India consumer

GENERAL CONSUMER

NOMURA
EQUITY RESEARCH

Consumer will continue to be king

Valuations likely to remain at a premium; Prefer ITC and GCPL within our coverage

September 20, 2012

Action: Prefer ITC in large caps and GCPL in midcap space

In the current environment, we prefer companies with a history of consistent delivery. ITC is our top Buy in the large cap space where we see mid-teens EBIT growth in the key cigarette business continuing in the next few years. We have upgraded HUVR to a Neutral on the back of continued strong operational performance.

Among the midcap names, we prefer GCPL, as its performance across geographies has been robust. We also like Jubilant Foodworks despite its high relative valuations. We believe its earnings will continue to surprise the street positively.

Strong growth outlook

We believe that over the next few quarters, the growth outlook continues to remain strong for consumer companies in India. Unlike our previous expectations, we are yet to witness any meaningful slowdown or trading down in the staples sector. Our on-the-ground feedback and company commentary suggest that volumes are likely to remain buoyant in the medium term, concerns such as delay in monsoons and economic slowdown notwithstanding.

Catalyst: Watch out for margins

While we expect growth to continue, we believe margin pressure may be imminent for some of the consumer names. Rising commodity prices (especially benzene and food products) along with rupee depreciation may pressure gross margins. We expect this to play out in 2HFY13F.

Valuations: Strong growth and defensive bias likely to keep valuations elevated

Consumer stocks are trading currently at an average of 27x FY14F P/E, higher than the long-term average of around 24x. We expect valuations to remain at current elevated levels in the near to medium term due to: a) continued strong growth, and b) prevailing risk-off environment.

Fig. 1: Stocks for action

		Price	Recommendation		Target Price INR		Upside/
Stock	**Ticker**	**INR**	**Old**	**New**	**Old**	**New**	**Downside**
Hindustan Unilever	HUVR IN	548	Reduce	Neutral	327	527	-4%
ITC	ITC IN	268	Buy	Unchanged	246	310	16%
Godrej Consumer Products	GCPL IN	659	Buy	Unchanged	524	800	21%
Jubilant Foodworks	JUBI IN	1,235	Buy	Unchanged	1,100	1,490	21%

Source: Bloomberg, Nomura Research. Pricing as on September 14, 2012

Anchor themes

Longer term, we see potential for the sector to deliver consistent high teens earnings growth. We prefer companies with strong market position, high visibility of earnings and a well diversified product portfolio.

Nomura vs consensus

We believe high sector valuations will continue to sustain in the near term, while consensus view is that valuations are likely to trend down.

Research analysts

India Consumer Related

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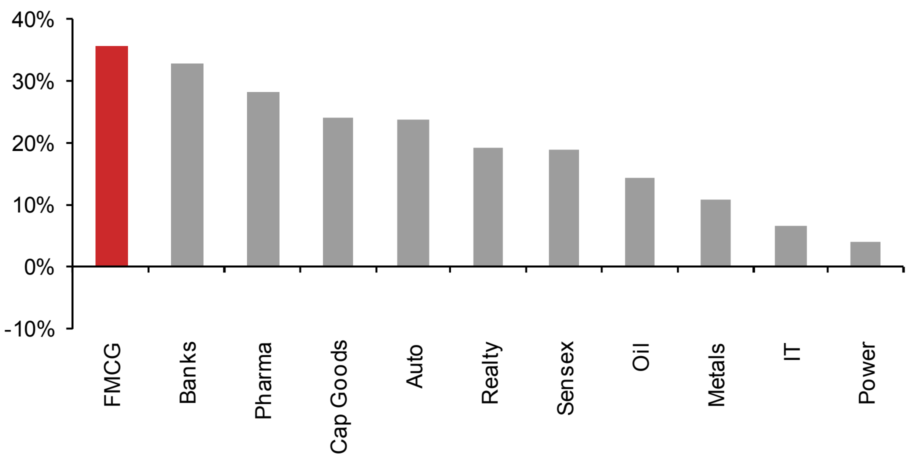
Consumer has been the best performing sector YTD
In 2012, consumer has been the best performing sector in India, with the FMCG index up 35.8% YTD (as of 14 September) vs. the benchmark Sensex +19%. This outperformance of 16.8% has been on account of continued delivery on the operational front from companies across the sector as well as a risk-off environment, where defensive sectors have been the flavor with investors. This is also reflected in the performance of other defensive sectors such as Pharmaceuticals, which has also had a strong run with the healthcare index at +28.3%, outperforming the Sensex by 9.3%.

Fig. 2: Consumer has been the best performing sector YTD



Source: Bloomberg, Nomura Research

Outperformance has been across the sector
If we look at the stocks in our coverage universe, we see that the outperformance vs. the Sensex is across the board with UNSP the top performing stock and Nestle India being the only underperformer. UNSP is +88% YTD (on the back of a sharp move in recent months on news reports of an M&A deal with Diageo; Source: The Economic Times, April 25, 2012), while Nestle, where underlying performance on the volume front has been underwhelming, has underperformed the Sensex.

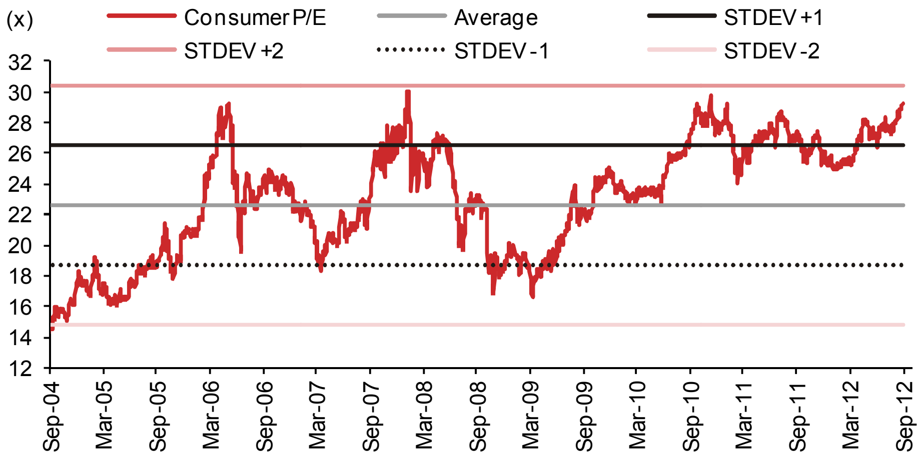
Fig. 3: Stock performance YTD

Stock	Ticker	Rating	14-Sep-12	2-Jan-12	YTD
United Spirits	UNSP IN	Neutral	928	495	88%
Godrej Consumer	GCPL IN	Buy	659	372	77%
Jubilant Foodworks	JUBI IN	Buy	1,235	752	64%
Asian Paints	APNT IN	Neutral	3,901	2,590	51%
Titan Industries	TTAN IN	Buy	241	175	37%
Marico	MRCO IN	Reduce	198	144	37%
Hindustan Unilever	HUVR IN	Neutral	548	402	36%
FMCG Index	**BSETMCG**	**NA**	**5,407**	**3,983**	**36%**
ITC	ITC IN	Buy	268	199	35%
Dabur	DABUR IN	Buy	127	100	27%
Colgate Palmolive	CLGT IN	Reduce	1,244	985	26%
GSK Consumer	SKB IN	Buy	3,070	2,500	23%
Sensex	**SENSEX**	**NA**	**18,464**	**15,518**	**19%**
Nestle India	NEST IN	Neutral	4,489	4,039	11%

Source: Bloomberg, Nomura Research

Outperformance has been largely led by multiple expansion
While there have been pockets of stocks where there have been meaningful earnings upgrades (Jubilant, HUVR, GCPL) by the Street, the majority of the outperformance has been on account of valuations getting more elevated across the sector. Given the largely stable earnings from consumer companies and consistent delivery on performance over the last 8-10 quarters, valuations across the sector have been steadily moving up.

Fig. 4: Consumer sector P/E is at the top end of the long-term average

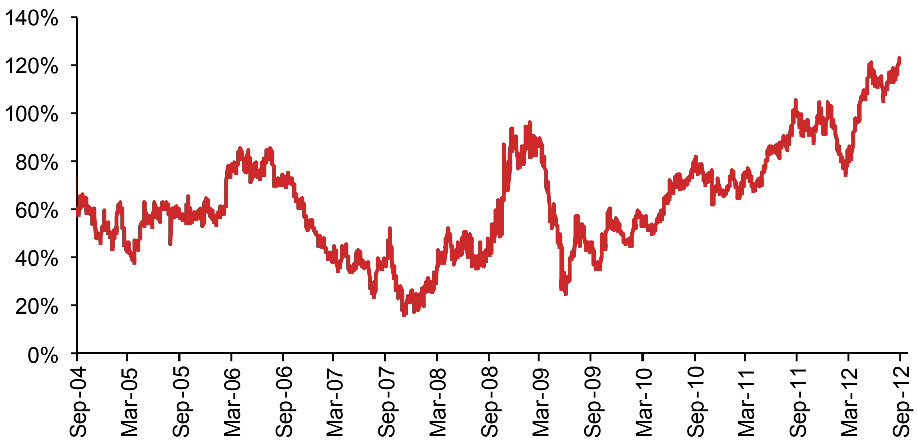


Source: Bloomberg, Nomura Research

Premium to Sensex is also at a multi-year high

Even when we look at valuations of the consumer sector vs. the Sensex, the premium is at multi-year highs. The consumer sector trades at a 117% (as of 14 September 2012) premium to the Sensex vs. the long-term average of 73%. This premium has moved up from 100% at the start of the year, which indicates that even if we see this on a short-term basis, valuations across the consumer sector have seen a significant re-rating.

Fig. 5: Consumer sector premium/discount to Sensex



Source: Bloomberg, Nomura Research

This re-rating has also been as a result of consistent delivery on performance

We believe one of the key reasons for this re-rating has been the consistent track record across companies in terms of delivery on operational performance. If we look at volume growth performance over the last few quarters, companies across the sector have shown consistent delivery in terms of volume growth, which investors have rewarded with higher multiples.

Fig. 6: Volume growth trend has been strong across the sector

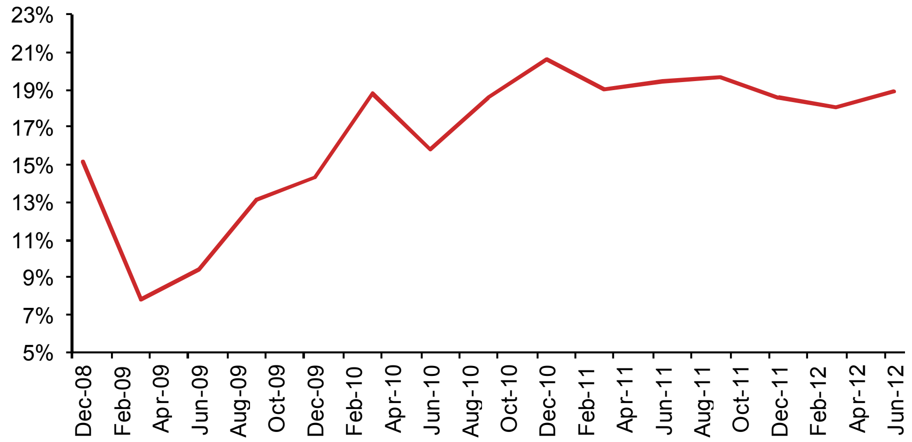
	Jun'11	Sep'11	Dec'11	Mar'12	Jun'12
HUVR	8	10	9	10	9
Dabur	9	5	9	10	12
Marico	21	14	20	17	14
Colgate	13	13	20	20	11

Source: Company data, Nomura Research

Sector performance has been sustained across full cycle

What is important to point out, in our view, is that this performance has been delivered across a full cycle. If we look at sector performance since the financial crisis in 2008, we see that sales growth has been fairly robust, despite the swings in commodity prices and threat of softening demand over the past 3-4 years. The only quarter where sales growth was sub-10% was in 2008, in the first quarter after the financial crisis.

Fig. 7: Sector sales growth has been strong

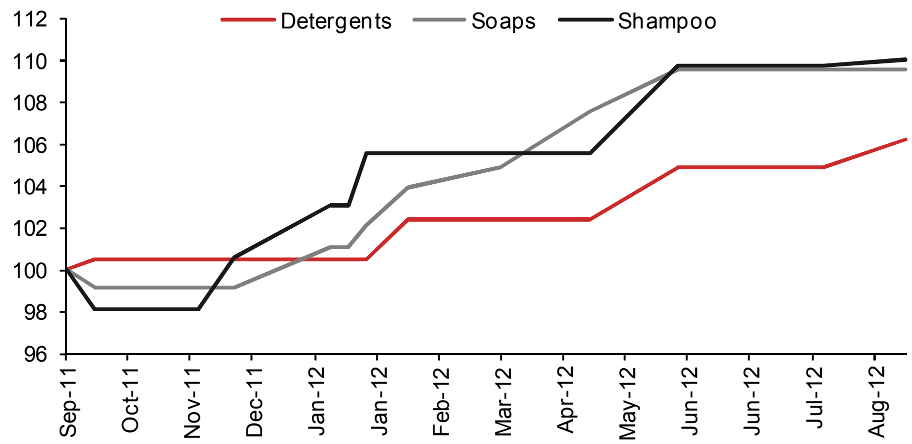


Source: Company data, Nomura Research

Pricing is now stabilising

FY12 saw a significant level of pricing action across categories, particularly as companies tried to balance the increasing commodity costs with price increases. A look at some of the key segments, such as soaps, detergents and shampoo, indicates that the pricing action is now showing signs of slowing down. We believe this trend is likely to sustain in the near term, as commodity cost pressures have eased significantly. Pricing is also a function of the demand situation and inflation, both of which have seen a slowdown in recent months. In FY13F, we believe that the majority of the impact on revenue growth will be in the form of volume growth with price/mix element being a smaller contributor.

Fig. 8: Price index across the key FMCG categories

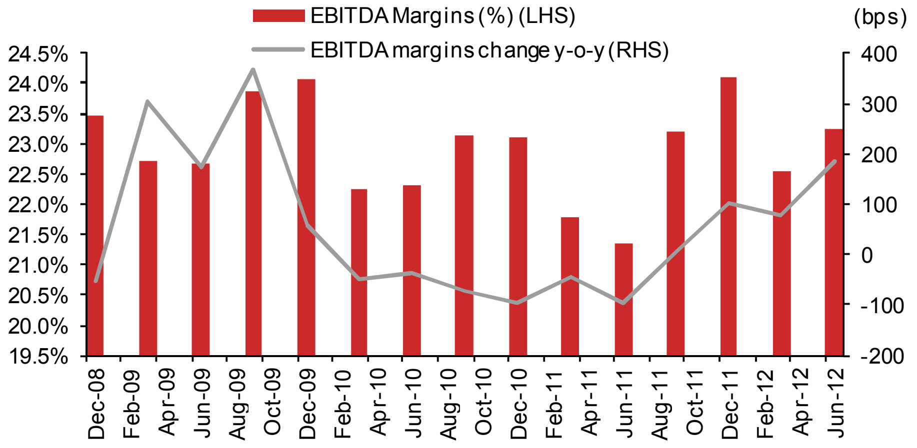


Source: Nomura Research

Margin performance has been volatile… as expected, but pressures maybe ahead

A look at EBITDA margin trends across the sector shows a significant level of variation across the time period. This is a reflection of two key variables: first, the commodity price trends and, second, the investment in advertising and promotion (A&P) in the sector. Over the past few quarters, there has been a recovery in EBITDA margins led primarily by softening of commodity costs.

Fig. 9: EBITDA margins across the sector

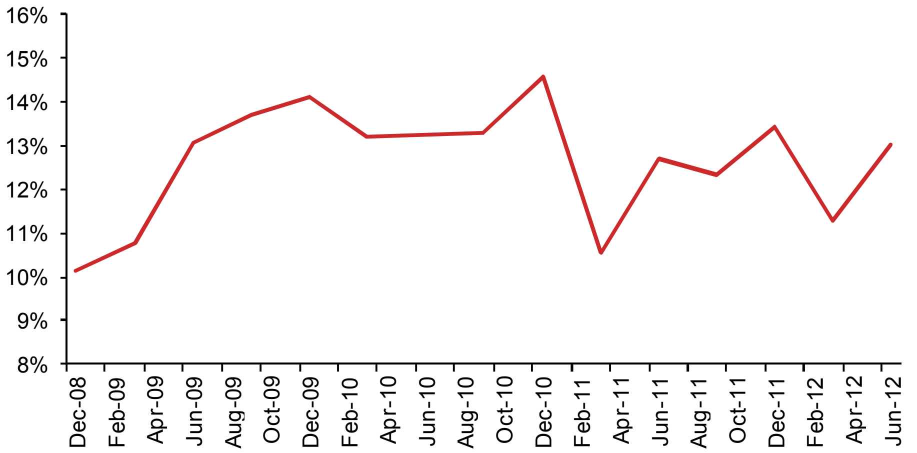


Source: Company data, Nomura Research

Considerable investment in A&P

Over the past few years, companies have made significant investment in A&P. A part of this investment has gone towards re-launching existing products with new variants, formulas, added benefits, etc, while the rest has been used in introducing or adding new products to the portfolio.

Fig. 10: Sector A&P spends have seen an increase recently

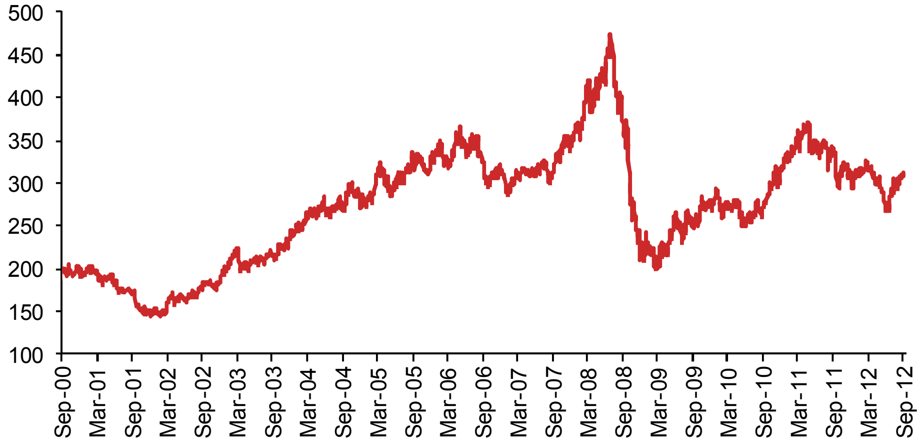


Source: Company data, Nomura Research

Recent fall in commodity costs to help gross margins in FY13

Over the past couple of quarters, commodity costs have softened from their FY12 peaks, which have meant companies across the sector have seen gross margins expand. The degree of benefit on gross margins has varied, depending on what commodities the companies are more reliant on and also the sourcing strategies, but the overall impact has been positive on gross margins. This is also visible from what has happened to the CRB Index, which has seen y-y declines, although the recent spurt is on account of the rise in crude oil prices. Commentary from companies has been that the gross margin benefit is likely to continue over the next couple of quarters.

