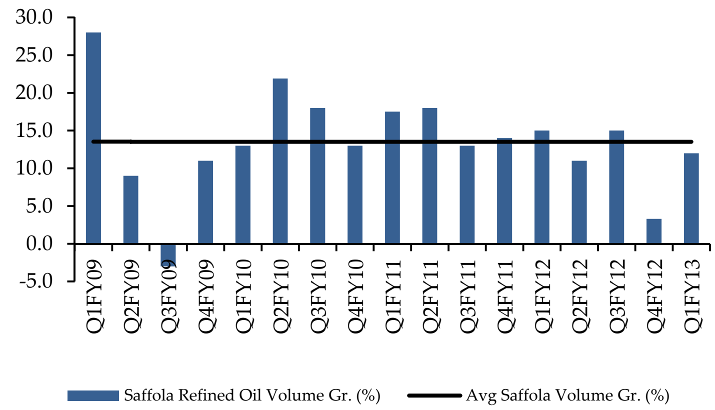
Marico has displayed robust performance in last 4-5 quarters on account of robust volume growth performance by Parachute Hair Oil. Parachute volume growth in the past few quarters was even higher than average growth in past 16 quarters owing to consumers shift towards the branded oil from loose oil. Parachute's brand equity played critical role in high input price scenario, in which most of the players implemented sharp price hike. Marico's price hike to the tune of >30% in FY12 had also been passed on to the consumer without affecting the volume growth.

Exhibit 5: Parachute Rigid Pack Volume Growth



Source: Company, Karvy Institutional Research

Exhibit 6: Saffola Refined Oil Volume Growth



Source: Company, Karvy Institutional Research

Assumptions for Four Key Business Segments:

- **Parachute:** We are optimistic on Parachute sales growth albeit we expect marginally slower growth vis-à-vis previous few quarters, as the correction in copra prices would make the business competitive. We expect 13.5%, 10% & 10% volume growth in Parachute oil in FY13E, FY14E & FY15E, respectively.
- **Saffola:** Saffola refined oil has also been maintaining strong volume growth performance and we believe 13-14% volume growth is sustainable during the next three years.
- **Personal Care Biz:** Marico would also start getting full benefit of recently-acquired personal care portfolio of Paras Pharma from Q2FY13 onwards. "Livon", "Set Wet" and "Zatak" brands are in the high volume growth categories and considering these brands' critical positioning and Marico's large distribution, we expect ~25% sales CAGR during the next three years.
- **Global Biz:** Marico's global business has been showing strong growth consistently on the back of regular foray into newer geographies. Except sluggish performance in Q1FY13E (largely on 2% revenue decline in Bangladesh), Marico has reported strong 25-30% growth. We expect Marico's global business would show 20% CAGR in FY12-FY15E.

Exhibit 7: Marico's Sales Mix (%)

Segments	FY09	FY10	FY11	FY12	FY13E	FY14E	FY15E
Coconut oil	35%	33%	32%	32%	31%	29%	28%
Other hair oil	20%	21%	21%	21%	21%	21%	21%
Saffola Oil	20%	16%	16%	16%	15%	16%	16%
IBD	19%	23%	24%	24%	23%	24%	25%
Kaya Sales	7%	7%	8%	7%	7%	7%	7%
Paras's Personal Care Business	0%	0%	0%	0%	3%	3%	3%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

Source: Company, Karvy Institutional Research

Exhibit 8: Volume Market Share in Key Categories

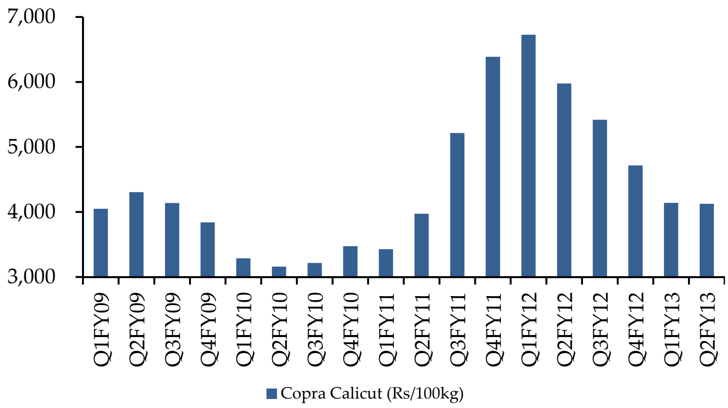
Brand & Territory	Market Share (%)	Rank
Coconut Oils - (Parachute and Nihar)	56	1st
Saffola Oils - Premium Refined Oils in Consumer Packs	58	1st
Hair Oils-(Parachute Advansed, Nihar, Hair & Care)	25	2nd
Kaya Skincare solutions	35	1st
Deodorants - (Setwet and Zatak)	6.3	2nd
Parachute Coconut Oil- (Bangladesh)	80	1st
Post wash Leave –On Serums (Livon and Silk & Shine)	84	1st
* X-Men Men's Shampoo (Vietnam)	47	1st
* Hair Code & Fiancée- Egypt	57	1st
Hair Creams/Gels (India) (Setwet)	37	1st

*Source: Company, Karvy Institutional Research, * Value market share*

2. Expect Better Operational Profitability

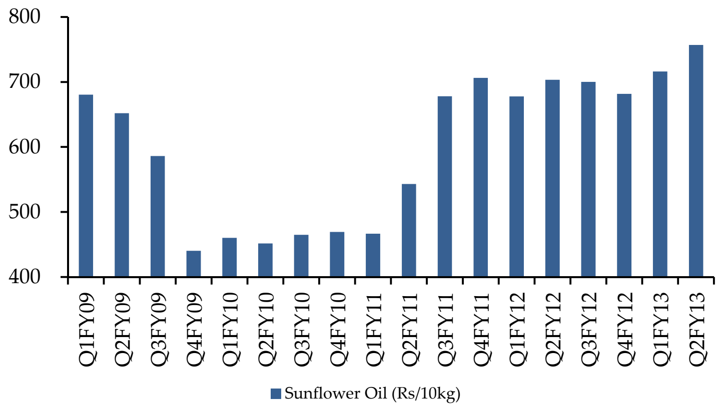
We expect Marico's operational profitability would improve on account of softening of key raw material prices, acquisition of high-margin personal care business of Paras Pharma, and better operational excellence in the international business. We expect Marico can show 24% EBITDA CAGR in FY12-15E as compared to 19% CAGR in FY09-12.