Fig. 11: CRB Index in USD



Source: Bloomberg, Nomura Research

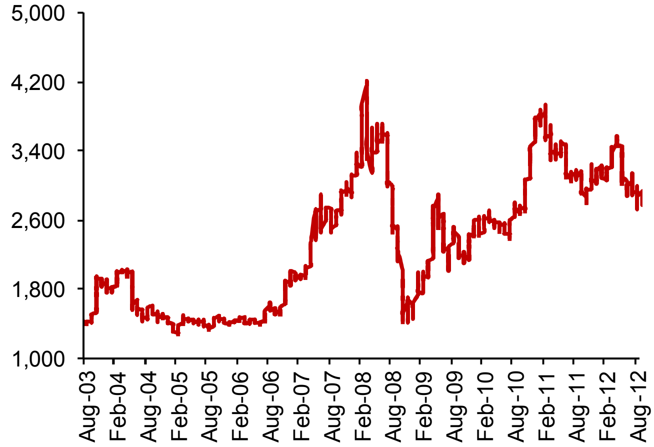
However, there have been some recent spikes in commodity costs particularly in commodities such as maize and wheat, which should temper some of the margin performance for food companies as well as in pockets of HPC categories such as oral care. Copra prices are still down substantially y-y, which should continue to benefit Marico into FY13F. Barley and milk prices being relatively stable are a positive for Nestle and GSK Consumer, in our view.

Fig. 12: Key movement on commodity prices

Commodity	Unit	Jun-12	Jul-12	Aug-12	Spot	m-m (%)	y-y (%)
Tea	Rs. Per KG	135	129	135	135	5%	25%
Coffee	Index	293	293	293	293	0%	-8%
Barley	Index	1,248	1,340	1,272	1,272	-5%	2%
Milk	Index	204	206	209	209	1%	8%
Polymer	Rs. per KG	91	90	91	93	1%	16%
Copra	Rs. per Quintal	4,039	4,171	4,150	4,150	-1%	-35%
LAB	Rs. per Tonne	114,100	110,100	114,100	117,100	4%	5%
Palm Oil	Index	2,964	3,023	2,985	2,985	-1%	-4%
Sugar	Index	2,968	3,285	3,494	3,494	6%	25%
Maize	Index	1,115	1,307	1,583	1,583	21%	24%
Wheat	Index	1,217	1,284	1,671	1,671	30%	42%
Titanium Dioxide	Index	286	278	278	278	0%	11%
Gold	Rs. per 10 gms	30,100	29,778	31,150	31,150	5%	24%

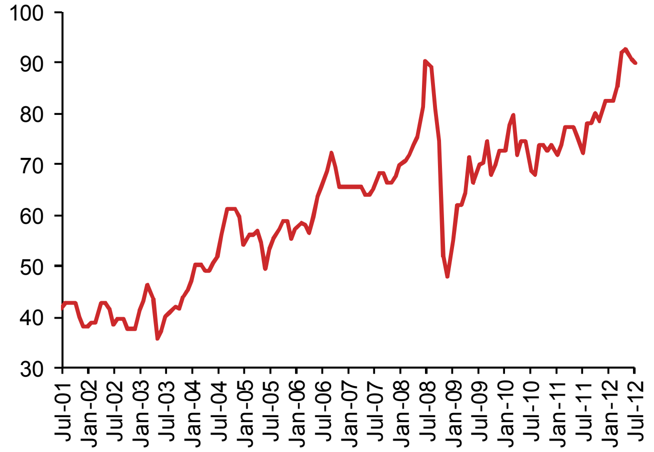
Source: Bloomberg, Nomura Research

Fig. 13: Palm Oil Index



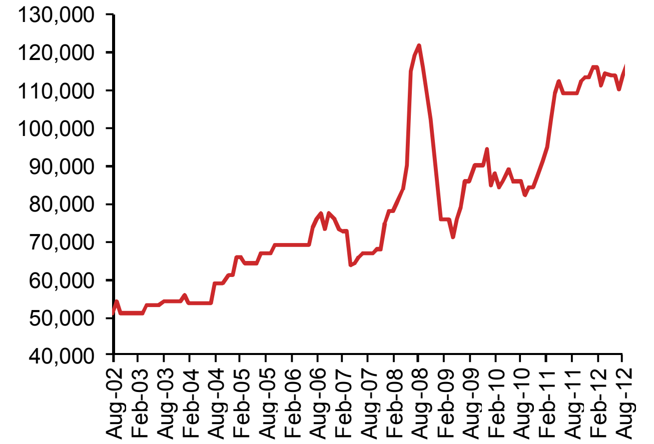
Source: Bloomberg, Nomura Research

Fig. 14: Polymer prices Per Kg



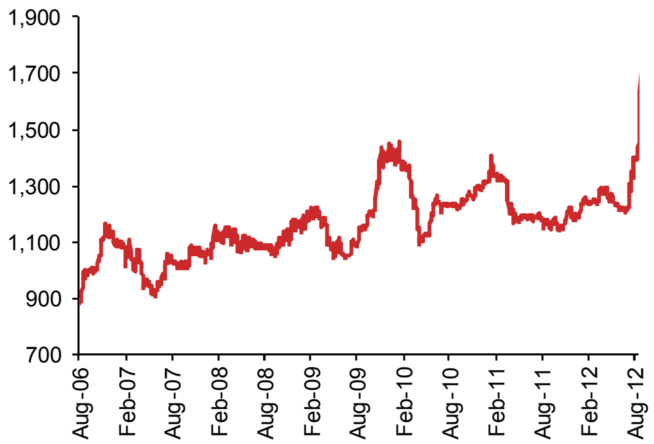
Source: Bloomberg, Nomura Research

Fig. 15: LAB price per tonne



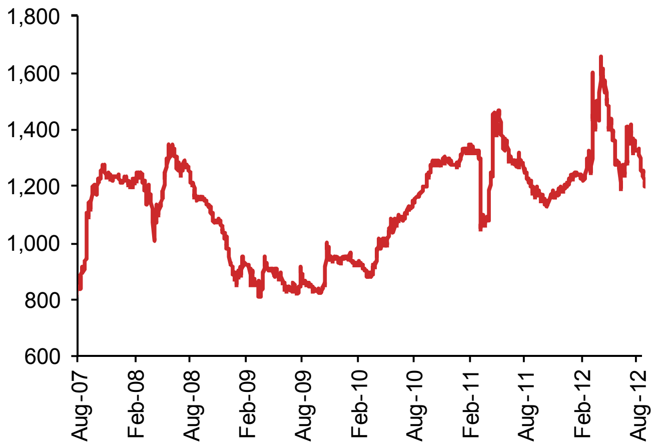
Source: Bloomberg, Nomura Research

Fig. 16: Wheat price index



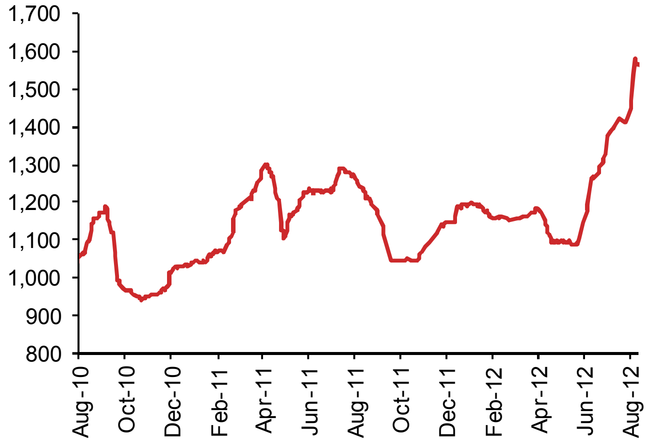
Source: Bloomberg, Nomura Research

Fig. 17: Barley price index



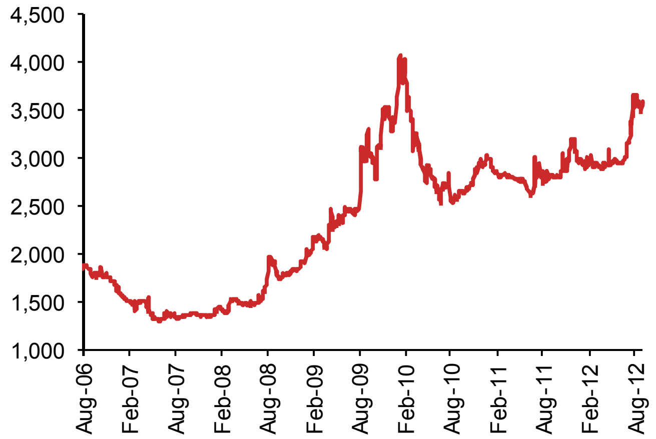
Source: Bloomberg, Nomura Research

Fig. 18: Maize price index



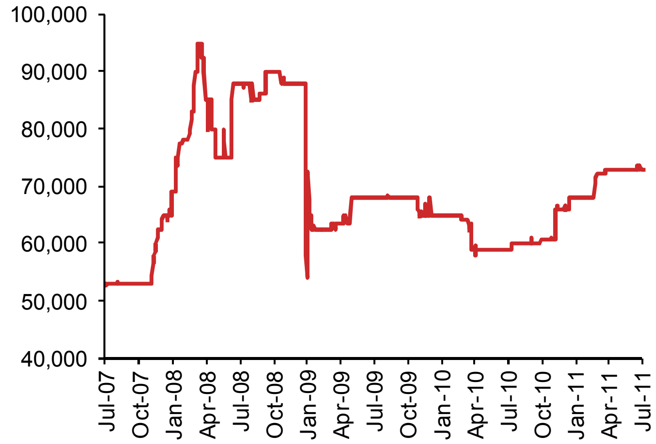
Source: Bloomberg, Nomura Research

Fig. 19: Sugar price index



Source: Bloomberg, Nomura Research

Fig. 20: Safflower Oil prices



Source: Bloomberg, Nomura Research

Our key recommendations

We have reviewed the performance of companies across the sector in 1QFY13 and, with a view towards the next year or so, have made several changes to our earnings estimates, target prices and ratings. We believe that, over the next year or so, the area within the consumer sector that will be relatively defensive is the staples sub-segment, with the consumer discretionary segment likely to come under some pressure.

We believe that, given the environment, stable and predictable cash flow generating companies will command a premium.

ITC is our top Buy in the sector, where predictability of cash flows is very high, despite several noises which have been made around packaging norms, changes in tax structure and competition from the illicit segment.

We are also upgrading HUVR to Neutral from Reduce, given the defensive nature of the stock as well as the turnaround in operations seen over the past few quarters. We have analysed how the changing portfolio mix is likely to help both volume growth trajectory as well as profitability in the medium term. However, we believe current valuations are too rich to build a Buy case and we would wait for a better entry point.

Within the midcap space, we prefer GCPL, where delivery on both domestic and international business has been consistently good and, with synergies from acquisitions continuing to accrue, we believe GCPL is in a sweet spot. In our view, valuations will continue to inch up to sector average multiples as investors continue to gain confidence on the company's international portfolio.

Within the consumer discretionary segment, we prefer Jubilant Foodworks, as its same store sales growth (SSSG) has held at 20%+ vs. company guidance of 18-20% for FY13F. Given the low ticket size, low levels of penetration, smaller price increases this year and innovation on the portfolio, we believe the company will be able to deliver 20% SSSG in FY13F. Management has also guided for 100 store openings this year, which again signals its confidence that demand will sustain. Its Dunkin' Donuts business will not be a big contributor this year, but going forward it has the potential to be a success.

Fig. 21: Summary of recommendation changes

Stock	Ticker	Price INR	Recommendation Old	Recommendation New	Target Price INR Old	Target Price INR New	Upside/Downside
Hindustan Unilever	HUVR IN	548	Reduce	Neutral	327	527	-4%
ITC	ITC IN	268	Buy	Unchanged	246	310	16%
Godrej Consumer Products	GCPL IN	659	Buy	Unchanged	524	800	21%
Jubilant Foodworks	JUBI IN	1,235	Buy	Unchanged	1,100	1,490	21%

Note: Pricing as of September 14, 2012
Source: Bloomberg, Nomura Research

Fig. 22: Sector valuations

Company	Ticker	Rating	Price Rs.	EPS growth FY14E %	FY13E P/E	FY14E P/E	FY14E PEG
Food and Beverages							
Nestle *	NEST IN	Neutral	4,489	22%	35.9x	29.4x	1.3x
GSK Consumer *	SKB IN	Buy	3,070	20%	30.3x	25.2x	1.2x
Jubilant Foodworks	JUBI IN	Buy	1,235	38%	49.9x	36.1x	0.9x
United Spirits	UNSP IN	Neutral	928	20%	33.5x	27.8x	1.4x
Average					**36.1x**	**29.1x**	
HPC							
Colgate Palmolive	CLGT IN	Reduce	1,244	14%	33.2x	29.0x	2.0x
Dabur	DABUR IN	Buy	127	20%	28.8x	23.9x	1.2x
Godrej Consumer	GCPL IN	Buy	659	24%	29.0x	23.3x	1.0x
Hindustan Unilever	HUVR IN	Neutral	548	16%	36.9x	31.7x	2.0x
Marico	MRCO IN	Reduce	198	16%	31.3x	26.9x	1.7x
Average					**34.3x**	**29.3x**	
Tobacco							
ITC	ITC IN	Buy	268	18%	28.8x	24.5x	1.4x
Paints							
Asian Paints	APNT IN	Neutral	3,901	20%	33.9x	28.2x	1.4x
Retail							
Titan Industries	TTAN IN	Buy	241	28%	26.2x	20.6x	0.7x

Note: Pricing as of September 14, 2012; * indicated Calendar year based numbers
Source: Bloomberg, Nomura Research

Hindustan Unilever HLL.NS HUVR IN

GENERAL CONSUMER

NOMURA
EQUITY RESEARCH

Move to Neutral– Look for a better entry point

Levers working well again; Upgrade to Neutral; would wait for a better entry point

September 20, 2012

Rating Up from Reduce	**Neutral**
Target price Increased from 327	INR 527
Closing price September 14, 2012	INR 548
Potential downside	-3.8%

Action: Upgrade to Neutral, TP raised to INR527

We upgrade HUVR to Neutral from Reduce and raise our TP to INR527 from INR327 on the back of structural improvements in the business. We have, over the last year or so, unsuccessfully argued that volume growth performance is unlikely to sustain and that valuations are likely to correct. But given the continued strong delivery on the operational front, valuation premiums have indeed only expanded further. We now believe HUVR has turned a corner and valuations are likely to sustain at higher levels than the long-term average in the near term. We struggle to build a Buy case from current levels, but we like HUVR from a fundamental view and reckon it would likely garner more interest on any correction from current levels.

Catalysts: Sustained volume growth and soft commodity prices

We see two key catalysts for stock price performance in the near term. First, we believe continued delivery on volume growth will be the key deliverable to watch. Second, soft commodity prices should allow the company to invest in growing the brands and innovation pipeline, which in our view will be key for long-term growth.

Valuation: HUVR trades at 31.7x FY14F PE

Given the sharp run-up since 1 August, (HUVR +17%, FMCG index +7%, Sensex +7%), HUVR now trades at 31.7x FY14F EPS of INR17.27. Given our forecast 16-18% earnings growth over the next couple of years, we believe it is difficult to build a Buy case from current levels. However, we note HUVR's strong franchise means the stock would likely garner more interest on any correction from current levels.

31 Mar	FY12		FY13F		FY14F		FY15F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	234,363	259,227	277,532	289,097	318,621		365,039
Reported net profit (mn)	27,907	29,380	32,121	33,566	37,331		44,075
Normalised net profit (mn)	26,770	29,380	32,121	33,566	37,331		44,075
FD normalised EPS	12.38	13.61	14.86	15.55	17.27		20.39
FD norm. EPS growth (%)	29.0	14.3	20.0	14.2	16.2		18.1
FD normalised P/E (x)	44.3	N/A	36.9	N/A	31.7	N/A	26.9
EV/EBITDA (x)	31.1	N/A	25.9	N/A	22.2	N/A	18.7
Price/book (x)	34.0	N/A	31.1	N/A	28.3	N/A	25.9
Dividend yield (%)	1.6	N/A	2.4	N/A	2.8	N/A	3.3
ROE (%)	92.6	101.4	88.1	104.5	93.5		100.2
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

HUVR is likely to grow profits at mid- to high-teens levels over the next few years on mix improvement and greater focus on execution. This means valuations will likely continue to remain at the upper end of its long-term average.

Nomura vs consensus

We are 3-5% ahead of consensus on FY13F and FY14F EPS. Our numbers now build in a 50bp margin improvment in FY13F on account of the change in product mix.

Research analysts

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

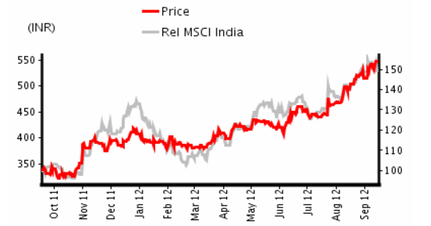
Key data on Hindustan Unilever

Income statement (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Revenue	**200,226**	**234,363**	**277,532**	**318,621**	**365,039**
Cost of goods sold	-101,820	-125,017	-147,073	-168,682	-192,540
Gross profit	**98,405**	**109,347**	**130,459**	**149,939**	**172,499**
SG&A	-60,886	-62,241	-74,086	-84,652	-96,003
Employee share expense	-10,149	-12,009	-14,229	-16,319	-18,697
Operating profit	**27,371**	**35,096**	**42,145**	**48,968**	**57,799**
EBITDA	**29,664**	**37,432**	**44,731**	**51,809**	**60,880**
Depreciation	-2,293	-2,335	-2,586	-2,841	-3,081
Amortisation					
EBIT	27,371	35,096	42,145	48,968	57,799
Net interest expense	-10	-17	-20	-20	-20
Associates & JCEs	0	0	0		
Other income					
Earnings before tax	**27,361**	**35,080**	**42,125**	**48,948**	**57,779**
Income tax	-6,503	-8,215	-9,899	-11,503	-13,578
Net profit after tax	**20,858**	**26,865**	**32,225**	**37,446**	**44,201**
Minority interests	-106	-95	-104	-115	-126
Other items					
Preferred dividends					
Normalised NPAT	**20,752**	**26,770**	**32,121**	**37,331**	**44,075**
Extraordinary items	2,208	1,137	0	0	0
Reported NPAT	**22,961**	**27,907**	**32,121**	**37,331**	**44,075**
Dividends	-16,420	-18,839	-28,909	-33,598	-39,667
Transfer to reserves	**6,541**	**9,068**	**3,212**	**3,733**	**4,407**
Valuation and ratio analysis					
Reported P/E (x)	51.5	42.4	36.9	31.7	26.9
Normalised P/E (x)	57.0	44.3	36.9	31.7	26.9
FD normalised P/E (x)	57.1	44.3	36.9	31.7	26.9
FD normalised P/E at price target (x)	54.9	42.6	35.5	30.5	25.8
Dividend yield (%)	1.4	1.6	2.4	2.8	3.3
Price/cashflow (x)	68.4	37.0	31.0	27.0	21.4
Price/book (x)	46.6	34.0	31.1	28.3	25.9
EV/EBITDA (x)	39.3	31.1	25.9	22.2	18.7
EV/EBIT (x)	42.6	33.2	27.5	23.5	19.7
Gross margin (%)	49.1	46.7	47.0	47.1	47.3
EBITDA margin (%)	14.8	16.0	16.1	16.3	16.7
EBIT margin (%)	13.7	15.0	15.2	15.4	15.8
Net margin (%)	11.5	11.9	11.6	11.7	12.1
Effective tax rate (%)	23.8	23.4	23.5	23.5	23.5
Dividend payout (%)	71.5	67.5	90.0	90.0	90.0
Capex to sales (%)	1.0	0.6	1.4	1.1	1.0
Capex to depreciation (x)	0.9	0.6	1.5	1.3	1.2
ROE (%)	92.5	92.6	88.1	93.5	100.2
ROA (pretax %)	35.0	39.9	42.0	42.7	46.1
Growth (%)					
Revenue	11.1	17.0	18.4	14.8	14.6
EBITDA	1.6	26.2	19.5	15.8	17.5
EBIT	0.3	28.2	20.1	16.2	18.0
Normalised EPS	0.0	28.8	20.0	16.2	18.1
Normalised FDEPS	-1.2	29.0	20.0	16.2	18.1
Per share					
Reported EPS (INR)	10.64	12.91	14.86	17.27	20.39
Norm EPS (INR)	9.61	12.38	14.86	17.27	20.39
Fully diluted norm EPS (INR)	9.60	12.38	14.86	17.27	20.39
Book value per share (INR)	11.77	16.12	17.61	19.33	21.17
DPS (INR)	7.61	8.72	13.37	15.54	18.18

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	10.5	24.3	55.4
Absolute (USD)	13.1	27.6	36.1
Relative to index	6.8	14.1	45.8
Market cap (USDmn)	21,768.0		
Estimated free float (%)	41.2		
52-week range (INR)	554.7/319.25		
3-mth avg daily turnover (USDmn)	21.60		
Major shareholders (%)			
LIC of India	6.9		
New India Assurance	1.3		

Source: Thomson Reuters, Nomura research

Notes

Margin improvements captured into its high valuations

Cashflow (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
EBITDA	29,664	37,432	44,731	51,809	60,880
Change in working capital	-3,545	3,850	4,548	3,548	8,398
Other operating cashflow	-8,803	-9,244	-11,082	-11,507	-13,963
Cashflow from operations	**17,316**	**32,037**	**38,197**	**43,850**	**55,315**
Capital expenditure	-2,099	-1,447	-3,826	-3,570	-3,714
Free cashflow	**15,217**	**30,590**	**34,371**	**40,280**	**51,601**
Reduction in investments	359	-11,337	0	0	0
Net acquisitions	0	0	0		
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments					
Cashflow after investing acts	**15,576**	**19,253**	**34,371**	**40,280**	**51,601**
Cash dividends	-14,032	-16,211	-28,909	-33,598	-39,667
Equity issue	322	-726	381	-387	0
Debt issue	-4,233	-108	0	0	0
Convertible debt issue	0	0	0	0	0
Others					
Cashflow from financial acts	**-17,943**	**-17,046**	**-28,527**	**-33,985**	**-39,667**
Net cashflow	**-2,367**	**2,207**	**5,843**	**6,295**	**11,933**
Beginning cash	20,124	17,756	19,964	25,807	32,102
Ending cash	17,756	19,964	25,807	32,102	44,036
Ending net debt	-17,756	-19,964	-25,807	-32,102	-44,036

Source: Company data, Nomura estimates

Notes

FCF generation continues to be strong, in our view

Balance sheet (INRmn)

As at 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Cash & equivalents	17,756	19,964	25,807	32,102	44,036
Marketable securities					
Accounts receivable	9,633	8,567	11,752	13,479	15,442
Inventories	28,757	26,674	35,733	43,647	48,479
Other current assets	8,247	8,641	10,933	12,254	14,203
Total current assets	**64,393**	**63,846**	**84,225**	**101,482**	**122,160**
LT investments	11,885	23,222	23,222	23,222	23,222
Fixed assets	25,264	25,036	26,953	27,939	28,811
Goodwill					
Other intangible assets					
Other LT assets					
Total assets	**101,542**	**112,104**	**134,399**	**152,642**	**174,192**
Short-term debt					
Accounts payable	58,648	57,399	70,887	81,303	93,147
Other current liabilities	17,335	19,680	25,275	29,369	34,667
Total current liabilities	**75,983**	**77,079**	**96,162**	**110,672**	**127,815**
Long-term debt	0	0	0	0	0
Convertible debt					
Other LT liabilities					
Total liabilities	**75,983**	**77,079**	**96,162**	**110,672**	**127,815**
Minority interest	146	183	183	183	183
Preferred stock					
Common stock	2,159	2,162	2,162	2,162	2,162
Retained earnings					
Proposed dividends					
Other equity and reserves	23,255	32,680	35,892	39,625	44,033
Total shareholders' equity	**25,413**	**34,842**	**38,054**	**41,787**	**46,194**
Total equity & liabilities	**101,542**	**112,104**	**134,399**	**152,642**	**174,192**
Liquidity (x)					
Current ratio	0.85	0.83	0.88	0.92	0.96
Interest cover	2,710.0	2,127.1	2,107.2	2,448.4	2,890.0
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	15.0	14.2	13.4	14.5	14.5
Days inventory	91.4	81.1	77.4	85.9	87.3
Days payable	201.1	169.9	159.2	164.7	165.4
Cash cycle	-94.6	-74.5	-68.4	-64.3	-63.6

Source: Company data, Nomura estimates

Notes

Balance sheet continues to support potential buybacks

HUL – one of the best performing consumer stocks within our universe in the past year

Over the past one year, HUVR has been the best performing consumer stock in our coverage universe – the stock has risen +63% vs. the FMCG index's gain of +35% and the Sensex's gain of +8%. We attribute the performance to its strong operational performance and a risk-off environment, suggesting that valuations across the consumer universe are now at multi-year highs.

Our rating on the stock over the past year or so has not captured the sharp increases in valuation multiples that have reached multi-year highs. As well, in terms of product mix changes and how it impacts the future earnings growth trajectory, we have been behind the curve in reading the change.

We are now taking a fresh look at the company, its product portfolio mix, likely earnings growth trajectory, drivers of future growth, as well as analysing what has happened over the past few years in terms of operational performance. We also look at whether valuation multiples can hold at current levels and what does that mean for the stock in the long term.

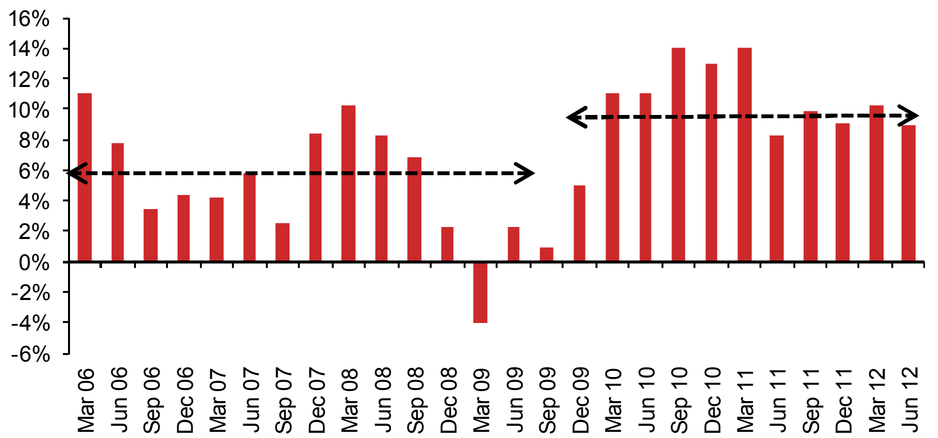
Volume growth trajectory has undergone a significant change

As we look at top-line performance over the past six years or so, it can clearly be classified into different phases. Over the past six years, HUVR has delivered volume growth of 7% and price/mix benefit of 7%, which added up to ~14% domestic business revenue growth, on our numbers.

However, if we break down this performance over the past couple of years, we see some trends emerging. Towards the latter half of FY10 and into FY11, the company shifted its focus to start growing volumes again. This resulted in FY11 volume growth averaging at 13% vs. the FY10 average of 5%. However, pricing remained under pressure, with average pricing declining by 3% to result in FY11 revenue growth of 10% in the domestic business.

In FY12, the company maintained its focus on volume growth, which resulted in its volume growth trajectory being maintained at high single-digit (~9%) despite the high base of FY11. However, with pressure on pricing having started to wane, the company was able to take selective price increases across the portfolio, which led to an average price/mix benefit of 9%. Together, this pushed its revenue growth trajectory to ~18% in FY12 from ~10% in FY11 and ~8% in FY10.

Fig. 23: Volume growth trajectory has seen an upward shift



Source: Company data, Nomura research

Volume growth has been the key positive surprise over the past few quarters

We believe volume growth has been the biggest positive surprise for the markets over the past 8-10 quarters. While the numbers delivered in FY11 could partly be explained by the low base in FY10, FY12 performance has been a positive surprise. Indeed, the double-digit FY12 volume growth number has been a key positive which has caught us and the Street by surprise.

What has enabled the change in growth trajectory?

• Growth has been strong across the sector:

While HUVR's performance over the past few quarters has been commendable, a look at the performance of other companies in the consumer staples space clearly shows that the entire sector has benefitted from the rise in consumption growth in India. In addition, we believe all the companies have invested in growing their distribution reach, which has also helped to drive the strong volume growth seen across the sector.

Fig. 24: Volume growth trajectory on an upswing across the sector

	Jun'11	Sep'11	Dec'11	Mar'12	Jun'12
HUVR	8	10	9	10	9
Dabur	9	5	9	10	12
Marico	21	14	20	17	14
Colgate	13	13	20	20	11

Source: Company data, Nomura research

• Distribution footprint expansion has been one of the key enablers:

Over the past few years, there has also been a significant thrust by the companies to increase their distribution footprint across the country. HUVR has invested in increasing its direct distribution reach, which has resulted in more than 6.5mn outlets in total, of which 2mn-plus outlets have direct distribution. Its efforts have been directed at improving both the quantity and quality of its reach to leverage all the direct and indirect benefits. This has meant much greater availability on the shelves across its outlets for the company. In rural India, the company has tripled its direct distribution network over the past couple of years. Together with programmes such as '*project shakti*' and '*project express*', HUVR has been able to extend its reach to more consumers in rural India, which we believe has translated into volumes.

• Renovation has seen a significant step-up:

Over the past few years, HUVR has also made significant investments to re-launch various parts of its portfolio. Over the past couple of years, ~60% of its portfolio has been touched by renovation. Within sub-categories, the company has also launched various innovations, which in our view has helped rekindle consumer interest and demand in a particular sub-segment. This has been true across categories and, is particularly relevant in personal products. The table below highlights some of the products which have been re-launched in the past year or so.

Fig. 25: Renovation of the portfolio has been a key factor in driving volumes

Product	Segment
Lux with Silk protein	Soaps and Detergents
Fair and Lovely Face washes	Personal Products
Dove Nourishing Oils range	Personal Products
Lakme absolute range	Personal Products
Sunsilk Keratinology	Personal Products
Pepsodent G	Personal Products
Clear Relaunched	Personal Products
Kissan range expanded and re-launched	Packaged Foods
Cup–a–Soup instant soups	Beverages
Bru Exotica	Beverages

Source: Company data

• Increased focus on personal products:

The company does acknowledge that personal products will be the key growth driver in the medium term. This segment includes categories such as oral care, hair care, face washes, and anti-ageing products and the like. Most of these segments have low penetration levels, high consumer interest given the rise in incomes and the accompanying aspiration value, and greater market readiness in terms of consumer acceptance. There has been significant focus on driving volumes in this segment, with a view to building segment leadership in the future. This we believe is another reason why volume growth trajectory has moved higher over the past few years. While there has been significant delivery on volume growth, opportunity to drive penetration levels in this segment continues to be attractive and we expect HUVR's overall volume growth trajectory to be supported by this segment over the next couple of years.

This segment also helps the company to drive mix improvement, as the premium segment is growing much faster than the mass end of the market. HUVR has taken continuous efforts to have products spanning the entire range, which has helped it drive growth as well as improve its product mix. For instance, the skin care segment – the premium end of the market which accounts for 20% of market share, has witnessed a CAGR of 40% over FY09-11, while the mass end of the market (~50%) has been growing at 10% over the same period.

Fig. 26: Skin care (face) segment market dynamics

% of the Market	Segments	Market CAGR FY09-11(%)
20	Premium	40
30	Mid	35
50	Mass	10

Source: Company data

Benefits from the above are likely to continue in the medium term

We believe all the factors listed above will remain relevant in the medium term. However, the degree of push to growth from these factors should vary. Given the expansion in incomes across the rural and urban consumer, we believe demand for staples will continue to be strong in the medium term.

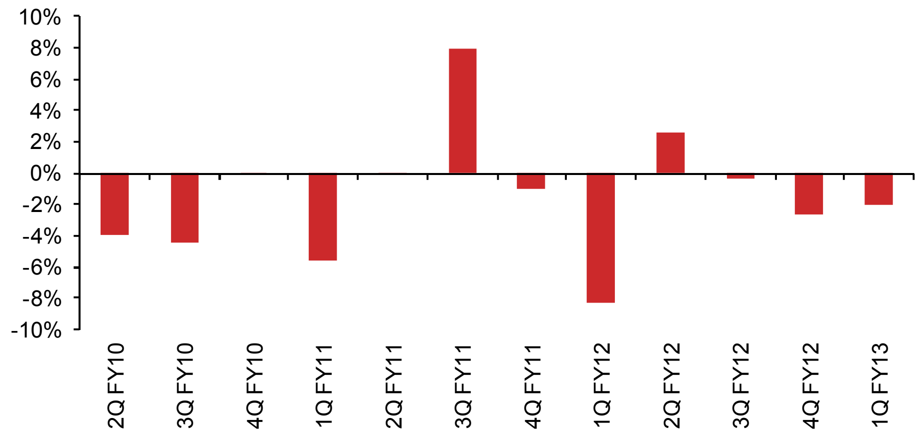
While there may be a short-term slowdown, particularly in some segments such as packaged foods, high-end anti-ageing products etc, for the longer term we expect the company's volume growth to continue at 8-10%.

Have the quarterly numbers been beating our expectations?

We have also assessed the company's quarterly company performance vs. our expectations to ascertain whether there has been any consistent and significant beat vs. our expectations. We have looked at data for the past 10 quarters or so. As noted before, HUVR's share-price performance has not entirely been a result of revenue, volume or earnings beat vs. expectations. Since the net profit number will include a significant level of 'noise' with variations in other income etc, we have looked at the most basic performance metric – revenue growth performance and, hence the underlying volume growth performance.

We find that over the past 10 quarters or so, the company has delivered more or less in line with our expectations albeit with small variations. In the most recent quarters, the numbers were actually marginally below our expectations.

Fig. 27: Quarterly performance actual vs. Nomura expectation

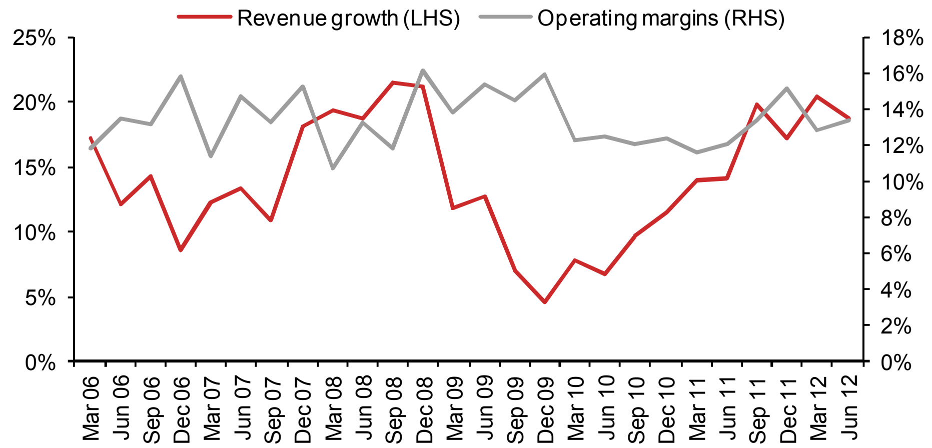


Source: Company data, Nomura research

Volumes vs. margins – has the debate ended?

In the past, there has been a disconnection between volume growth and margins. When the company focused on restoring volume growth, it usually came at the expense of margins, as A&P spends grew significantly and vice versa. However, this has not been the case of late, as the company has been able to deliver both volume growth as well as margin improvement. The company now seems, in our view, on the path where it will look to grow volumes in a profitable manner.

Fig. 28: Revenue growth vs. operating margins

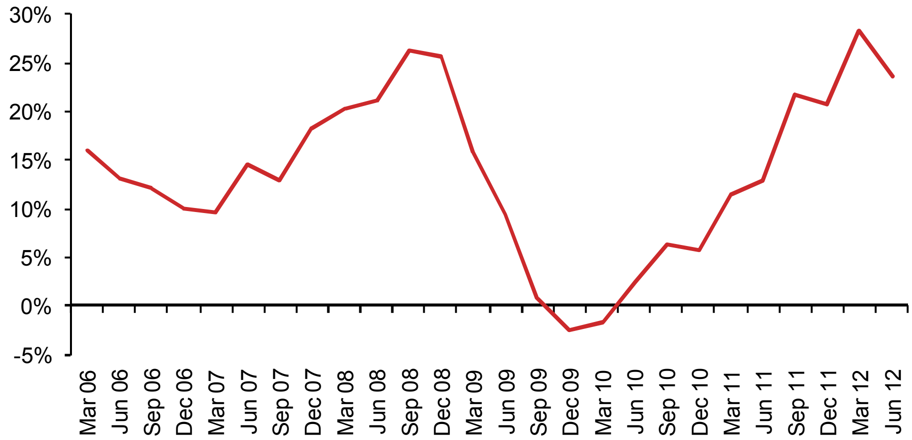


Source: Company data, Nomura research

What has helped make this change?