Exhibit 9: Copra Consist ~40% of Total RM Cost



Source: Company, Karvy Institutional Research

Exhibit 10: Sunflower Oils Consist ~13% of Total RM Cost



Source: Company, Karvy Institutional Research

EBITDA Mix to Improve: We expect better operational performance of global business due to backward integration and inclusion of high-margin personal care business of Paras Pharma would reduce the profitability dependence on coconut oil.

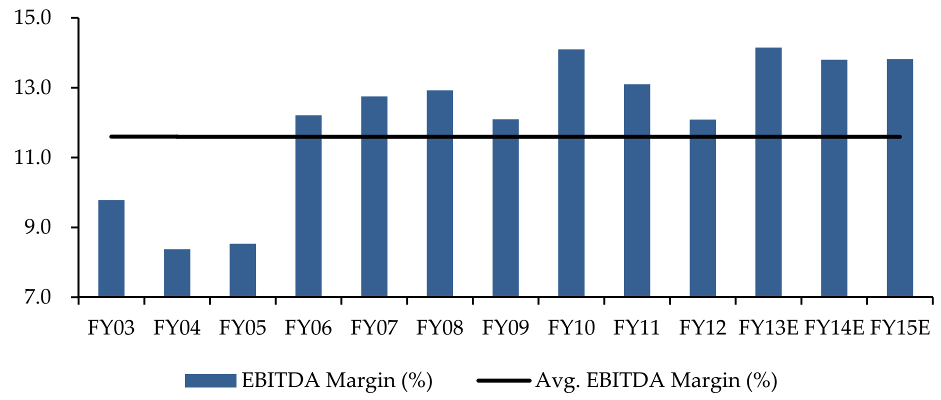
Exhibit 11: Marico's EBITDA Mix (%)

EBITDA Mix (%)	FY12	FY13E	FY14E	FY15E
Coconut oil	49.2%	51.7%	42.0%	38.8%
Other hair oil	23.1%	21.0%	21.6%	21.6%
Saffola Oil	14.1%	12.0%	12.6%	12.9%
IBD	20.5%	15.4%	19.0%	21.1%
Kaya Sales	-6.9%	-4.3%	0.5%	1.0%
Paras's Personal Care Business	0.0%	4.1%	4.5%	4.7%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Company, Karvy Institutional Research

EBITDA Margin to Rise: We expect improved overall EBITDA margin profile of Marico in coming years. Marico is expected to maintain ~14% EBITDA margin in FY12-15E as compared to average 12% EBITDA margin in past nine years and average 13% in the past three years.

Exhibit 12: EBITDA margin



Source: Company, Karvy Institutional Research

3. Kaya Business – Expect Breakeven by FY13-end

Marico runs skin care businesses though Kaya brand and operates 82 stores in India and 25 stores overseas. The Company has been running this business since over last nine years and today it contributes ~7% to its total sales.

However, even though Marico is in this business since a long time, it continues to incur losses even at operational level. Marico has incurred loss to the tune of >Rs. 1 bn in the past five years for just operating this business.

Meanwhile, Kaya business has improved its operational performance post acquisition of high-margin Derma Rx. While the domestic Kaya business reached almost the breakeven level in FY12, Marico's Management expects the overall Kaya business to breakeven by FY13-end.

Exhibit 13: Key Assumptions

Key Assumptions	FY11	FY12	FY13E	FY14E	FY15E
Parachute Rigid Pack Volume Growth (%)	10.3	11.1	13.5	10.0	10.0
Coconut Hair Oil Sales Mix	31.9	32.5	30.8	29.4	28.3
Saffola Sales Growth (%)	16.4	28.2	19.8	20.9	20.9
Saffola Sales Mix (%)	15.5	15.5	15.4	15.8	16.2
IBD Sales Mix (%)	23.8	23.6	23.0	23.8	24.2
Kaya Sales Mix (%)	7.6	7.0	6.7	6.7	6.7
Effective Tax Rate (%)	22.6	19.5	20.5	20.5	20.5

Source: Company, Karvy Institutional Research

Financials-Consolidated

Exhibit 14: Profit and Loss Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Net Revenues	31,283	40,083	48,494	57,230	67,343
% Growth	17.6	28.1	21.0	18.0	17.7
Raw Material	16,179	20,987	23,933	28,508	33,702
Staff	2,303	3,073	3,711	4,454	5,211
Other Expenses	8,703	11,179	13,987	16,371	19,124
Total Expenditures	27,186	35,239	41,632	49,332	58,037
EBITDA	4,098	4,844	6,862	7,898	9,306
% Growth	9.2	18.2	41.7	15.1	17.8
EBITDA Margins (%)	13.1	12.1	14.2	13.8	13.8
Other Income	279	326	350	377	512
Interest	393	424	502	345	187
Depreciation	708	725	944	1,000	1,055
Profit Before Tax	3,764	4,003	5,767	6,930	8,575
Provision for tax	850	783	1,182	1,421	1,758
Effective tax rate (%)	22.6	19.5	20.5	20.5	20.5
Reported PAT	2,864	3,171	4,533	5,455	6,760
% Growth	23.6	10.7	42.9	20.4	23.9
Adjusted Net Profit	2,668	3,175	4,533	5,455	6,760
% Growth	5.3	19.0	42.8	20.4	23.9