We believe one of the key reasons why HUVR has been able to manage the change is it has taken a re-look at its portfolio. We believe HUVR has a renewed focus on which parts of the portfolio to grow and at what profitability levels. If we look at the revenue growth numbers on a yearly basis across various segments, the soaps portfolio saw only single-digit growth in FY11 and FY12. However, the detergents segment, which is still growing relatively well in our view, has seen a sharp jump in FY12 revenue, registering growth of ~30%. This is also the more profitable part of the segment, which has helped the company improve segment margins to 12.2% from 7.5% reached a few quarters ago.

Fig. 29: Soaps and detergents segment has seen a significant pick-up in revenue



Source: Company data, Nomura research

A&P spends are more calibrated

Historically, the company's volume growth has come at the expense of a significant rise in A&P spends. However, over the last few quarters, the company has been able to calibrate A&P spends with a view to competing in segments that have scope for profitable growth. Over the past six quarters or so, AUVR's overall spending on A&P has remained at 12.5-14% levels while it managed to deliver average volume growth of 10%, much higher than its long-term average. It is important to note that during this period, there have been a number of re-launches, new product introductions and specific promotions across segments.

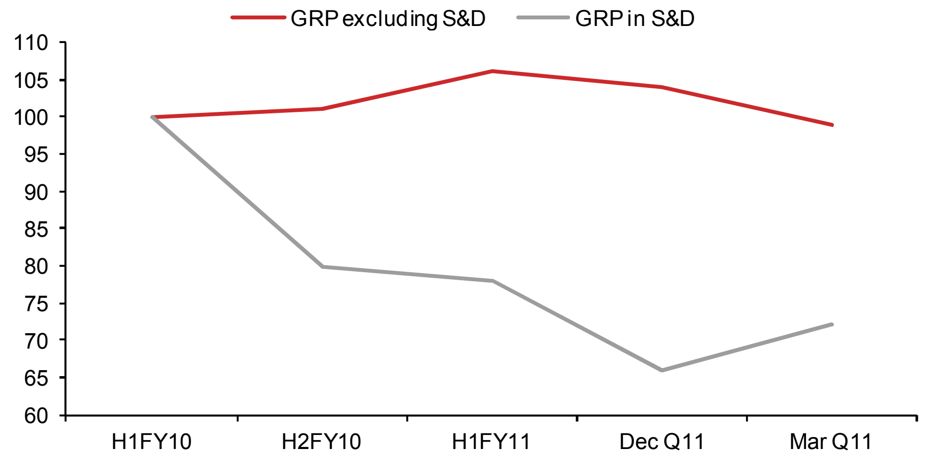
Fig. 30: A&P spends as a percentage of domestic sales

Source: Company data, Nomura research

A&P also calibrated across segments

While the company continues to invest in A&P, there is a significant difference in the amount invested among the categories. If we look at indexed spending in soaps and detergents and other segments, this variation is clearly illustrated. Although spending in the S&D segment has gone down, overall spending excluding the S&D segment has increased. This is a key positive in our view as the company is investing in growing segments, and less so in large and mature categories.

Fig. 31: Indexed spending on categories

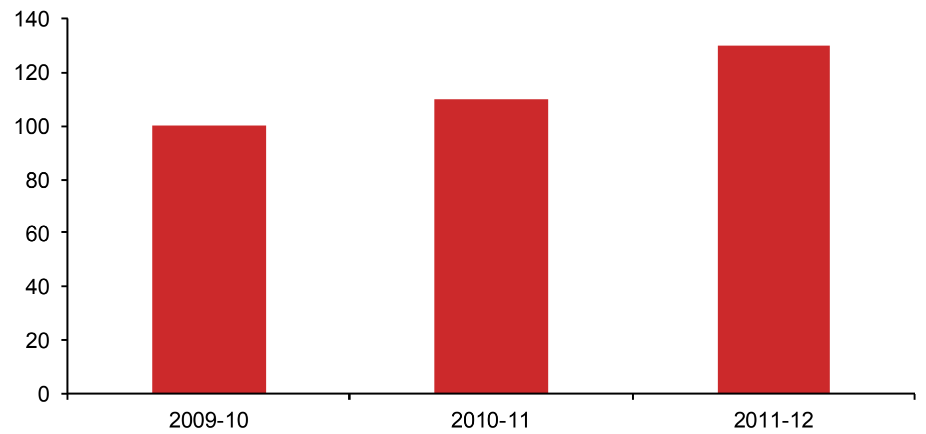


Source: Company data, Nomura research

Focus is also on cost-saving initiatives

While volume growth has seen a significant turnaround, the company has also focused on cost-saving initiatives across the board. This helps to cushion the company's profitability in times of high input costs and it adds to margin benefits as input prices ease off. The chart below illustrates the significant rise in indexed cost-saving measures over the last couple of years. These measures are seen across various segments, including supply chain, sourcing, manufacturing, packaging etc.

Fig. 32: Indexed cost-saving measures



Source: Company data, Nomura research

A look at what is happening to the portfolio mix at HUVR

We believe one of the reasons why HUVR has attracted investor interest anew is its changed product mix. For a long time, HUVR was highly reliant on the soaps and detergents (S&D) segment for profit growth. As growth in this segment slowed, partly due to penetration levels reaching saturation and profitability declining to reflect the realities of a highly competitive segment, the company's overall growth also declined. This was especially evident in FY11, when profitability of the S&D segment reached a multi-year low, suggesting that overall profit growth was flat on a y-y basis.

Fig. 33: Portfolio mix undergoing a change

EBIT share (%)	CY04	CY05	CY06	CY07	FY09	FY10	FY11	FY12	FY13F	FY14F	FY15F
Soaps & Detergents	42.9	37.7	38.3	44.2	45.8	41.7	30.0	35.0	34.6	33.1	31.9
Personal Products	45.6	47.9	48.9	46.2	44.2	45.2	53.7	49.5	52.2	54.3	56.1
Beverages	13.3	13.4	10.9	10.3	9.5	11.2	13.1	10.4	10.1	9.7	9.4
Packaged Foods	(4.9)	(0.7)	1.0	1.4	0.3	0.6	1.1	0.7	0.8	0.8	0.8
Others	3.2	1.7	0.9	(2.1)	0.1	1.2	2.1	4.3	2.3	2.1	1.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Company data, Nomura estimates

Portfolio moving more towards personal products

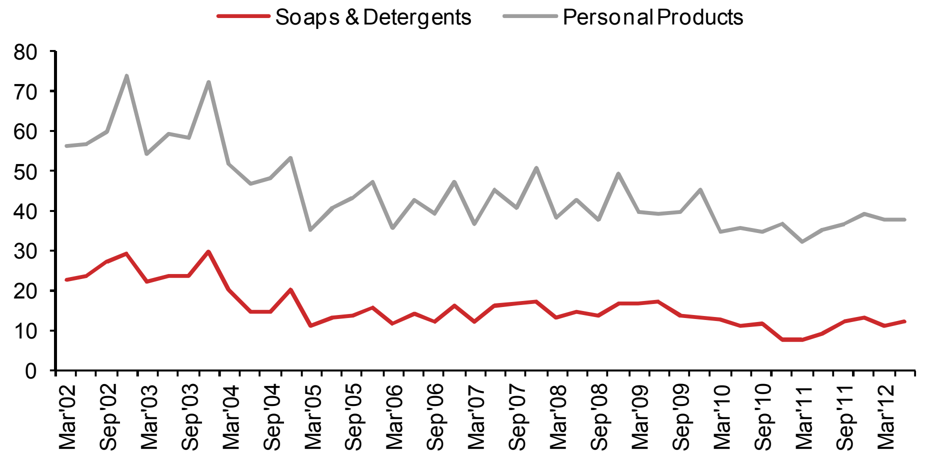
Over the past few years, HUVR's portfolio mix has undergone changes with personal products (PP) gaining share while its reliance on S&D declined.

From ~45% of profits in FY09, we believe contribution from S&D will decline gradually to ~32% in FY15F. On the other hand, we estimate contribution from PP will improve from ~44% in FY09 to 56% in FY15F.

This is a key shift, as the company now moves from being dependent on a category (which is largely penetrated and, hence low profitability) to segments that are deemed to have low penetration levels and scope for long-term growth opportunity. Additionally, the profitability of PP doubles that of S&D.

We expect this gradual shift to continue over the next few years, which should help to improve the overall profitability of the company in the medium term.

Fig. 34: EBIT margins in the two key segments are significantly different



Source: Company data, Nomura research

Our changed expectations by segment

We have made changes to our model in terms of revenue and earnings growth expectations.

For S&D, we expect the company to deliver 12% revenue growth over the next 2-3 years via a mix of volumes and price change. As discussed above, mix improvement is a long-term phenomenon and we estimate this will account for 2-4% of total revenue growth in the next 2-3 years. We expect pricing actions (pricing increases) to remain with volume growth likely to be in mid single-digits. We believe the firm's focus on volume growth is likely to be a key driver, with potential for market -share gain from smaller players.

In the PP segment, volume growth has averaged in the mid-teens range over the last few quarters. We expect this momentum to continue, as the PP segment is not highly penetrated and it is garnering increased interest from consumers. The PP segment offers growth opportunity in our view, and we expect the company to drive volume in this segment in the near term. We conservatively expect only 3-4% price and product mix benefit from this segment.

We expect the beverage segment to deliver low teens revenue growth, with some parts of the portfolio needing some rejuvenation. This will entail an investment over the next few quarters, but should help the company deliver stable revenue growth in the medium term.

HUVR's packaged foods portfolio has been a bit of a disappointment, and the company has acknowledged that it needs to do better in this segment. Activation plans behind soupy noodles as well as ready-to-eat packaged foods have been a good starting point, but the potential in this segment remains significantly under-utilized, in our opinion.

Stock performance also helped by other factors

HUVR has had a strong run since August 1, 2012. The stock is up +17% vs. the Sensex's gain of +7% and the FMCG index's gain +7% in the period. However, this performance is clouded by the underperformance in the earlier part of the year.

Fig. 35: Sector price performance

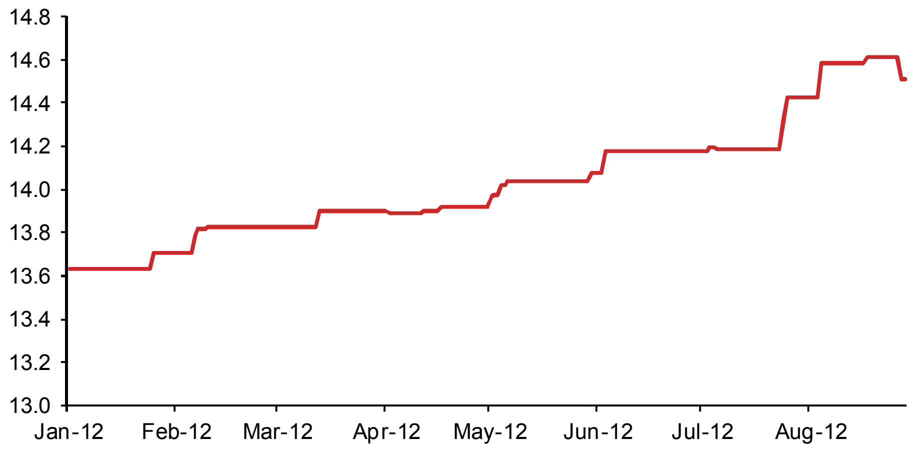
Stock	Ticker	Rating	14-Sep-12	2-Jan-12	YTD
United Spirits	UNSP IN	Neutral	928	495	88%
Godrej Consumer	GCPL IN	Buy	659	372	77%
Jubilant Foodworks	JUBI IN	Buy	1,235	752	64%
Asian Paints	APNT IN	Neutral	3,901	2,590	51%
Titan Industries	TTAN IN	Buy	241	175	37%
Marico	MRCO IN	Reduce	198	144	37%
Hindustan Unilever	HUVR IN	Neutral	548	402	36%
FMCG Index	**BSETMCG**	**NA**	**5,407**	**3,983**	**36%**
ITC	ITC IN	Buy	268	199	35%
Dabur	DABUR IN	Buy	127	100	27%
Colgate Palmolive	CLGT IN	Reduce	1,244	985	26%
GSK Consumer	SKB IN	Buy	3,070	2,500	23%
Sensex	**SENSEX**	**NA**	**18,464**	**15,518**	**19%**
Nestle India	NEST IN	Neutral	4,489	4,039	11%

Source: Bloomberg, Nomura research

What has driven this share price performance?

We attribute the share-price performance to two main reasons. First, the underlying performance has been very strong in 1QFY13. HUVR's volume growth trajectory has remained at ~10%, which is higher than street expectations. As such, consensus has upgraded earnings, which has been one of the reasons for stock performance over the last quarter, in our view.

Fig. 36: HUVR consensus earnings expectations for FY13F



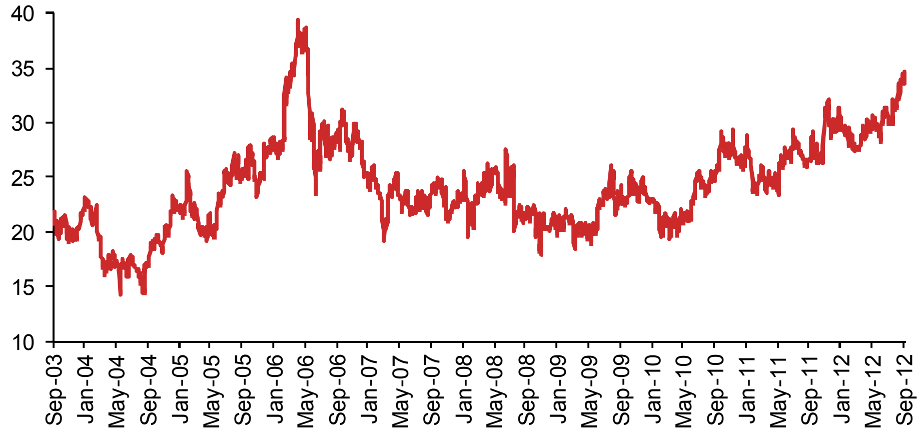
Source: Bloomberg, Nomura research

However, the magnitude of earnings upgrades has been only ~6.5% since the beginning of the year. We believe the recent share-price performance is not only led by changes in consensus earnings expectations, but also on account of the increase in the valuation premium vs. the Sensex.

Multiple re-rating has been significant over the last couple of years

If we have a look at how the one-year forward P/E of HUVR has moved over the last few years, the sharp re-rating vs. the Sensex is visible. The stock has moved from a trading range of 22-23x one-year forward at the start of CY10 to ~37.5x currently. This is a move of more than 63% purely in terms of multiple de-rating since the start of CY10. We believe this has been only partly driven by the company's performance over the last few quarters, while a majority of it has been driven by P/E multiple expansion.

Fig. 37: HUVR one year forward P/E has seen a significant re-rating

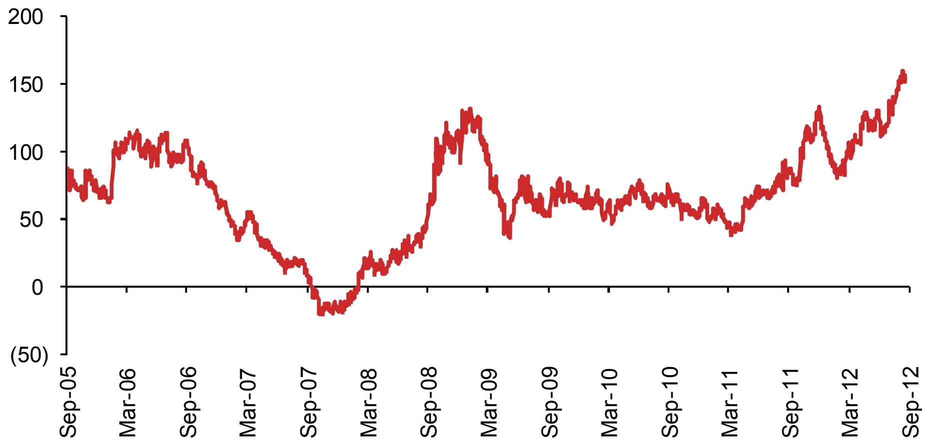


Source: Bloomberg, Nomura research

Move exaggerated by the risk-off environment

We believe this valuation re-rating is also exaggerated by a risk-off environment, where investors have continued to drive valuations of consumer stocks to multi-year highs. This is borne out when we look at HUVR's relative valuation vs. the Sensex. From trading at a 50% premium to Sensex valuation in 2010, the stock now trades at almost a 185% premium to the Sensex.

Fig. 38: HUVR valuation premium to Sensex has seen a sharp increase



Source: Bloomberg, Nomura research

HUVR has a strong inverse correlation with Sensex historically

We look at the historical performance of HUVR to analyze if there are other factors that impact its share-price performance. To detect trends, we look at various parameters such as volume growth, pricing, margin performance, input cost pressures, etc. While all these factors have affected the company and stock performances, we note that HUVR shares have a strong inverse correlation with the benchmark Sensex in the last decade.

The table below illustrates the performance of HUVR and the Sensex index. When the Sensex performed well, HUVR's share-price performance lagged and vice versa. This has so far repeated in 2012, with HUVR's share price up +30% vs. the Sensex's gain of +14%. Over the last five years or so, the correlation has been -70%.

Fig. 39: HUVR's performance has strong inverse co-relation to Sensex

Year	Sensex	Chg (%)	HUVR	Chg (%)	Sensex v HUVR
03-Jan-00	5,375		239		
01-Jan-01	3,955	-26.4%	200	-16.4%	10.1%
01-Jan-02	3,246	-17.9%	221	10.3%	28.2%
01-Jan-03	3,390	4.4%	182	-17.6%	-22.1%
01-Jan-04	5,915	74.5%	213	17.0%	-57.5%
03-Jan-05	6,679	12.9%	145	-32.0%	-44.9%
02-Jan-06	9,390	40.6%	195	35.0%	-5.6%
02-Jan-07	13,942	48.5%	216	10.9%	-37.6%
01-Jan-08	20,301	45.6%	218	0.9%	-44.7%
01-Jan-09	9,903	-51.2%	251	14.8%	66.0%
04-Jan-10	17,559	77.3%	265	5.6%	-71.7%
03-Jan-11	20,561	17.1%	313	18.3%	1.2%
02-Jan-12	15,518	-24.5%	402	28.5%	53.0%

Source: Bloomberg

Changes to our estimates

As we take into account HUVR's audited FY12 numbers and its changed product mix, we believe its earnings growth trajectory is likely to change over the medium term. From relying heavily on the slow-growing and low-profitability S&D segment, HUVR will, increasingly, focus on the PP segment, which has higher growth and profitability potential. We expect the changed focus to help improve its bended margins over the medium term.

Fig. 40: Changes to estimates

	FY13F			FY14F		
(INRmn)	Old	New	Chg (%)	Old	New	Chg (%)
Revenues	259,227	272,357	5%	289,097	312,374	8%
Net Profit	29,380	32,121	9%	33,566	37,331	11%
EPS	13.6	14.9	9%	15.6	17.3	11%

Source: Nomura research

The headline change in estimates is driven by a number of factors.

1) The audited FY12F numbers were 5% ahead of our numbers.

2) As discussed above, we now believe HUVR's revenue growth trajectory will move higher in the medium term. This plays a significant part in our upgrade. Our revenue growth expectation has moved to 12% to 15% over the medium term, led largely by volume growth.

3) Additionally as a result of product mix changes, we are now building in a 50bp margin expansion in FY13F, and a small 30bp improvement in each of the next two years. This compares with our earlier expectations of flat margins.

We expect margin improvement to be somewhat offset by increased A&P spending in areas such as oral care, where competition continues to be strong. In skin care, competitive intensity is high as well but we believe it offers attractive long-term opportunity for growth.

Where are we vs. consensus

Our top-line and bottom-line new numbers are ahead of consensus. We believe HUVR's improved products mix and focus on execution will help it to deliver mid- to high-teens profit numbers over the next couple of years. We also believe this will be aided by margin expansion from the improving mix of product portfolio. While there remains a risk that HUVR may choose to invest more on A&P to drive market-share gains in the near term, we believe margins are still likely to see an upward trajectory over the next couple of years. We are 3-5% ahead of consensus on bottom line for FY13F and FY14F. We would also caution that our numbers now build in most of the positives, and any earnings upgrade vs. our new numbers is unlikely in our view.

Fig. 41: Nomura v consensus

	FY13F			FY14F		
(INRmn)	Nomura	Cons	Nom v Cons (%)	Nomura	Cons	Nom v Cons (%)
Revenues	272,357	261,911	4%	312,374	297,343	5%
Net Profit	32,121	30,718	5%	37,331	35,881	4%
EPS	14.9	14.5	3%	17.3	16.5	5%

Source: Bloomberg, Nomura research

Increasing TP from INR327 to INR527

We increase our TP from INR327 to INR527, as we assign a higher multiple of 28x average FY14-FY15F EPS of INR18.8 (vs 21x previously) to account for its potential improving growth dynamics over the medium term.

We believe a multiple of 28x is justifiable in the medium term:

- HUVR is now likely to deliver mid- to high-teens earnings growth over the next few years, in our view, and we believe this puts it in line with Nestlé's earnings growth profile. We value Nestle at 28x one-year forward earnings and now assign a similar multiple on HUVR.
- HUVR has traded at high absolute valuations of 30x+ in the past, which has been characterized by high earnings growth. We believe over the next few years, given the company's likely earnings growth, HUVR should trade at high valuations. The longer-term average is still 24x, but we believe a 10-12% premium over that multiple in the short to medium term is justified.

Our equity strategy team is cautious on market performance in the near term. This will mean flow of funds into defensive sectors, such as consumer staples, will likely continue in the near term. HUVR is the largest company by revenues and breadth of portfolio in India, and we believe it is a defensive company to own in the staples space in India. We believe the stock will continue to trade at a premium in the near term.

Upgrading to Neutral

We upgrade HUVR to Neutral, driven by:

- Consistent volume growth that the company has shown over the past few quarters. We believe given the greater focus on execution, this is likely to continue in the medium term.
- Product mix is improving in terms of profitability with contribution from the PP segment increasing and reliance on S&D reducing. The PP segment has twice the margins as S&D and this is a key long-term positive for the company, in our view.

Feedback from management meeting

- **Categories continue to see solid growth**: The company continues to see solid growth across categories. Rural growth is holding up and there are no visible signs of "trade down". Key segments such as S&D and PP continue to grow at a healthy pace.
- **Market share gains**: Over the past few quarters, the company has seen fast market-share gains in many segments. We believe it is gaining share from unorganized players, especially from S&P names, which on our estimate could account for 25-30% of total market share. The company believes over the longer term, it can win consumers from unorganised players.
- **Focus on volume growth**: HUVR will continue to focus on driving volume growth, which it has done in the past 8-10 quarters. HUVR believes this will be its key growth driver. For the longer term, it is looking to deliver 6-10% volume growth across various categories, which we believe can be achieved given significant growth potential in its categories especially in PP and packaged goods.
- **Categories of the future**: HUVR cites several categories that are still in the nascent stage in terms of development. Some of these categories are body wash, face wash, anti ageing, premium coffee, fabric conditioner, etc. which the company believes will act as pillars of long-term growth along with its existing large categories.
- **Packaged food offers huge potential**: HUVR's portfolio is 85:15 split towards the HPC segment while Unilever (ULVR LN, REDUCE,) globally has a more even 50:50 split of HPC and packaged food. While HUVR does not see the split moving in line with Unilever's in the medium term, it sees this as a significant opportunity in the long term. HUVR believes market readiness in the HPC segment for leveraging global brands and products is much higher than that in packaged foods.

- **Portfolio will continue to be rejuvenated**: Over the last couple of years, ~60% of HUVR's portfolio has undergone some sorts of innovation. For categories such as oral care, HUVR has launched products at the premium end to fill its portfolio gaps. In other segments such as PP, there has been a number of re-launches to rejuvenate the portfolio. This will continue over the medium term, according to the company, to meet its long-term volume growth guidance.
- **Poor monsoons and weakening currency are near-term risks**: According to HUVR, poor monsoons and weakening currency are two risk factors in the near term. While it is too early to say how demand will progress given the deficient monsoons, there could be some short-term impacts especially if inflation rises.

Risks

We see two key risks for the company going forward, which could impact its underlying performance.

- Marked increase in competitive intensity in the key segments, which can force the company to increase A&P spending significantly from current levels. This has happened in the past, and hence there is a risk of the same happening again.
- Input costs remain a key long-term risk for HUVR. Over the next year or so, there could be significant spikes in input costs, which will be a negative for margins.

Still smoking…

Continues to deliver despite tough regulatory environment; Reiterate BUY

September 20, 2012

Rating Remains	**Buy**
Target price Increased from 246	INR 310
Closing price September 14, 2012	INR 268
Potential upside	+15.7%

Action: Reiterate Buy on continuing delivery in cigarette business

While the regulatory environment has been uncertain, with large increases in excise duty in both FY10 and FY12 budgets, ITC has been able to pass on these price increases to consumers and deliver robust revenue and earnings growth. This has been the case for the last 6-8 years, and we believe ITC will continue to deliver mid to high teens earnings growth, even if there remains some uncertainly on the regulatory front. Given this resilience which the company has demonstrated, we believe ITC should continue to be a core holding in the Indian consumer sector. Reiterate BUY with an increased TP of INR 310.

Catalysts: FMCG business reaching break-even

ITC has been investing a significant sum in building a consumer goods business over the last decade or so. This segment, called FMCG, now has revenues of INR55bn+, which makes it the second largest in the country by sales. This business is now likely to break even in the next 4-5 quarters, which will be a significant positive for ITC, we believe.

Valuation: ITC trades at 24.5x FY14F

ITC trades at 24.5x FY14F earnings vs the sector market-cap-weighted average of 27x and Hindustan Unilever at 31.7x. We expect ITC to deliver average earnings growth of 17-18% over the next couple of years, largely in line with the sector average, so we expect the valuation gap to close. We have increased our valuation multiple for the core cigarette business from 23x to 25x, and our increased SoTP valuation of INR310 gives 16% upside from current levels.

31 Mar	FY12	FY13F		FY14F		FY15F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	265,442	302,459	305,461	344,049	356,977		416,448
Reported net profit (mn)	62,581	71,339	72,782	81,075	85,603		102,168
Normalised net profit (mn)	61,340	71,339	72,782	81,075	85,603		102,168
FD normalised EPS	7.85	9.22	9.31	10.48	10.95		13.07
FD norm. EPS growth (%)	26.5	20.3	18.7	13.6	17.6		19.4
FD normalised P/E (x)	34.2	N/A	28.8	N/A	24.5	N/A	20.5
EV/EBITDA (x)	22.3	N/A	19.0	N/A	16.0	N/A	13.5
Price/book (x)	10.3	N/A	9.4	N/A	8.4	N/A	7.6
Dividend yield (%)	1.9	N/A	2.5	N/A	2.9	N/A	3.5
ROE (%)	33.3	36.9	34.0	40.6	36.2		38.8
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

Cigarettes account for 15% of overall tobacco consumption in India. Longer term, as incomes move up, we see this number rising, which should support mid- to high-single-digit volume growth in the core cigarettes business for ITC.

Nomura vs consensus

We are largely in line with consensus on our earnings for FY13F and FY14F.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

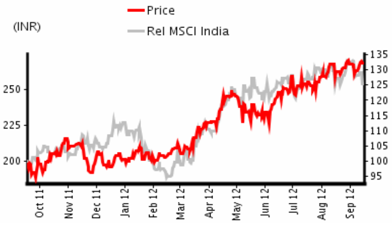
Key data on ITC

Income statement (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Revenue	**225,337**	**265,442**	**305,461**	**356,977**	**416,448**
Cost of goods sold	-86,300	-101,263	-115,289	-132,631	-152,725
Gross profit	**139,037**	**164,178**	**190,173**	**224,346**	**263,724**
SG&A	-52,006	-59,311	-67,432	-77,999	-89,734
Employee share expense	-17,240	-19,443	-22,362	-26,680	-31,568
Operating profit	**69,792**	**85,425**	**100,378**	**119,667**	**142,422**
EBITDA	**76,783**	**92,880**	**108,550**	**128,538**	**151,930**
Depreciation	-6,991	-7,455	-8,172	-8,872	-9,508
Amortisation	0	0	0	0	0
EBIT	69,792	85,425	100,378	119,667	142,422
Net interest expense	-608	-696	-700	-800	-900
Associates & JCEs	0	0	0	0	0
Other income	3,460	5,711	7,605	9,105	11,105
Earnings before tax	**72,644**	**90,440**	**107,283**	**127,972**	**152,627**
Income tax	-23,655	-28,458	-33,794	-41,591	-49,604
Net profit after tax	**48,989**	**61,982**	**73,489**	**86,381**	**103,023**
Minority interests	-515	-643	-707	-777	-855
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	**48,474**	**61,340**	**72,782**	**85,603**	**102,168**
Extraordinary items	1,705	1,242	0	0	0
Reported NPAT	**50,179**	**62,581**	**72,782**	**85,603**	**102,168**
Dividends	-40,024	-40,885	-52,039	-61,206	-73,050
Transfer to reserves	**10,154**	**21,697**	**20,743**	**24,397**	**29,118**
Valuation and ratio analysis					
Reported P/E (x)	41.8	33.5	28.8	24.5	20.5
Normalised P/E (x)	43.3	34.2	28.8	24.5	20.5
FD normalised P/E (x)	43.3	34.2	28.8	24.5	20.5
FD normalised P/E at price target (x)	50.0	39.5	33.3	28.3	23.7
Dividend yield (%)	1.9	1.9	2.5	2.9	3.5
Price/cashflow (x)	31.7	24.7	33.5	22.1	18.7
Price/book (x)	12.0	10.3	9.4	8.4	7.6
EV/EBITDA (x)	27.0	22.3	19.0	16.0	13.5
EV/EBIT (x)	29.7	24.2	20.5	17.2	14.4
Gross margin (%)	61.7	61.9	62.3	62.8	63.3
EBITDA margin (%)	34.1	35.0	35.5	36.0	36.5
EBIT margin (%)	31.0	32.2	32.9	33.5	34.2
Net margin (%)	22.3	23.6	23.8	24.0	24.5
Effective tax rate (%)	32.6	31.5	31.5	32.5	32.5
Dividend payout (%)	79.8	65.3	71.5	71.5	71.5
Capex to sales (%)	6.0	8.8	-1.3	3.5	3.0
Capex to depreciation (x)	1.9	3.1	-0.5	1.4	1.3
ROE (%)	30.9	33.3	34.0	36.2	38.8
ROA (pretax %)	30.1	33.6	35.5	38.0	40.1
Growth (%)					
Revenue	16.7	17.8	15.1	16.9	16.7
EBITDA	18.1	21.0	16.9	18.4	18.2
EBIT	19.1	22.4	17.5	19.2	19.0
Normalised EPS	20.0	26.5	18.7	17.6	19.4
Normalised FDEPS	20.0	26.5	18.7	17.6	19.4
Per share					
Reported EPS (INR)	6.42	8.00	9.31	10.95	13.07
Norm EPS (INR)	6.20	7.85	9.31	10.95	13.07
Fully diluted norm EPS (INR)	6.20	7.85	9.31	10.95	13.07
Book value per share (INR)	22.31	26.02	28.67	31.79	35.51
DPS (INR)	5.17	5.23	6.66	7.83	9.34

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	0.2	9.6	34.5
Absolute (USD)	2.5	12.5	17.7
Relative to index	-3.6	-0.6	24.8
Market cap (USDmn)	38,538.9		
Estimated free float (%)	67.0		
52-week range (INR)	273.25/185		
3-mth avg daily turnover (USDmn)	24.24		
Major shareholders (%)			
LIC of India	12.7		
UTI	11.6		

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
EBITDA	76,783	92,880	108,550	128,538	151,930
Change in working capital	-3,898	-1,290	643	365	421
Other operating cashflow	-6,747	-6,565	-46,504	-34,063	-40,254
Cashflow from operations	**66,138**	**85,025**	**62,688**	**94,840**	**112,097**
Capital expenditure	-13,453	-23,397	3,908	-12,500	-12,500
Free cashflow	**52,684**	**61,628**	**66,596**	**82,340**	**99,597**
Reduction in investments	1,326	-3,390	-25,000	-15,000	-20,000
Net acquisitions					
Reduction in other LT assets	-3,444	-10,228	18,908	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments					
Cashflow after investing acts	**50,567**	**48,010**	**60,504**	**67,340**	**79,597**
Cash dividends	-40,024	-40,885	-52,039	-61,206	-73,050
Equity issue	102	80	0	0	0
Debt issue	138	-173	0	0	0
Convertible debt issue	0	0	0	0	0
Others	0	0	0	0	0
Cashflow from financial acts	**-39,784**	**-40,977**	**-52,039**	**-61,206**	**-73,050**
Net cashflow	**10,783**	**7,032**	**8,465**	**6,133**	**6,547**
Beginning cash	13,486	24,269	31,301	39,766	45,900
Ending cash	24,269	31,301	39,766	45,900	52,447
Ending net debt	-23,023	-30,229	-38,694	-44,827	-51,374

Source: Company data, Nomura estimates

Balance sheet (INRmn)

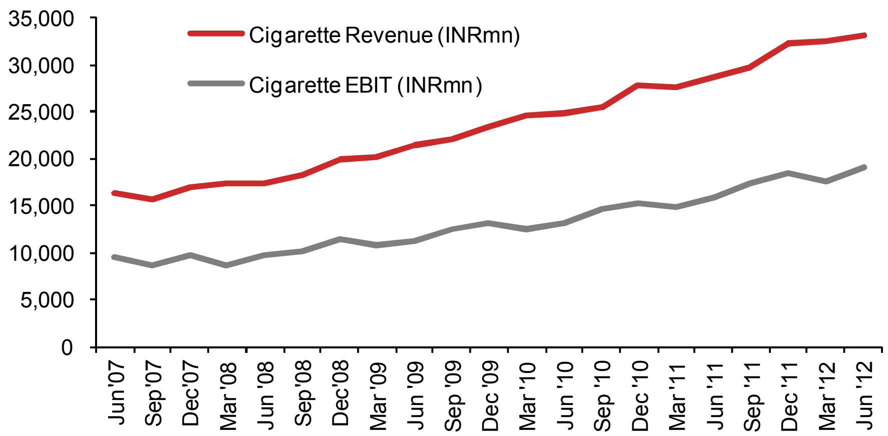
As at 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Cash & equivalents	24,269	31,301	39,766	45,900	52,447
Marketable securities	40,629	0	0	0	0
Accounts receivable	24,361	27,630	31,801	37,165	43,356
Inventories	57,331	64,281	73,645	86,066	100,404
Other current assets	3,665	1,316	1,674	1,956	2,282
Total current assets	**150,255**	**124,528**	**146,887**	**171,086**	**198,489**
LT investments	8,049	52,068	77,068	92,068	112,068
Fixed assets	91,438	97,152	103,981	107,609	110,601
Goodwill	0	3,141	3,141	3,141	3,141
Other intangible assets	0	0	0	0	0
Other LT assets	13,680	23,908	5,000	5,000	5,000
Total assets	**263,422**	**300,798**	**336,077**	**378,905**	**429,300**
Short-term debt	995	19	19	19	19
Accounts payable	46,683	49,961	57,745	67,483	78,726
Other current liabilities	41,485	44,787	51,540	60,232	70,266
Total current liabilities	**89,162**	**94,767**	**109,303**	**127,734**	**149,011**
Long-term debt	251	1,054	1,054	1,054	1,054
Convertible debt	0	0	0	0	0
Other LT liabilities	0	0	0	0	0
Total liabilities	**89,413**	**95,821**	**110,357**	**128,788**	**150,065**
Minority interest	1,408	1,571	1,571	1,571	1,571
Preferred stock	0	0	0	0	0
Common stock	7,738	7,818	7,818	7,818	7,818
Retained earnings	156,750	186,767	207,510	231,907	261,025
Proposed dividends					
Other equity and reserves	8,112	8,820	8,820	8,820	8,820
Total shareholders' equity	**172,600**	**203,406**	**224,149**	**248,546**	**277,664**
Total equity & liabilities	**263,422**	**300,798**	**336,077**	**378,905**	**429,300**
Liquidity (x)					
Current ratio	1.69	1.31	1.34	1.34	1.33
Interest cover	114.7	122.8	143.4	149.6	158.2
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	38.0	35.8	35.5	35.3	35.3
Days inventory	228.9	219.8	218.3	219.8	222.8
Days payable	177.8	174.7	170.5	172.3	174.7
Cash cycle	89.2	81.0	83.3	82.7	83.4

Source: Company data, Nomura estimates

Cigarette business still smoking…

While there was some investor apprehension around the performance of the cigarette business heading into Q1YFY13, ITC once again delivered a robust performance with volumes flat to marginally positive against expectations of a significant drop. This was confirmed when earnings were announced, with ITC reporting net revenue +15% for the quarter. This is in line with our view that despite regulatory uncertainties, ITC has been delivering strong and consistent revenue growth in the cigarette business. Importantly, this has also been followed by consistent and relatively stable margins on a long- term basis.