Source: Company, Karvy Institutional Research

Exhibit 15: Balance Sheet

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Equity capital	614	615	646	646	646
Reserves & surplus	8,540	10,815	19,884	24,513	30,240
Shareholders' funds	**9,155**	**11,430**	**20,529**	**25,158**	**30,885**
Minorities interests	219	249	301	356	413
Total Debt	7,670	8,048	7,398	3,214	2,528
Capital Employed	**17,044**	**19,727**	**28,228**	**28,727**	**33,826**
Net fixed assets	8,553	8,973	16,530	16,130	15,675
Cash & Cash Eq.	2,206	1,588	1,291	1,084	5,118
Net other Current Assets	4,059	4,570	7,228	8,333	9,854
Investment	890	2,957	2,957	2,957	2,957
Net Deferred Tax Assets	1,337	1,639	223	223	223
Total assets	**17,044**	**19,727**	**28,228**	**28,727**	**33,826**

Source: Company, Karvy Institutional Research

Exhibit 16: Cash Flow Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
PBT	3,764	4,003	5,767	6,930	8,575
Depreciation	708	725	944	1,000	1,055
Tax	(534)	(709)	(1,182)	(1,421)	(1,758)
Change in Wkg Cap	(340)	(511)	(2,658)	(1,105)	(1,521)
CF from Operations	3,992	3,932	3,373	5,749	6,539
Capex	(4,647)	(1,086)	(8,500)	(600)	(600)
Investments	(63)	(2,067)	-	-	-
CF from Investing	(4,710)	(3,153)	(8,500)	(600)	(600)
Change in Equity	5	1	5,227	-	-
Change in Debt	3,212	378	(650)	(4,185)	(686)
Dividends & others	(546)	(500)	(661)	(826)	(1,033)
CF from Financing	2,278	(546)	3,415	(5,356)	(1,905)
Change in Cash	1,560	233	(1,713)	(207)	4,034

Source: Company, Karvy Institutional Research

Exhibit 17: Key Ratios

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Raw Material Cost/Sales (%)	51.7	52.4	49.4	49.8	50.0
Manpower Cost/Sales (%)	7.4	7.7	7.7	7.8	7.7
Operating & Other Cost/Sales (%)	27.8	27.9	28.8	28.6	28.4
Revenue Growth (%)	17.6	28.1	21.0	18.0	17.7
EBITDA Margins (%)	13.1	12.1	14.2	13.8	13.8
Net Income Margins (%)	8.5	7.9	9.3	9.5	10.0
ROCE (%)	25.6	26.5	24.3	27.5	27.5
ROE (%)	29.1	27.8	22.1	21.7	21.9

Source: Company, Karvy Institutional Research

Exhibit 18: Valuation Parameters

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
EPS (Rs.)	4.3	5.2	7.0	8.4	10.5
P/E (x)	9.0	2.1	0.7	1.2	0.8
BV (Rs)	14.9	18.6	31.8	39.0	47.8
P/BV (x)	13.8	11.0	6.4	5.3	4.3
EV/EBITDA (x)	31.9	26.7	19.7	16.7	13.6
Fixed assets turnover ratio (x)	6.8	8.0	8.7	11.1	14.3
Net Debt/Equity (x)	0.6	0.6	0.3	0.1	(0.1)
EV/Sales	47.2	39.7	29.2	24.3	19.6

Source: Company, Karvy Institutional Research

FMCG

October 18, 2012

Institutional Equities
India Research

Jyothy Laboratories

COMPANY UPDATE

Bloomberg: JYL IN
Reuters: JYOI.BO

BUY

Think Beyond Near Term Glitches

Jyothy Laboratories (Jyothy) has come out well from the phase marked with tremendous pressure in terms of acquisition of Henkel India (Henkel), slow growth of core business owing to distribution restructuring and liability of interest payment. On the back of improved performance and better clarity for the future, the stock has run up by 92% in the past 6-months. However, we are still positive on the stock and post the near-term glitches – *through change in distribution model* – we expect Jyothy's business would be balanced and with higher profitability. We believe that with this assumption, Jyothy's valuation discount vis-à-vis its peers would shrink further.

Improvement in Core Business Suggests Better Prospects: In the core business, "Exo" has shown 70% growth in last four quarters v/s 33% growth of Jyothy's standalone business. Its contribution to standalone sales stood at ~18% six quarters ago, which reached to 27% in Q1FY13. We expect "Exo" would continue to show strong growth on account of Jyothy's plan is to launch Exo on pan-India basis by FY13-end, compared to its availability in five states currently. Besides, we expect "Ujala Supreme" would be able to protect its profitability despite launch of "Rin Perfect Shine" by HUL. We believe that though Jyothy can shed some volume and market share, better pricing scope for "Ujala Supreme" can sustain the growth rate for Jyothy, going forward.

Henkel to Register 22% Sales CAGR in FY12-15E: Post acquisition of Henkel, Jyothy has reduced its dependence on "Ujala Supreme". We believe Henkel can become a classic case of business turnaround, as its encouraging performance suggests that it would sustain this performance, going forward. We expect that Henkel would register 22% sales CAGR in FY12-15E owing to better distribution reach and repositioning of certain brands.