Fig. 42: Cigarette business revenue growth has been consistent

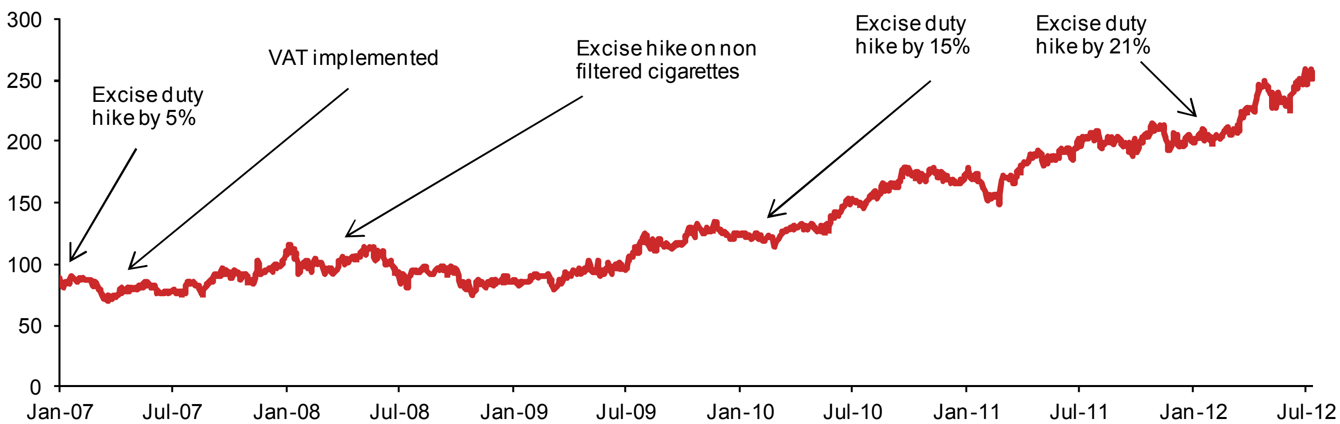


Source: Company data, Nomura research

Despite a number of regulatory changes over the last five years…

The regulatory overhang in terms of either excise duty increases, packaging norms, VAT increases in states, etc., has weighed on investor sentiment towards ITC. However, despite fears that it would have an impact on the company's ability to consistently deliver profits, ITC has been delivering mid teens EBIT growth in the cigarette business over the last five years or so. We believe ITC will continue to manage these issues over the long term and deliver revenue and profit growth in the mid to high teens.

Fig. 43: History of rise in taxes



Source: Nomura research

Excise duty hikes now factored in

Post the budget the net impact of increase in excise duty is about 21%. ITC has already taken 12-13% pricing increases, which should help offset most of the excise duty increases. Although ITC's recent pricing increases do not reflect the VAT increases in the states, the overall impact of the VAT increases on ITC has been relatively small. One reason is that states such as Rajasthan and Uttar Pradesh where the VAT increases were as high as 50% are not very large markets for ITC. While cumulative price increases have been in the 12-13% range, this has not been uniform across all brands. Prices on some of the brands have been left unchanged. ITC points to the fact that it competes across various price points from INR2 to INR7 per stick and says its pricing decisions are not only related to tax increases. ITC says it takes strategic price actions across brands from time to time and this will continue. With margins at 50% for the business, price increases taken so far are sufficient to offset the increase in excise duty.

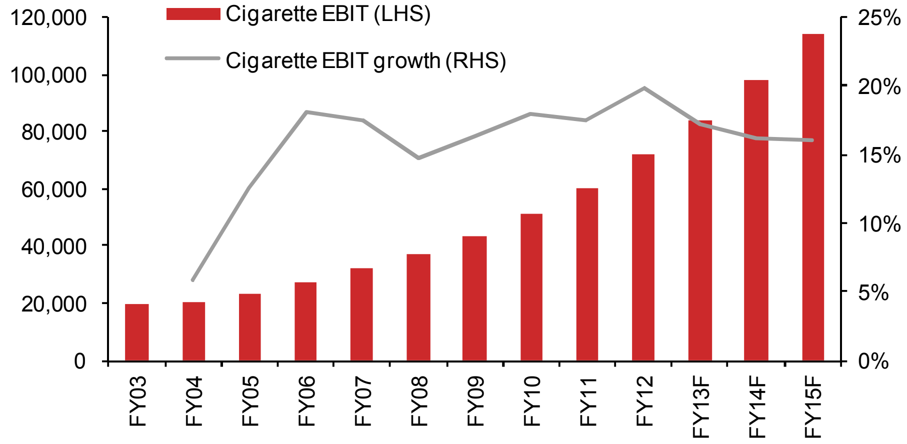
Cigarette business to deliver mid-teens EBIT growth in FY13F

For FY13F, given the price increases, ITC expects volume growth to be flat to marginally positive. However, price increases will help drive revenue growth, and together with improvement in mix, should help ITC deliver 15-16% EBIT growth in the cigarette business, as per the company. As a result of the mix improvement, we expect margins to improve by 30-40bps on an annual basis in FY13F. Q1FY13 performance was significantly ahead of this, which is likely to temper down over the next few quarters, we believe.

Long-term drivers of the cigarette business

- Cigarette consumption still accounts for only 15% of overall tobacco consumption in the country. Over the long term, as consumers migrate to cigarettes from other forms of tobacco, ITC will be the biggest beneficiary, we believe.
- Mix improvement across the bigger brands has been substantial, and this has played a key role in improving margins in the cigarette business. Consumers have been trading up from the regular-size sticks to King size across markets, and this has helped the margins as has been evident over the last couple of years. This is the biggest positive for the company as the mix improvement part is likely to be a sustainable form of revenue and profitability driver in the medium term. The King-size sticks are growing at a double-digit percentage, much faster than the regular-sized ones. This is a key long term driver of cigarette business profitability.
- The competitive landscape remains a positive for ITC as foreign investment in expanding capacities is banned by the government. This is unlikely to change in the medium term as the government has been reluctant to allow foreign participation in tobacco, which means ITC will continue to have a dominant share of the market in the medium to long term.
- Some of the states have banned use of Pan Masala as well as other forms of tobacco recently. This move is likely to help migrate consumers to cigarettes over the long term, where ITC will likely be the biggest beneficiary, in our view. While we do not expect any short-term benefits from this move, in the longer term, it is a positive for ITC, in our view.
- Overall for the medium term, EBIT growth of ~16% is still the company target, and this is a positive as there has been some apprehension in the market that ITC could start to see a material slowdown in cigarette business profit growth in the next couple of years as a result of the sharp price increases over the last couple of years.

Fig. 44: Cigarette business EBIT growth has been consistent



Source: Company data, Nomura estimates

FMCG business continues to be on track

The FMCG (Fast Moving Consumer Goods) business remains on track with a target of 20%+ revenue growth to continue over the medium term. Several parts of the portfolio are now profitable and ITC is expecting to breakeven by end of FY13 in this business. Even if this seems a bit ambitious at the outset, we believe the breakeven is not more than 4-5 quarters away. We are not building it into our model yet, but if ITC continues to deliver robust sales growth performance of 20% in an environment where gross margin pressures are easing, then breakeven could happen sooner than expected.

Segmental details related to the FMCG business:

- The soaps business has been gaining market share and is now up to 6% or so. This has been impressive in a segment where the top 2 players have been incumbents for many decades. The premium end of the segment is growing much faster than regular soaps, and ITC intends to leverage this shift to launch new variants and benefit from the trading up process. This is a common theme which we have seen all the large players in the segment reiterate over the last year or so. In the premium segment, brand equity plays a significant part in driving revenues, which is where all the larger players such as Hindustan Unilever, Godrej Consumer and ITC seem to have grown faster than the market in each of the last few quarters.
- Shampoo performance has been somewhat underwhelming, although the anti-dandruff segment is growing much faster than the regular segment. To correct this underperformance, ITC has re-launched various varieties and expects positive results to come through over the next couple of quarters. This will mean that A&P expenses are likely to see an uptrend in the short term, but this will allow ITC to establish its brands in the medium term.
- The skin care business has a significant amount of potential, although the off-take at this time is a bit slow. Skin as a category is more difficult to break into, but ITC is confident that given the right investments, it will be able to make a mark in the segment.
- New launches such as face washes and lip balms have been launched earlier this year and ITC will enter some more subcategories over the next few years. However, there are no plans at this time to enter segments such as toothpaste and detergents.

Hotels business will continue to be weak in the near term

After a weak performance in Q1FY13, we expect that Q2 will be on similar lines. Although the performance in hotels has been hurt by the weak economic sentiment, one more thing to highlight is that ITC has and will continue to book some of the initial start-up expenses related to its Chennai property. This property is now fully ready to go online, but ITC is waiting for some final approvals after which the property will be operational. This is expected sometime in Q3FY13. Margins are likely to remain under pressure here in the near term and are something which needs to be watched, in our view.

Changes to our estimates

There are only marginal changes to our estimates for FY13F, but we are more confident that the company will be able to deliver strong earnings growth into the medium term. We have thus increased our forecasts for FY14F and introduce FY15F numbers. We believe over the next 3 years ITC will be able to deliver high teens earnings growth. We are now building in that expectation into our numbers. Our FY14F numbers increase by around 6%, largely driven by margin improvement coming through as a result of mix improvement in the cigarette business.

Fig. 45: Headline changes to estimates

	FY13F			FY14F		
(In INRmn)	**Old**	**New**	**Chg (%)**	**Old**	**New**	**Chg (%)**
Revenues	302,459	305,461	1%	344,049	356,977	4%
EBITDA	109,940	108,550	-1%	125,683	128,538	2%
EBITDA margins (%)	36.3%	35.5%		36.5%	36.0%	
Net Profit	71,339	72,782	2%	81,075	85,603	6%

Source: Nomura estimates

Target price increased to INR310 from INR246

We are also moving our TP higher from INR246 to INR310. This is driven partly by earnings forecast changes, partly by roll forward of the time period on which the target is based, and partly driven by higher valuation for the cigarette and FMCG business.

We now value the cigarette business at 25x one-year forward earnings vs 23x earlier. We believe given the fact that ITC has been able to consistently deliver mid teens EBIT growth despite the uncertain regulatory environment, and the high return ratios that the business generates, it is justified to value the business on a higher multiple. Consumer company valuations have moved up across the board, and with the sector market-cap-weighted average now at 27x FY14F, we believe ITC's cigarette business deserves to trade at similar multiples for a similar earnings growth profile.

The other key change to our valuation is on the FMCG business. We have increased our multiple from 3x sales to 4x sales, which we believe is justified given that the business is very close to breaking even and will be turning profitable soon. This will be a significant boost for the company and a key long-term positive.

Our valuation methodology for the other businesses is largely unchanged. We value cash at book value as before.

Fig. 46: Sum-of-the-parts valuation

	Per share (INR)	**Comment**
Cigarettes	221	P/E multiple of 25x
Hotels	7	P/E multiple of 22x, in line with Industry players
Paper	13	EV/EBIT of 8x, in line with Industry players
New Venture	53	4x sales
Agri business	6	1x sales
Core business (A)	299	
Cash + Liquid Investments (B)	11	At Book
Total (A+B)	**310**	

Source: Nomura research

Valuation

ITC trades at 24.5x FY14F EPS vs the sector market-cap-weighted average closer to 27x. Even mid-cap names such as Marico are trading at higher multiples than ITC, despite ITC's better liquidity. Although there are some concerns around the company's ability to pass on price increases to consumers, we believe ITC over the long term has demonstrated that demand for cigarettes remains relatively inelastic. Add to that the improving mix across brands, which will help improve margins. Given the consistent delivery over the last few years, we believe ITC deserves to trade at sector-average multiples and not at a discount.

Fig. 47: Sector valuations

Company	Ticker	Rating	Price Rs.	EPS growth FY14E %	FY13E P/E	FY14E P/E	FY14E PEG
Food and Beverages							
Nestle *	NEST IN	Neutral	4,489	22%	35.9x	29.4x	1.3x
GSK Consumer *	SKB IN	Buy	3,070	20%	30.3x	25.2x	1.2x
Jubilant Foodworks	JUBI IN	Buy	1,235	38%	49.9x	36.1x	0.9x
United Spirits	UNSP IN	Neutral	928	20%	33.5x	27.8x	1.4x
Average					**36.1x**	**29.1x**	
HPC							
Colgate Palmolive	CLGT IN	Reduce	1,244	14%	33.2x	29.0x	2.0x
Dabur	DABUR IN	Buy	127	20%	28.8x	23.9x	1.2x
Godrej Consumer	GCPL IN	Buy	659	24%	29.0x	23.3x	1.0x
Hindustan Unilever	HUVR IN	Neutral	548	16%	36.9x	31.7x	2.0x
Marico	MRCO IN	Reduce	198	16%	31.3x	26.9x	1.7x
Average					**34.3x**	**29.3x**	
Tobacco							
ITC	ITC IN	Buy	268	18%	28.8x	24.5x	1.4x
Paints							
Asian Paints	APNT IN	Neutral	3,901	20%	33.9x	28.2x	1.4x
Retail							
Titan Industries	TTAN IN	Buy	241	28%	26.2x	20.6x	0.7x

Note: Pricing as of September 14, 2012; * indicated Calendar year based numbers

Source: Bloomberg, Nomura Research

Investment risks

Policy directives from the union government form the biggest risk to our investment view. The tobacco sector is highly levered to policy decision from the central and state governments. Any changes in the tax structure could prove to be a negative for the company. Stricter laws against smoking and potential changes to include plain packaging could also have a negative impact on ITC's earnings and thus our target price.

ITC has a dominant 70% market share by volume in India's cigarette sector, with the cigarette business accounting for over 80% of ITC's profits. Any potential opening up of the sector to foreign companies would increase competition, which could hurt ITC's dominant position in the market. Additionally, continuing losses in the FMCG business is a risk.

Godrej Consumer GOCP.NS GCPL IN

GENERAL CONSUMER

NOMURA
EQUITY RESEARCH

Geographically diversified portfolio

International strategy delivering on the promise; more to come in the next two years

September 20, 2012

Rating Remains	**Buy**
Target price Increased from 524	INR 800
Closing price September 14, 2012	INR 659
Potential upside	+21.4%

Action: Reiterate Buy on strong core business growth

GCPL has delivered strong operational performances both on the domestic and international front over the past couple of years. We expect this performance to continue in the medium term, with management focused on delivering volume growth ahead of industry. International business is now a substantial part of the portfolio, where the inorganic route has worked well for GCPL. We reiterate our Buy rating with an increased target price of INR800, on the back of increases in our earnings forecasts as well as P/E multiples. We now value GCPL in line with the sector average, as we believe consistent delivery should be rewarded with higher valuations.

Catalysts: Softening commodity costs and cross-pollination of products from international portfolio

Softening commodity prices will have a positive impact on profitability for GCPL. The impact in 1QFY13 was minimal, but we expect 2Q gross margin performance to pick up. In the medium term, we believe there are significant cross-pollination opportunities for the company to take parts of the product portfolio to different geographies.

Valuation: GCPL trades at 23.3x FY14F EPS

GCPL trades at 23.3x FY14F EPS, which is lower than the sector average. We believe that as company continues to deliver on its promise of strong performance in international business, valuations will continue to move ahead in the near term. We believe GCPL is one the best-placed companies in the mid-cap space within the consumer sector, offering investors exposure to a diversified portfolio mix across geographies.

31 Mar	FY12	FY13F		FY14F		FY15F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	48,662	54,757	63,427	62,906	78,898		94,740
Reported net profit (mn)	7,267	7,568	7,743	8,682	9,626		11,916
Normalised net profit (mn)	5,366	7,568	7,743	8,682	9,626		11,916
FD normalised EPS	15.77	23.39	22.75	33.79	28.29		35.02
FD norm. EPS growth (%)	6.9	28.1	44.3	44.5	24.3		23.8
FD normalised P/E (x)	41.8	N/A	29.0	N/A	23.3	N/A	18.8
EV/EBITDA (x)	26.6	N/A	19.7	N/A	15.2	N/A	11.9
Price/book (x)	7.9	N/A	6.6	N/A	5.6	N/A	4.6
Dividend yield (%)	0.9	N/A	1.0	N/A	1.3	N/A	1.7
ROE (%)	31.9	30.8	25.0	27.9	26.0		26.8
Net debt/equity (%)	32.7	69.3	10.6	46.7	net cash		net cash

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

Longer term, we prefer food companies over HPC names in the consumer space in India. With lower penetration levels and higher pricing power, food companies should outperform HPC names in terms of revenue and profit growth longer term, we believe.

Nomura vs consensus

We are 6% ahead of consensus on FY13F earnings, as we believe integration of acquisitions is on track and likely to surprise on the upside.