Outlook & Valuation

We change Jyothy's valuations criteria from 20x P/E of FY14E earnings to 19x P/E on 24-month forward earnings to streamline the valuation criteria. Our target P/E is still ~30% discount to its peer valuations to recompense any delay in execution. We recommend that near-term glitches and its impact of the stock should be considered as an opportunity to get into the stock. With this we maintain our **"BUY"** recommendation on the Company with enhanced target price of Rs. 201 per share (from Rs. 180 earlier).

Key Financials

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Revenue	6,174	9,130	13,686	16,561	19,848
EBITDA	727	842	1,858	2,378	2,843
Net Profits (Adj)	688	536	953	1,434	1,873
EPS (Rs)	4.3	3.3	5.9	8.9	11.6
PER (x)	39.9	51.1	28.8	19.1	14.6
P/BV (x)	4.3	4.5	4.4	4.3	4.2
EV/EBITDA (x)	34.0	38.5	17.3	13.2	10.9

Source: Company, Karvy Institutional Research

Recommendation

CMP:	Rs172
Target Price:	Rs201
Upside (%)	17%

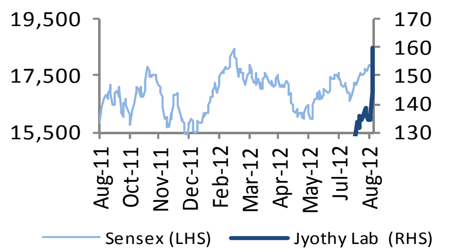
Stock Information

Market Cap. (Rs bn / US$ mn)	28/523
52-week High/Low (Rs)	184/63
3m ADV (Rs mn /US$ mn)	48/0.9
Beta	0.7
Sensex/ Nifty	18,611/5,660
Share outstanding (mn)	161

Stock Performance (%)

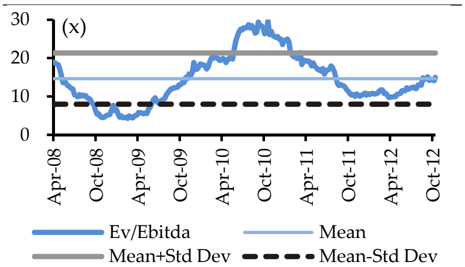
	1M	3M	12M	YTD
Absolute	7.9	35.4	144.6	112.7
Rel. to Sensex	7.5	24.4	123.8	76.6

Performance



Source: Bloomberg, Karvy Institutional Research

1 Year Forward EV/EBITDA



Source: Bloomberg, Karvy Institutional Research

Analysts Contact

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Company Financial Snapshot

Profit & loss

Rs mn	FY13E	FY14E	FY15E
Net sales	**13,686**	**16,561**	**19,848**
EBIDTA	**1,858**	**2,378**	**2,843**
Depreciation	263	275	289
Interest Expense	591	534	476
PBT	**1,198**	**1,787**	**2,314**
Tax	205	280	334
Adj. PAT	**953**	**1,434**	**1,873**
EPS (Rs)	5.9	8.9	11.6
DPS (Rs)	5.0	7.0	9.0
Profit and Loss Ratios			
EBIDTA Margin %	13.6	14.4	14.3
Adj Net Margin %	7.0	8.7	9.4
Valuation Multiples			
P/E (X)	28.8	19.1	14.6
EV/EBIDTA (X)	17.3	13.2	10.9
EV/Sales (X)	2.3	1.9	1.6

Company Background

Jyothy Laboratories – promoted by MP Ramachandran – was incorporated in 1983. The Company is known for its *"Ujala Supreme"* brand.

In the aftermath of establishing *"Ujala Supreme"*, Jyothy entered into mosquito repellent segment and dishwashing business in 2000 through launch of *"Maxo"* cyclothin coil & *"Exo"* dish wash.

However, the major turnaround of the business occurred especially in the aftermath of acquisition of Henkel India Henkel) in mid-2011.

The Company has more balanced product portfolio with 7-8 national brands like *"Ujala Supreme"*, *"Exo"*, *"Maxo"*, *"Henko"*, *"Pril"*, *"Fa"* and *"Margo"* brands.

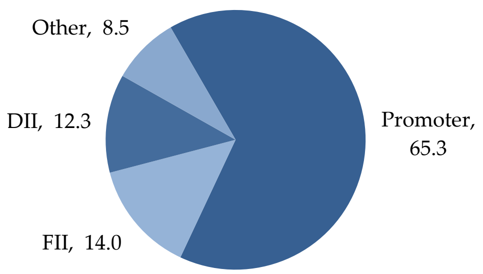
Balance Sheet

Rs mn	FY13E	FY14E	FY15E
Total Assets	**14,333**	**14,720**	**15,293**
Net Fixed Assets	10,378	10,331	10,316
Current Assets	3,941	4,374	4,961
Other Assets	15	15	15
Total Liabilities	**14,333**	**14,720**	**15,293**
Net worth	6,214	6,328	6,503
Debt	5,143	4,643	4,143
Current Liabilities	2,708	3,408	4,197
Deferred Tax & Minority Int	268	342	449
Balance Sheet Ratios			
RoE %	15.3	22.7	28.8
RoCE %	16.2	21.3	26.0
Net Debt/Equity	0.8	0.6	0.5
Equity/Total Assets	0.5	0.6	0.6
P/BV (X)	4.4	4.3	4.2