Research analysts

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

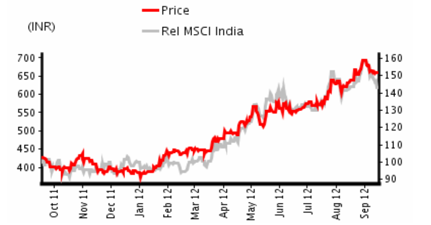
Key data on Godrej Consumer

Income statement (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Revenue	**36,430**	**48,662**	**63,427**	**78,898**	**94,740**
Cost of goods sold	-17,134	-23,185	-30,906	-38,998	-46,828
Gross profit	**19,296**	**25,476**	**32,520**	**39,901**	**47,912**
SG&A	-10,127	-13,425	-16,710	-20,198	-23,904
Employee share expense	-2,845	-3,919	-5,057	-5,997	-7,124
Operating profit	**6,324**	**8,132**	**10,754**	**13,706**	**16,885**
EBITDA	**6,823**	**8,777**	**11,556**	**14,527**	**17,727**
Depreciation	-499	-644	-802	-822	-842
Amortisation	0	0	0	0	0
EBIT	6,324	8,132	10,754	13,706	16,885
Net interest expense	-519	-658	-650	-610	-540
Associates & JCEs	0	0	0	0	0
Other income	268	398	450	500	550
Earnings before tax	**6,073**	**7,872**	**10,554**	**13,596**	**16,895**
Income tax	-1,302	-2,261	-2,111	-2,719	-3,379
Net profit after tax	**4,771**	**5,611**	**8,443**	**10,876**	**13,516**
Minority interests	0	-245	-700	-1,250	-1,600
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	**4,771**	**5,366**	**7,743**	**9,626**	**11,916**
Extraordinary items	376	1,901	0	0	0
Reported NPAT	**5,147**	**7,267**	**7,743**	**9,626**	**11,916**
Dividends	-1,966	-1,966	-2,246	-2,995	-3,743
Transfer to reserves	**3,181**	**5,301**	**5,497**	**6,632**	**8,172**
Valuation and ratio analysis					
Reported P/E (x)	41.4	30.9	29.0	23.3	18.8
Normalised P/E (x)	44.7	41.8	29.0	23.3	18.8
FD normalised P/E (x)	44.7	41.8	29.0	23.3	18.8
FD normalised P/E at price target (x)	54.3	50.7	35.2	28.3	22.8
Dividend yield (%)	0.9	0.9	1.0	1.3	1.7
Price/cashflow (x)	27.4	19.0	17.9	16.0	14.0
Price/book (x)	12.3	7.9	6.6	5.6	4.6
EV/EBITDA (x)	34.7	26.6	19.7	15.2	11.9
EV/EBIT (x)	37.4	28.7	21.2	16.1	12.5
Gross margin (%)	53.0	52.4	51.3	50.6	50.6
EBITDA margin (%)	18.7	18.0	18.2	18.4	18.7
EBIT margin (%)	17.4	16.7	17.0	17.4	17.8
Net margin (%)	14.1	14.9	12.2	12.2	12.6
Effective tax rate (%)	21.4	28.7	20.0	20.0	20.0
Dividend payout (%)	38.2	27.1	29.0	31.1	31.4
Capex to sales (%)	69.6	13.7	5.9	4.0	2.1
Capex to depreciation (x)	50.8	10.4	4.7	3.8	2.3
ROE (%)	38.2	31.9	25.0	26.0	26.8
ROA (pretax %)	23.0	16.9	19.2	22.7	26.3
Growth (%)					
Revenue	78.5	33.6	30.3	24.4	20.1
EBITDA	61.8	28.6	31.7	25.7	22.0
EBIT	58.8	28.6	32.2	27.4	23.2
Normalised EPS	34.2	6.9	44.3	24.3	23.8
Normalised FDEPS	34.2	6.9	44.3	24.3	23.8
Per share					
Reported EPS (INR)	15.91	21.35	22.75	28.29	35.02
Norm EPS (INR)	14.74	15.77	22.75	28.29	35.02
Fully diluted norm EPS (INR)	14.74	15.77	22.75	28.29	35.02
Book value per share (INR)	53.58	83.05	99.20	118.69	142.71
DPS (INR)	6.08	5.78	6.60	8.80	11.00

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	4.4	18.7	54.8
Absolute (USD)	6.7	21.8	35.8
Relative to index	0.7	10.2	46.6
Market cap (USDmn)	4,129.0		
Estimated free float (%)	19.7		
52-week range (INR)	702/355		
3-mth avg daily turnover (USDmn)	2.91		
Major shareholders (%)			
Baytree Investment (Mauritus) PTE Ltd	4.9		
Aberdeen Global Indian Equity Fund Mauritius Ltd	4.1		

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
EBITDA	6,823	8,777	11,556	14,527	17,727
Change in working capital	2,833	-2,172	1,088	1,464	952
Other operating cashflow	-1,877	5,226	-101	-1,939	-2,673
Cashflow from operations	**7,779**	**11,831**	**12,543**	**14,053**	**16,006**
Capital expenditure	-25,344	-6,683	-3,734	-3,140	-1,969
Free cashflow	**-17,565**	**5,148**	**8,809**	**10,913**	**14,037**
Reduction in investments	670	0	0	0	0
Net acquisitions	0	0	0	0	0
Reduction in other LT assets	-1,293	-371	-897	-951	-890
Addition in other LT liabilities	77	349	0	0	0
Adjustments	0	0	0	0	0
Cashflow after investing acts	**-18,111**	**5,126**	**7,911**	**9,961**	**13,147**
Cash dividends	-1,966	-1,966	-2,246	-2,995	-3,743
Equity issue	4,976	17	0	0	0
Debt issue	14,319	953	-3,000	-3,000	-3,000
Convertible debt issue	0	0	0	0	0
Others	0	0	0	0	0
Cashflow from financial acts	**17,328**	**-996**	**-5,246**	**-5,995**	**-6,743**
Net cashflow	**-782**	**4,130**	**2,665**	**3,967**	**6,403**
Beginning cash	3,052	2,269	6,399	9,064	13,031
Ending cash	2,269	6,399	9,064	13,031	19,434
Ending net debt	12,419	9,242	3,576	-3,390	-12,794

Source: Company data, Nomura estimates

Balance sheet (INRmn)

As at 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Cash & equivalents	2,269	6,399	9,064	13,031	19,434
Marketable securities	0	0	0	0	0
Accounts receivable	3,840	4,725	6,159	7,661	9,200
Inventories	4,394	7,839	9,794	11,519	13,831
Other current assets	0	0	0	0	0
Total current assets	**10,503**	**18,963**	**25,017**	**32,211**	**42,465**
LT investments	0	0	0	0	0
Fixed assets	30,857	37,294	37,316	37,494	36,325
Goodwill	0	0	0	0	0
Other intangible assets	0	0	0	0	0
Other LT assets	3,540	3,911	4,808	5,759	6,650
Total assets	**44,900**	**60,167**	**67,141**	**75,464**	**85,440**
Short-term debt	0	0	0	0	0
Accounts payable	12,596	14,755	19,232	23,923	28,726
Other current liabilities	0	0	0	0	0
Total current liabilities	**12,596**	**14,755**	**19,232**	**23,923**	**28,726**
Long-term debt	14,688	15,640	12,640	9,640	6,640
Convertible debt	0	0	0	0	0
Other LT liabilities	279	628	628	628	628
Total liabilities	**27,562**	**31,023**	**32,500**	**34,191**	**35,994**
Minority interest	0	882	882	882	882
Preferred stock	0	0	0	0	0
Common stock	324	340	340	340	340
Retained earnings	16,928	27,812	33,309	39,940	48,113
Proposed dividends					
Other equity and reserves	86	111	111	111	111
Total shareholders' equity	**17,338**	**28,262**	**33,759**	**40,391**	**48,564**
Total equity & liabilities	**44,900**	**60,167**	**67,141**	**75,464**	**85,440**
Liquidity (x)					
Current ratio	0.83	1.29	1.30	1.35	1.48
Interest cover	12.2	12.4	16.5	22.5	31.3
Leverage					
Net debt/EBITDA (x)	1.82	1.05	0.31	net cash	net cash
Net debt/equity (%)	71.6	32.7	10.6	net cash	net cash
Activity (days)					
Days receivable	25.0	32.2	31.3	32.0	32.5
Days inventory	75.0	96.6	104.1	99.7	98.8
Days payable	190.9	215.9	200.7	202.0	205.2
Cash cycle	-90.9	-87.1	-65.2	-70.2	-73.9

Source: Company data, Nomura estimates

GCPL has been one of the best performers YTD

YTD performance of GCPL stock has reflected the strong underlying performance that the company has delivered. This has been on the back of some earnings upgrades, but more important driven by a re-rating of the stock higher to consumer average multiples. GCPL has outperformed the Sensex by 58% YTD to 14 September. Even measured against the FMCG index, the stock has outperformed by 41%.

Fig. 48: Stock price performance

Stock	Ticker	Rating	14-Sep-12	2-Jan-12	YTD
United Spirits	UNSP IN	Neutral	928	495	88%
Godrej Consumer	GCPL IN	Buy	659	372	77%
Jubilant Foodworks	JUBI IN	Buy	1,235	752	64%
Asian Paints	APNT IN	Neutral	3,901	2,590	51%
Titan Industries	TTAN IN	Buy	241	175	37%
Marico	MRCO IN	Reduce	198	144	37%
Hindustan Unilever	HUVR IN	Neutral	548	402	36%
FMCG Index	**BSETMCG**	**NA**	**5,407**	**3,983**	**36%**
ITC	ITC IN	Buy	268	199	35%
Dabur	DABUR IN	Buy	127	100	27%
Colgate Palmolive	CLGT IN	Reduce	1,244	985	26%
GSK Consumer	SKB IN	Buy	3,070	2,500	23%
Sensex	**SENSEX**	**NA**	**18,464**	**15,518**	**19%**
Nestle India	NEST IN	Neutral	4,489	4,039	11%

Source: Bloomberg, Nomura research

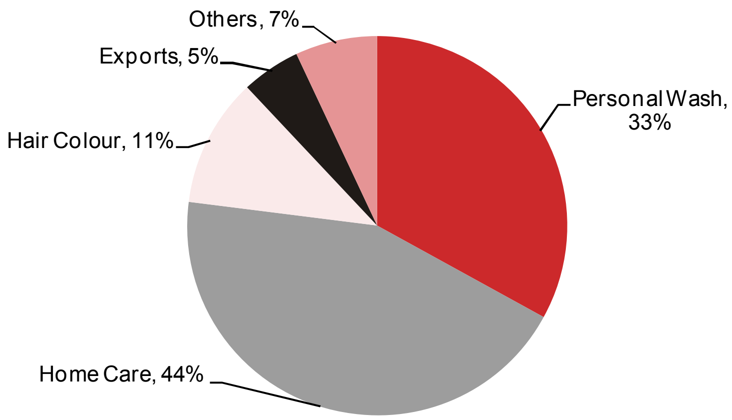
Key drivers of this performance

As we look at the share price performance YTD, this has been driven by two key factors. Firstly, underlying performance across geographies and segments has been ahead of the market, with the company gaining share in many of the markets in which it operates. We look at this performance by geography and category to understand what the key growth drivers of the future are, and how that is likely to impact earnings growth trajectory over the medium term.

Domestic business has outperformed industry growth

Domestic business in two of the largest segments of Personal wash and Homecare has consistently outperformed industry growth over the past few quarters. In FY12, the company recorded net sales growth of 21% and net income growth of 37% in the domestic business, with margins showing improvement. Personal wash and Homecare together account for more than 75% of the revenues in the domestic business, where growth prospects remain good.

Fig. 49: Domestic business split



Source: Company data, Nomura research

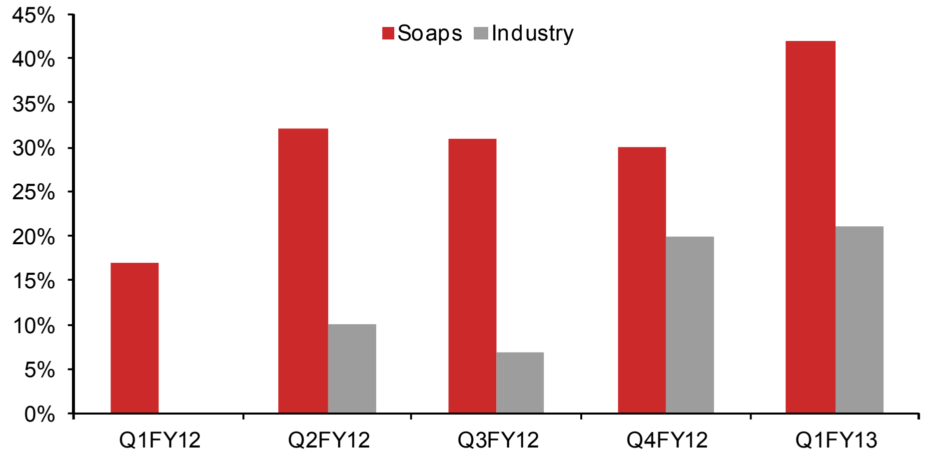
Personal wash business has been very strong

Over the past 8-10 quarters, GCPL has delivered strong growth led by market share gains in the key soaps portfolio. This has been a key positive surprise, as historically, this was seen as a slow-growth business, which is why GCPL used to trade at much lower multiples vs. FMCG peers. However, the company has surprised the Street with consistent growth much ahead of the market. We believe there are a few reasons behind the shift in growth trajectory for the soaps business.

- The company expanded its distribution reach significantly over the past couple of years. This was also helped by the merger of the erstwhile Godrej Household Products (GHPL) (unlisted) with GCPL. GHPL had a strong distribution network in south India, while GCPL historically was stronger in north and west India. The merger of the two entities led to a significant revenue synergy opportunity, from which the company is still benefitting.
- GCPL always had some of the best-known brands in the segment historically. However, there was a level of underinvestment in these brands, as a result of which the true potential of these brands were not realized. This has now been reversed, with company investing significant amount of money behind growing these brands.

As a result of these changes, over the last couple of years GCPL has gained a significant level of market share in the soaps segment, which has now only enhanced its strong no 2 position in the market. Going forward, management is confident that there remains scope to expand share further and will be looking to keep up the momentum in the soaps business.

Fig. 50: Soaps segment value growth has been ahead of market consistently



Source: Company data, Nomura research

Household insecticides have been key growth driver…

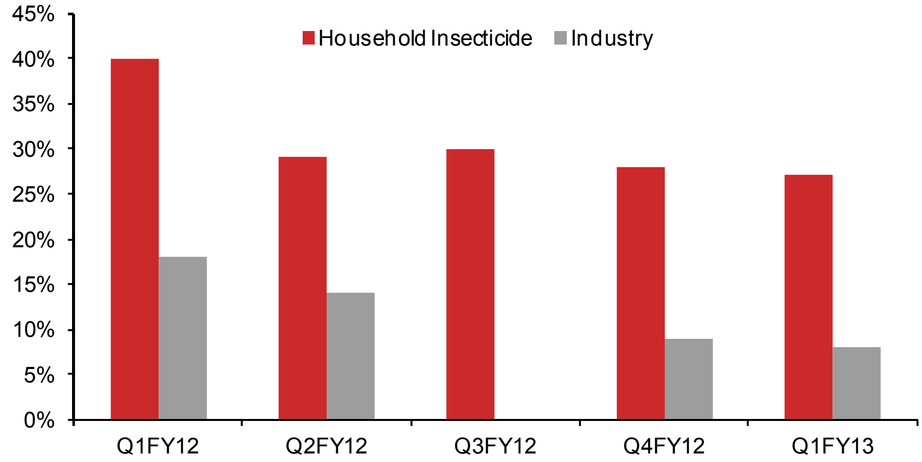
The other large segment in the domestic portfolio is the household insecticide (HI) business. This accounts for ~44% of the domestic business and is by far the largest part of the portfolio. As we mentioned above, the merger of GHPL with GCPL has had a significant positive impact on the HI portfolio. There have also been a number of other factors which have helped the growth of the HI business in India.

- HI historically was a seasonal business in India. However, with growing awareness of these products, usage has increased significantly over the past few years. However, despite the increase in usage, there is still significant room to grow usage for these products in India over the medium term. Seasonality is now much less in the business with awareness and need for these products increasing over time. The company has also increased the A&P spends behind this segment.
- The company has invested in a significant innovation pipeline in this business, which has helped it to bring new products to market. A couple of examples of this are a number of innovations in the coils segment, where the company now has traditional coils, smokeless coils, etc, which consumers would not have thought about five years back. Management continues to remain committed to keeping the innovation pipeline

full, which means there remains scope for further market-defining products from GCPL in the medium term, in our view.

- Distribution has been significantly enhanced both by increasing direct distribution as well as on account of the merger of GHPL and GCPL. This has led to significant growth in the segment, purely on account of gains in distribution.

Fig. 51: Household insecticide business has been on a strong footing



Source: Company data, Nomura research

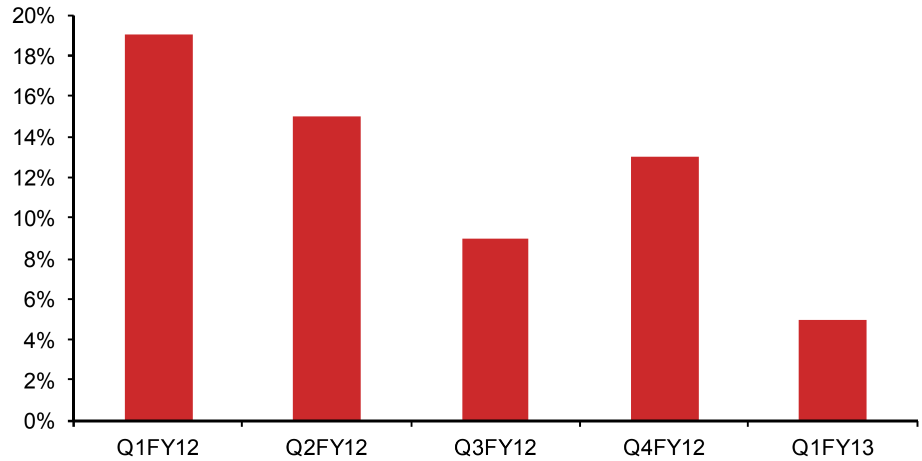
…and will continue to be so

While there has been significant amount of growth in this segment over the past couple of years, management remains confident that HI will be the key growth driver in the medium term. One key reason for this is the opportunity to get products from the Indonesia business to India in the near to medium term. Plans are already in place for this, and there is likely to be traction on this front in FY13.

Hair colour portfolio has had investment behind it

The one part of the portfolio which has been lagging in growth is the Hair colour segment. Competitive activity in this segment has been significant with international players like L'Oreal being very active. However, GCPL has made a number of investments in this business including new products and newer an innovative distribution, which should help it revive the business in the medium term. However, this revival is not likely to come through in the near term. Over the medium term, we remain confident that GCPL will be able to drive a niche in this market and establish a strong market presence. Like in the HI portfolio, we believe that this business has significant scope for cross-pollination of products from its international portfolio.