Cash Flow

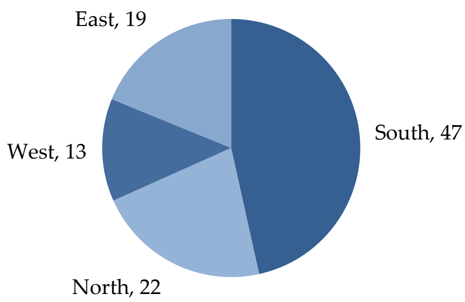
Rs mn	FY13E	FY14E	FY15E
PBT	1,198	1,787	2,314
Depreciation	263	275	289
Tax	(205)	(280)	(334)
Change in Wkg Cap	168	570	120
CF from Operations	**2,016**	**2,886**	**2,866**
Capex	(275)	(228)	(275)
Investments	(15)	-	-
CF from Investing	**(290)**	**(228)**	**(275)**
Change in Equity	81	-	-
Change in Debt	(500)	(500)	(500)
Dividends & others	(943)	(1,321)	(1,698)
CF from Financing	**(1,954)**	**(2,355)**	**(2,675)**
Change in Cash	(228)	304	(83)

Shareholding Pattern (%)



Source: BSE

Revenue Mix (%)

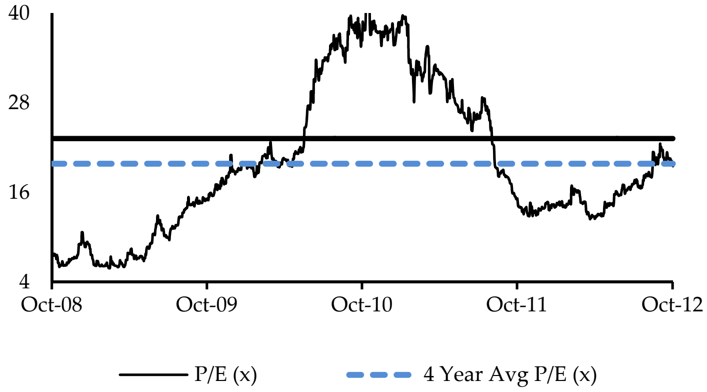


Source: Company

Outlook & Valuation

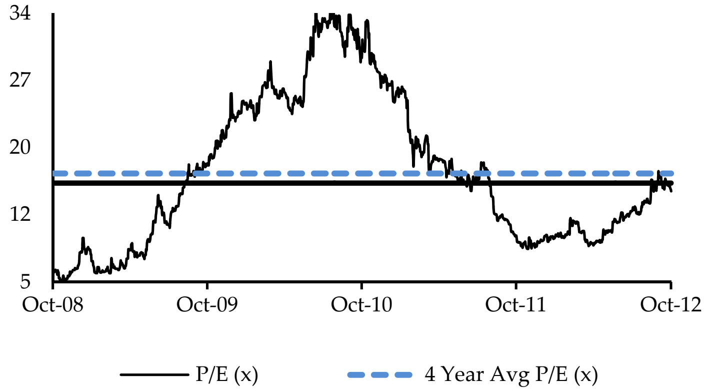
We change Jyothy's valuations criteria from 20x P/E of FY14E earnings to 19x P/E on 24-month forward earnings to streamline the valuation criteria with other companies under our coverage. Our target P/E is still ~30% discount to its peer valuations to recompense any delay in execution. We recommend that near-term glitches and its impact of the stock should be considered as an opportunity to get into the stock. With this we maintain our **"BUY"** recommendation on the Company with enhanced target price of Rs. 201 per share (from Rs. 180 earlier).

Exhibit 1: Jyothy Labs P/E Band (12-month Fwd)



Source: Bloomberg, Karvy Institutional Research

Exhibit 2: Jyothy Labs P/E Band (24-month Fwd)



Source: Bloomberg, Karvy Institutional Research

Investment Rationale

Our investment argument is based on following premises:

1. Improvement in Core Biz Suggests Better Prospects
2. Henkel to Show 22% Sales CAGR in FY12-15E
3. Synergy to Benefit Jyothy-Henkel Combine
4. EBITDA Margin to Improve from Q2FY13E despite Near-term Glitches

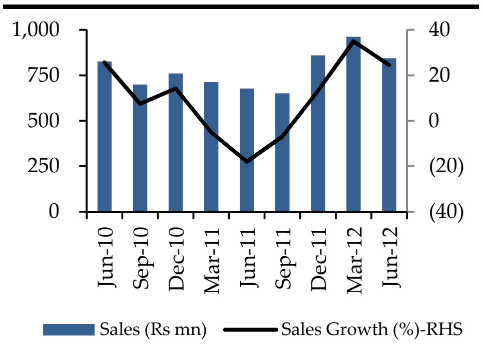
1. Improvement in Core Biz Suggests Better Prospects

A. "Exo" to Sustain Robust Growth: In the core business, "Exo" has shown 70% growth in last four quarters vis-à-vis 33% growth of Jyothy's standalone business. Its contribution to total sales stood at ~18% six quarters ago which reached to 27% in Q1FY13. "Exo" was available only in Kerala till FY10-end, which was subsequently launched in Delhi, Punjab Haryana & West Bengal in a phased manner, which proved to be immensely beneficial to the Company. Besides, Jyothy launched round-shaped "Exo" in FY11, for which consumer acceptance was surprisingly strong. Round-shaped "Exo" contributed 50% to total sales of "Exo" bar in FY12. We expect "Exo" would continue to show strong growth on account of Jyothy's plan is to launch Exo on pan-India basis by FY13-end.

B. "Ujala Supreme" to Sustain Profitability: There were concerns over competition for Jyothy in fabric whitener space after the launch of "Rin Perfect Shine" by HUL. The fabric care category is characterized by low volume and high margin. As we believe that HUL entered into this owing to high-margin of this category, HUL won't kill profitability of the category through price cut. Post entry of big player like HUL, we expect several initiatives by Jyothy for product development which would largely be in the direction of achieving better price growth. We believe that though Jyothy can shed some volume and market share, better pricing scope for "Ujala Supreme" can sustain the growth rate for Jyothy, going forward.

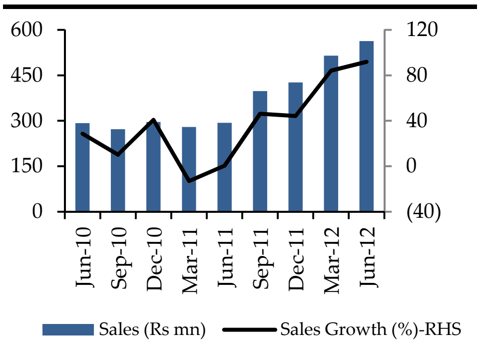
C. "Maxo" Remains a Laggard: In coil repellent space "Maxo" is unlikely to achieve convincing growth due to Jyothy's belated entry and lackadaisical strategy amid stiff competition, while profitability continues to be a major concern for Jyothy. Through new team and cost-rationalization, its Management is planning to improve sales and profitability.

Exhibit 3: Fabric Care Performance



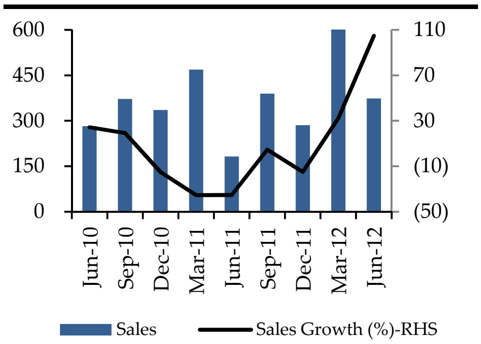
Source: Company, Karvy Institutional Research

Exhibit 4: Exo Performance



Source: Company, Karvy Institutional Research

Exhibit 5: Maxo Performance



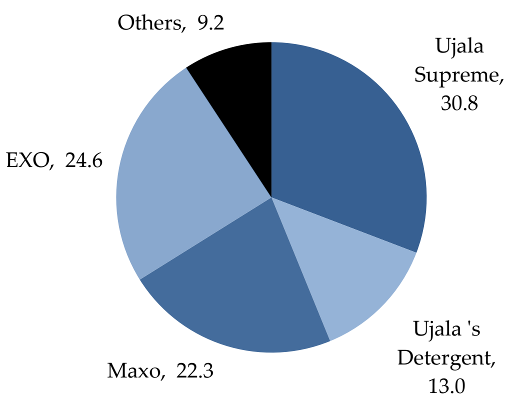
Source: Company, Karvy Institutional Research

2. Henkel to Show 22% Sales CAGR in FY12-15E

Our View: Henkel would register 22% sales CAGR in FY12-15E owing to better distribution reach and repositioning of certain brands

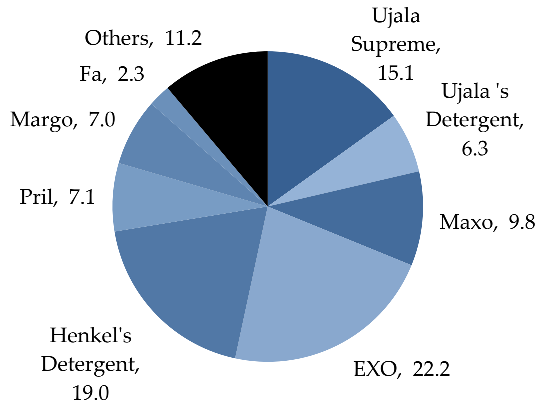
Post acquisition of Henkel, Jyothy has decreased its dependence on "Ujala Supreme". We believe that Henkel can become a classic case of business turnaround, as its encouraging performance suggests that it would sustain this performance, going forward. Henkel's products – *which were available at 2 lakh outlets earlier* – are likely to reach to 5-6 lakh outlets by FY13-end. Jyothy's Management guided that the brands like "Margo", "Pril", "Henko" & "Fa" are in the focus area in the same order and guided for strong volume growth of >20% in FY13E, despite implementing 12-15% price-hike.

Exhibit 6: Jyothy's Sales Mix in FY12



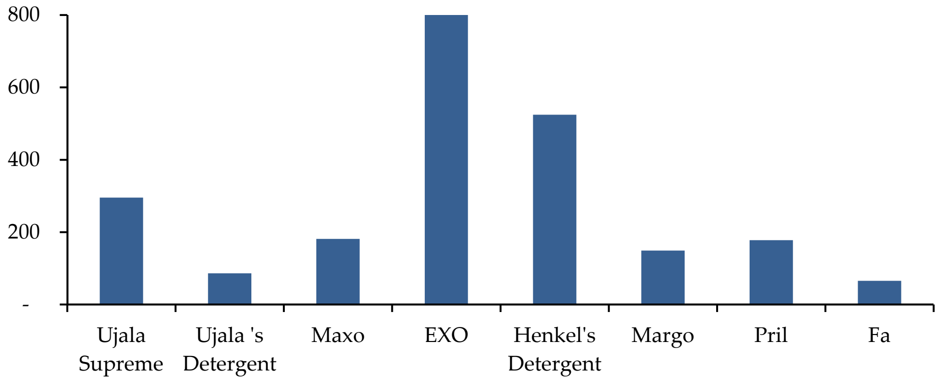
Source: Company, Karvy Institutional Research

Exhibit 7: Jyothy's Sales Mix in FY15E



Source: Company, Karvy Institutional Research

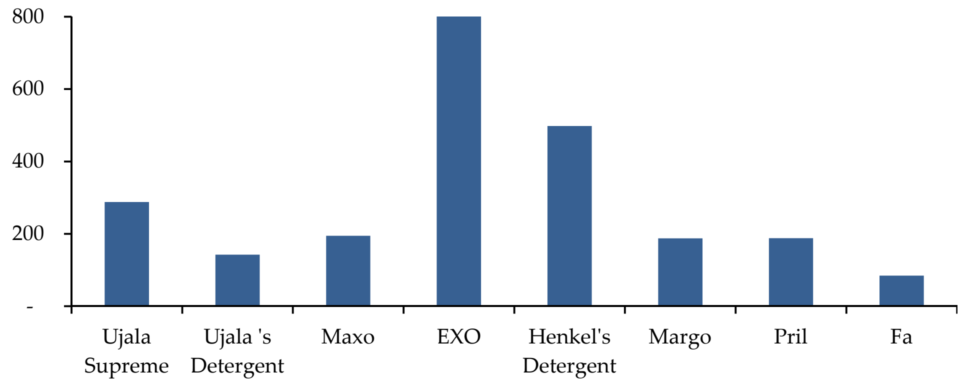
Exhibit 8: Breakup of Incremental Sales in FY13E (Rs mn)



Source: Company, Karvy Institutional Research

Our View: Henkel's products – which were available at 2 lakh outlets earlier – are likely to reach to 5-6 lakh outlets by FY13-end. Thus Henkel would show 22% sales CAGR in FY12-15E owing to better distribution reach and repositioning / restructuring of certain brands.

Exhibit 9: Breakup of Incremental Sales in FY14E (Rs mn)



Source: Company, Karvy Institutional Research

3. Synergy to Benefit Jyothy-Henkel Combine

A. Favorable Rural-Urban Mix: Before acquisition of Henkel, Jyothy's rural sales contribution was dominantly higher at ~70%, while Henkel was largely a dominant player in urban markets. Post acquisition of Henkel, the revenue mix has become more balanced and now Jyothy would get advantage of better presence in both markets.

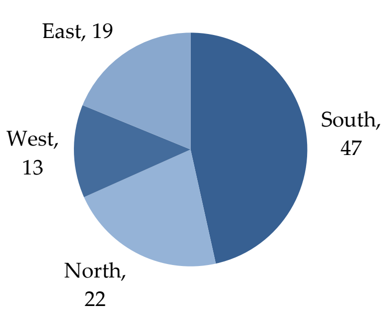
B. Sharing Distribution Strength: Acquisition of Henkel by Jyothy has been benefitted the Jyothy-Henkel combine in terms of sharing each other's distribution strength. While Jyothy is very strong in the Southern India, Henkel is strong in Easterner India is strong.

Exhibit 10: Urban-Rural Brand Division

Brand Division	Whose Brand
Urban Market	
Ujala Supreme	Jyothy
Exo	Jyothy
Henko	Henkel
Pril	Henkel
Fa	Henkel
Mr White	Henkel
Rural Market	
Ujala Supreme	Jyothy
Exo	Jyothy
Maxo	Jyothy
Stiff & Shine	Jyothy
Jeeva	Jyothy
Check	Henkel
Margo	Henkel
Neem	Henkel

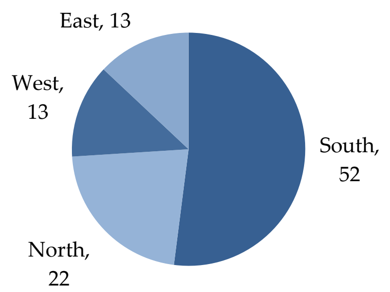
Source: Company, Karvy Institutional Research

Exhibit 11: Regional Presence-Joint



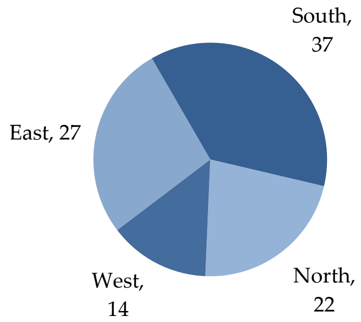
Source: Company, Karvy Institutional Research

Exhibit 12: Regional Presence- Jyothy



Source: Company, Karvy Institutional Research

Exhibit 13: Regional Presence- Henkel



Source: Company, Karvy Institutional Research

Our View: As the rural market provides necessary volume growth, while the urban market ensures better price growth, a right blend of rural-urban markets would be beneficial for Jyothy-Henkel combine. Again,, using a common distribution platform using each other's underlying strengths augur well Jyothy-Henkel combine as well.

4. EBITDA Margin to Improve from Q2FY13E despite Near-term Glitches

Jyothy has recently reduced distributor and retail margin to 6% (from 8%) and 10% (from 12-14%), respectively on account of improvement in operational profitability. Besides, its Management has also started reducing the number of distributors to 1,000 from current 7,000 (Jyothy & Henkel combined).

Jyothy's Management guided that reduction in the distribution margin would improve operational profitability by ~500 bps as they would not pass on this benefit to consumer. As some benefits would be partially offset by higher A&P, its Management expects incremental ~300 bps rise in EBITDA margin. As the Company reduced distribution margin from August 01, 2012, we expect rise in EBITDA margin from Q2FY13 onwards. However, full benefit would start reflecting from H2FY13 onwards.

Our View: Reduction in distribution margin and cut down in number of distributors would impact Jyothy's sales in the near-term. The current inventory level is for 40 days so liquidation of that much of inventory along with reduction in distribution margin can impact Jyothy's sales volume in H2FY13. We are cautious for H2FY13 sales, as we expect this transformation phase would require some of time to yield benefits.

Exhibit 14: Key Assumptions

Key Assumptions	FY11	FY12	FY13E	FY14E	FY15E
Avg. Ujala Price (75ml)	13.0	14.5	15.7	17.1	18.8
Ujala Supreme Volume Growth (%)	4.6	(9.1)	5.1	4.0	4.0
Maxo Growth (%)	(17.3)	-	10.8	11.8	6.9
Exo Growth (%)	21.0	43.3	44.0	45.0	30.0
Laundry Revenue (Rs mn)	94	419	667	784	793
Henkel Detergent Growth (%)	(7.6)	(15.0)	26.5	19.9	26.5
Fa Growth (%)	6.4	(10.8)	36.6	34.5	40.0
Prill Growth (%)	35.7	9.2	23.2	19.9	25.4

Source: Company, Karvy Institutional Research

Financials- Consolidated

Exhibit 15: Profit and Loss Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
Net Revenues	6,174	9,130	13,686	16,561	19,848
% Growth	3.3	47.9	49.9	21.0	19.8
Raw Material	3,203	5,030	7,377	8,784	10,591
Staff	813	1,136	1,211	1,413	1,673
Other Expenses	1,432	2,122	3,239	3,986	4,741
Total Expenditures	5,447	8,288	11,828	14,183	17,005
EBITDA	727	842	1,858	2,378	2,843
% Growth	(21.8)	15.8	120.8	28.0	19.5
EBITDA Margins (%)	11.8	9.2	13.6	14.4	14.3
Other Income	237	227	147	159	178
Interest	238	440	591	534	476
Depreciation	247	225	263	275	289
Profit Before Tax	584	890	1,198	1,787	2,314
Provision for tax	199	121	205	280	334
Effective tax rate (%)	34.1	19.0	19.0	19.0	19.0
Reported PAT	446	752	953	1,434	1,873
% Growth	(35.1)	68.5	26.7	50.5	30.6
Adjusted Net Profit	536	589	953	1,434	1,873
% Growth	(22.0)	9.7	61.9	50.5	30.6

Source: Company, Karvy Institutional Research

Exhibit 16: Balance Sheet

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Equity Share Capital	81	81	161	161	161
Reserves & surplus	6,230	5,897	6,053	6,166	6,341
Shareholders' funds	**6,311**	**5,977**	**6,214**	**6,328**	**6,503**
Minorities interests	5	66	107	181	288
Total Debt	**690**	**5,407**	**5,143**	**4,643**	**4,143**
Capital Employed	**7,006**	**11,451**	**11,465**	**11,151**	**10,934**
Net fixed assets	2,607	9,383	10,378	10,331	10,316
Cash & Cash Eq.	2,809	1,381	449	753	670
Net Other current assets	1,199	903	784	213	94
Investments	607	-	15	15	15
Net Deferred tax Assets	(216)	(216)	(161)	(161)	(161)
Total Assets	**7,006**	**11,451**	**11,465**	**11,151**	**10,934**

Source: Company, Karvy Institutional Research

Exhibit 17: Cash Flow Statement

Y/E Mar (Rs mn)	FY11	FY12	FY13E	FY14E	FY15E
PBT	812	583	1,198	1,787	2,314
Depreciation	130	247	263	275	289
Tax	(225)	(228)	(205)	(280)	(334)
Change in Wkg Cap	(583)	584	168	570	120
CF from Operations	**(55)**	**1,241**	**2,016**	**2,886**	**2,866**
Capex	(348)	(7,832)	(275)	(228)	(275)
Investments	(2,172)	1,518	(15)	-	-
CF from Investing	**(2,430)**	**(6,146)**	**(290)**	**(228)**	**(275)**
Change in Equity	2,244	-	81	-	-
Change in Debt	560	4,338	(500)	(500)	(500)
Dividends & others	(338)	32	(943)	(1,321)	(1,698)
CF from Financing	**2,444**	**4,132**	**(1,954)**	**(2,355)**	**(2,675)**
Change in Cash	(41)	(773)	(228)	304	(83)

Source: Company, Karvy Institutional Research

Exhibit 18: Key Ratios

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
Raw Material Cost/Sales (%)	51.9	55.1	53.9	53.0	53.4
Manpower Cost/Sales (%)	13.2	12.4	8.8	8.5	8.4
Operating & Other Cost/Sales (%)	23.2	23.2	23.7	24.1	23.9
Revenue Growth (%)	3.3	47.9	49.9	21.0	19.8
EBITDA Margins (%)	11.8	9.2	13.6	14.4	14.3
Net Income Margins (%)	11.1	5.9	7.0	8.7	9.4
ROCE (%)	10.4	7.1	16.2	21.3	26.0
ROE (%)	10.9	8.8	15.3	22.7	28.8

Source: Company, Karvy Institutional Research

Exhibit 19: Valuation Parameters

Y/E Mar	FY11	FY12	FY13E	FY14E	FY15E
EPS (Rs.)	4.3	3.3	5.9	8.9	11.6
P/E (x)	39.9	51.1	28.8	19.1	14.6
BV (Rs)	39.1	38.0	38.5	39.2	40.3
P/BV (x)	4.3	4.5	4.4	4.3	4.2
EV/EBITDA (x)	34.0	38.5	17.3	13.2	10.9
Fixed assets turnover ratio (x)	2.8	2.5	4.1	5.1	6.1
Net Debt/Equity (x)	(0.3)	0.8	0.8	0.6	0.5
EV/Sales	4.0	3.5	2.3	1.9	1.6

Source: Company, Karvy Institutional Research

KARVY STOCK BROKING

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