Fig. 52: Hair colours segment value growth has been slower than other segments



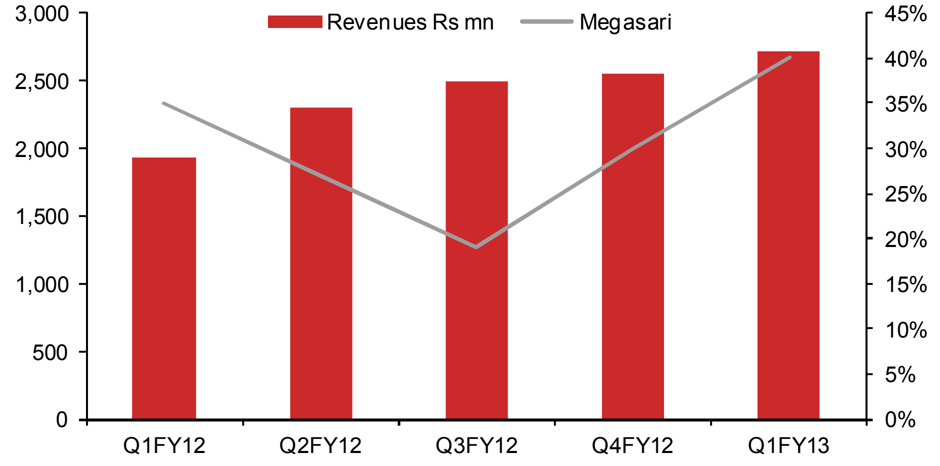
Source: Company data, Nomura research

International business has been the other key reason for share price performance
Over the past few years, GCPL has made a number of acquisitions outside India with a view to growing in Asia and Africa. The medium-term target is to have a significant presence outside India, and South East Asia and Africa are two regions where there is significant growth opportunity in the segments in which GCPL operates.

There was initial scepticism over how GCPL will manage to integrate operations across so many geographies and regions where they had limited or no experience of operations. However, over the past couple of years, the company has through performance shown the ability to manage these acquisitions and deliver on their promised targets. This has been the single most important factor in driving the share price over the past couple of years, in our view. While the company has always maintained that these acquisitions would be EPS accretive from year 1, the actual delivery on these targets was a surprise to many in the market.

GCPL now has an established management structure in place with the head of business in each country reporting to the head of international business, who is spearheading the integration of the operations across the geographies.

Fig. 53: Strong performance at Megasari – Key part of the international business



Source: Company data, Nomura research

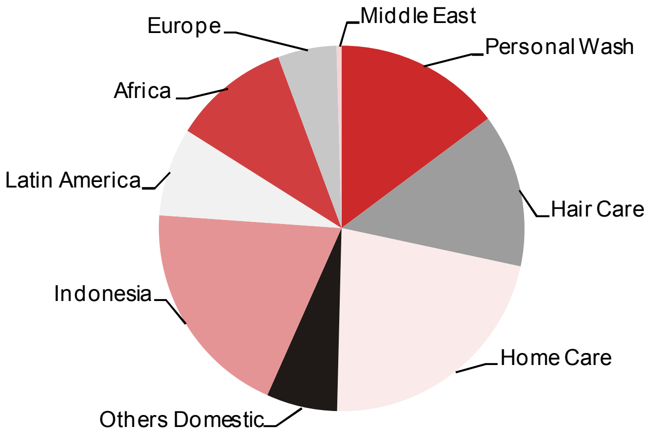
Indonesia and Africa are the key moving parts
Within the international business portfolio, we believe there are two significant regions which are going to be the growth drivers in the medium term: 1) Indonesia, where the company operates through Megasari; and 2) Africa, where together with some of its legacy assets in South Africa, the ongoing phased acquisition of the Darling group is expected to provide the second leg of growth. In the near term, Indonesia will be the most important country outside India, as the business there is already at a good scale and Megasari has significant market position in the segments in which it operates. However, in the medium to longer term, the company sees growth opportunity in Africa to be much bigger and the phased acquisition of Darling group is a step towards establishing an early lead in those markets.

Business mix now more balanced between international and domestic
As can be seen from the chart below, GCPL now offers a fairly balanced mix in terms of which markets and segments drive growth. While domestic business still accounts for 57% of the business, the international portfolio is now a significant contributor at 43% of revenue. Going forward, the international portfolio – especially the Africa portfolio – will likely expand, given the ongoing integration of the Darling group. However, we believe the India business will continue to be a large part of the portfolio given that HI is growing ahead of most other segments and is likely to sustain its growth momentum in the medium term, in our view. We believe Soaps business will also remain a significant revenue growth driver in the medium term, with scope to gain market share still relevant in that segment.

In the international business, we see Indonesia's share likely rising in the medium term, as growth rates in that segment are high and Megasari's position in the market remains strong. The company already has had significant gains in market share in the segment with the launch of Hit Magic Paper, a product which is likely to be seen in India sometime during FY13F.

The Africa business is growing in scale and relevance for GCPL, with the Darling acquisition now in this second phase. The company is very confident that once the full acquisition is complete, there will be significant room to drive revenue synergies.

Fig. 54: GCP's portfolio revenue mix is very balanced



Source: Company data, Nomura research

Changes to estimates

Changes to our estimates are driven mainly by changes to reflect the Darling acquisition for FY14F and FY15F. Changes at the top-line level are more than at the bottom line, as we are only building in a marginal improvement in margins each year vs. our earlier expectations.

Fig. 55: Changes to estimates

	FY13F			FY14F		
INRmn	**Old**	**New**	**Chg (%)**	**Old**	**New**	**Chg (%)**
Revenue	54,757	63,427	16%	62,906	78,898	25%
EBITDA	10,655	11,556	8%	12,049	14,527	21%
Net Income	7,568	7,743	2%	8,682	9,626	11%

Source: Nomura estimates

Increasing TP to INR800

We are also increasing our target price from INR524 to INR800 as a result of

• Change in earnings estimates

• Roll forward of TP

• Increase in multiple from 22x to 25x

We now value GCPL at 25x average FY14F and FY1F5 EPS of INR31.7. The multiple expansion is justified, in our view, as a result of strong operating performance both in the domestic and international businesses as well as a more diverse geographic mix. Our multiple for GCPL is now largely in line with the sector average multiple.

Maintain Buy

We are maintaining our Buy recommendation on GCPL given continuing strong growth across geographies. We believe in the medium term there remain significant opportunities for the company to cross-sell products into different geographies.

Jubilant Foodworks JUBI.NS JUBI IN

FOOD & BEVERAGE

NOMURA
EQUITY RESEARCH

Core holding in India consumption basket

Moderating returns, but still an attractive franchise to own

September 20, 2012

Rating Remains	**Buy**
Target price Increased from 1100	INR 1490
Closing price September 14, 2012	INR 1235
Potential upside	+20.6%

Action: Delivery continues to be strong; maintain Buy

Jubilant Foodworks delivered strong same-store-sales growth (SSSG) of 29.6% for FY12. With penetration of pizza still low and consumption in major cities continuing to hold up, we believe SSSG will continue to be in the 20% range over the next couple of years. The company has guided for 18-20% SSSG for FY13, which could be conservative. The launch of Dunkin Donuts will likely add another leg of growth in the medium term. We continue to like the execution model at Jubilant and believe the opportunity remains sizeable, which should support long-term growth. Maintain Buy with an increased TP of INR1,490, implying 20.6% upside.

Catalysts: Strong SSSG and under-penetrated pizza market

We see two key long-term catalysts which will likely continue to drive stock price performance over the medium term. First, we expect SSSG to remain in the 20%-plus range over the next couple of years, which should be the main driver of revenue and earnings. Second, we expect the company to continue to add 90 stores each year over the next 3-4 years given that penetration levels are still low.

Valuation: Expensive but justified, in our view

While the consensus view argues that valuation is high, we believe in the short term, this is likely to sustain given strong SSSG. We have increased our TP to reflect this strong growth and recommend the stock as one of the core holdings in our India consumption basket for long-term investors.

31 Mar	FY12	FY13F		FY14F		FY15F	
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	10,186	14,193	14,313	17,646	18,988		24,404
Reported net profit (mn)	258	1,707	1,611	2,257	2,228		3,078
Normalised net profit (mn)	323	1,707	1,611	2,257	2,228		3,078
FD normalised EPS	4.97	26.45	24.75	34.98	34.24		47.29
FD norm. EPS growth (%)	-55.7	53.5	398.0	32.3	38.3		38.1
FD normalised P/E (x)	248.5	N/A	49.9	N/A	36.1	N/A	26.1
EV/EBITDA (x)	71.2	N/A	29.1	N/A	21.6	N/A	16.1
Price/book (x)	26.9	N/A	17.6	N/A	13.1	N/A	9.7
Dividend yield (%)	na	N/A	na	N/A	0.8	N/A	1.2
ROE (%)	10.6	52.8	42.7	50.1	41.6		42.7
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Company data, Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

JFL is the leader in India's pizza market, with 65% share. Low penetration of pizza and rising affordability make JFL one of the most attractive long-term stories to own in the Indian consumer space, in our view.

Nomura vs consensus

We are largely in line with consensus on earnings for FY13F, but believe SSSG will stay in the 15-20% range over the medium term vs consensus expectations of a slowdown.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

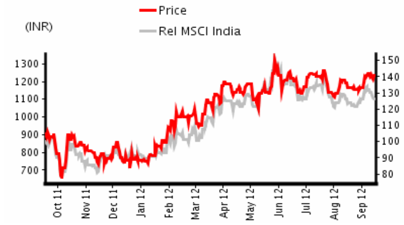
Key data on Jubilant Foodworks

Income statement (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Revenue	**6,781**	**10,186**	**14,313**	**18,988**	**24,404**
Cost of goods sold	-1,974	-3,028	-3,577	-4,708	-5,878
Gross profit	**4,807**	**7,159**	**10,736**	**14,280**	**18,525**
SG&A	-2,541	-4,435	-5,602	-7,440	-9,508
Employee share expense	-1,356	-1,975	-2,920	-3,854	-4,954
Operating profit	**910**	**750**	**2,214**	**2,986**	**4,063**
EBITDA	**1,203**	**1,127**	**2,748**	**3,702**	**4,955**
Depreciation	-293	-377	-534	-716	-892
Amortisation	0	0	0	0	0
EBIT	910	750	2,214	2,986	4,063
Net interest expense	-3	0	0	0	0
Associates & JCEs	0	0	0	0	0
Other income	22	62	190	340	530
Earnings before tax	**928**	**812**	**2,404**	**3,326**	**4,593**
Income tax	-204	-488	-793	-1,097	-1,516
Net profit after tax	**724**	**323**	**1,611**	**2,228**	**3,078**
Minority interests	0	0	0	0	0
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	**724**	**323**	**1,611**	**2,228**	**3,078**
Extraordinary items	-7	-65	0	0	0
Reported NPAT	**717**	**258**	**1,611**	**2,228**	**3,078**
Dividends	0	0	0	-651	-976
Transfer to reserves	**717**	**258**	**1,611**	**1,577**	**2,101**
Valuation and ratio analysis					
Reported P/E (x)	111.1	311.5	49.9	36.1	26.1
Normalised P/E (x)	110.1	248.5	49.9	36.1	26.1
FD normalised P/E (x)	110.1	248.5	49.9	36.1	26.1
FD normalised P/E at price target (x)	126.6	285.7	57.4	41.5	30.0
Dividend yield (%)	na	na	na	0.8	1.2
Price/cashflow (x)	53.4	43.0	33.8	24.9	18.2
Price/book (x)	41.1	26.9	17.6	13.1	9.7
EV/EBITDA (x)	66.7	71.2	29.1	21.6	16.1
EV/EBIT (x)	88.3	107.1	36.2	26.8	19.6
Gross margin (%)	70.9	70.3	75.0	75.2	75.9
EBITDA margin (%)	17.7	11.1	19.2	19.5	20.3
EBIT margin (%)	13.4	7.4	15.5	15.7	16.7
Net margin (%)	10.6	2.5	11.3	11.7	12.6
Effective tax rate (%)	22.0	60.2	33.0	33.0	33.0
Dividend payout (%)	0.0	0.0	0.0	29.2	31.7
Capex to sales (%)	9.4	12.0	11.9	8.4	6.5
Capex to depreciation (x)	2.2	3.2	3.2	2.2	1.8
ROE (%)	46.5	10.6	42.7	41.6	42.7
ROA (pretax %)	37.4	19.9	39.7	39.0	40.6
Growth (%)					
Revenue	59.9	50.2	40.5	32.7	28.5
EBITDA	80.7	-6.3	143.9	34.7	33.8
EBIT	115.3	-17.6	195.4	34.8	36.1
Normalised EPS	113.7	-55.7	398.0	38.3	38.1
Normalised FDEPS	113.7	-55.7	398.0	38.3	38.1
Per share					
Reported EPS (INR)	11.12	3.97	24.75	34.24	47.29
Norm EPS (INR)	11.22	4.97	24.75	34.24	47.29
Fully diluted norm EPS (INR)	11.22	4.97	24.75	34.24	47.29
Book value per share (INR)	30.08	45.92	70.28	94.52	126.81
DPS (INR)	0.00	0.00	0.00	10.00	15.00

Source: Company data, Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	3.6	0.3	39.6
Absolute (USD)	6.1	2.9	22.2
Relative to index	-0.1	-9.9	30.0
Market cap (USDmn)	1,477.3		
Estimated free float (%)	38.0		
52-week range (INR)	1354.4/633.95		
3-mth avg daily turnover (USDmn)	11.23		
Major shareholders (%)			
Promoters	61.3		
Weston Investment	7.8		

Source: Thomson Reuters, Nomura research

Cashflow (INRmn)

Year-end 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
EBITDA	1,203	1,127	2,748	3,702	4,955
Change in working capital	-18	448	231	282	460
Other operating cashflow	309	294	-603	-757	-986
Cashflow from operations	**1,494**	**1,869**	**2,376**	**3,226**	**4,429**
Capital expenditure	-638	-1,220	-1,701	-1,594	-1,585
Free cashflow	**856**	**649**	**676**	**1,632**	**2,844**
Reduction in investments	-205	-718	-500	-800	-1,500
Net acquisitions	0	0	0	0	0
Reduction in other LT assets	-31	29	0	0	0
Addition in other LT liabilities	26	73	0	0	0
Adjustments	0	0	0	0	
Cashflow after investing acts	**647**	**34**	**176**	**832**	**1,344**
Cash dividends	0	0	0	-651	-976
Equity issue	-541	5	0	0	0
Debt issue	-86	0	0	0	0
Convertible debt issue	0	0	0	0	0
Others	0	0	0	0	0
Cashflow from financial acts	**-627**	**5**	**0**	**-651**	**-976**
Net cashflow	**20**	**39**	**176**	**182**	**368**
Beginning cash	70	90	129	305	487
Ending cash	90	129	305	487	854
Ending net debt	-90	-129	-305	-487	-854

Source: Company data, Nomura estimates

Balance sheet (INRmn)

As at 31 Mar	FY11	FY12	FY13F	FY14F	FY15F
Cash & equivalents	90	129	305	487	854
Marketable securities	0	0	0	0	0
Accounts receivable	41	64	78	104	134
Inventories	142	187	274	364	468
Other current assets	719	689	980	1,301	1,538
Total current assets	**993**	**1,070**	**1,638**	**2,255**	**2,994**
LT investments	205	923	1,423	2,223	3,723
Fixed assets	1,835	2,678	3,845	4,722	5,416
Goodwill	0	0	0	0	0
Other intangible assets	0	0	0	0	0
Other LT assets	31	2	2	2	2
Total assets	**3,064**	**4,672**	**6,907**	**9,202**	**12,134**
Short-term debt	0	0	0	0	0
Accounts payable	0	0	0	0	0
Other current liabilities	1,086	1,572	2,196	2,913	3,744
Total current liabilities	**1,086**	**1,572**	**2,196**	**2,913**	**3,744**
Long-term debt	0	0	0	0	0
Convertible debt	0	0	0	0	0
Other LT liabilities	65	138	138	138	138
Total liabilities	**1,150**	**1,709**	**2,334**	**3,051**	**3,882**
Minority interest	0	0	0	0	0
Preferred stock	0	0	0	0	0
Common stock	645	651	651	651	651
Retained earnings	1,269	2,312	3,923	5,501	7,602
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**1,914**	**2,963**	**4,574**	**6,151**	**8,253**
Total equity & liabilities	**3,064**	**4,672**	**6,907**	**9,202**	**12,134**
Liquidity (x)					
Current ratio	0.91	0.68	0.75	0.77	0.80
Interest cover	265.9	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	1.9	1.9	1.8	1.8	1.8
Days inventory	19.7	19.9	23.5	24.8	25.8
Days payable	0.0	0.0	0.0	0.0	0.0
Cash cycle	21.6	21.8	25.4	26.5	27.6

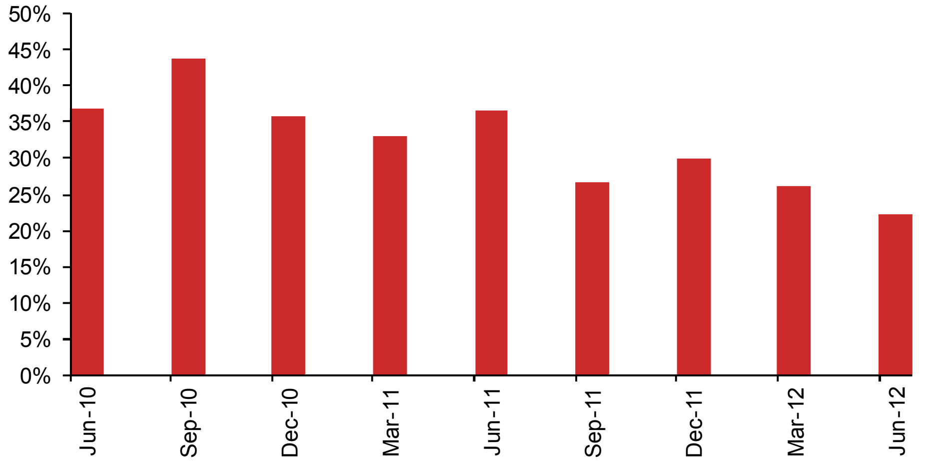
Source: Company data, Nomura estimates

1Q FY13 indicates some slowdown…

Jubilant has seen some levelling off in the pace of SSSG in 1Q FY13. While the slowdown is not significant on a sequential basis, we believe it is important to highlight a few factors that were behind slowdown during the quarter.

- 1Q FY13 SSSG of 22.3% y-y comes on an exceptionally strong 1Q FY12, when the company delivered 36.7% y-y SSSG. Given the slowing macro environment, it was expected by us and consensus that there would be some level of slowing down.
- Despite the slowdown in SSSG, the company has increased its guidance on the number of store openings for the full year. We view this as a positive and a sign that management remains confident of underlying demand.

Fig. 56: SSSG trend has slowed but remains robust and above company guidance



Source: Company data, Nomura research

Strong performance vs other ‘consumer discretionary’ players’

Another factor we highlight here is that discretionary spend across the board faced significant headwinds during the quarter, with the underlying volume growth numbers largely underwhelming including the following:

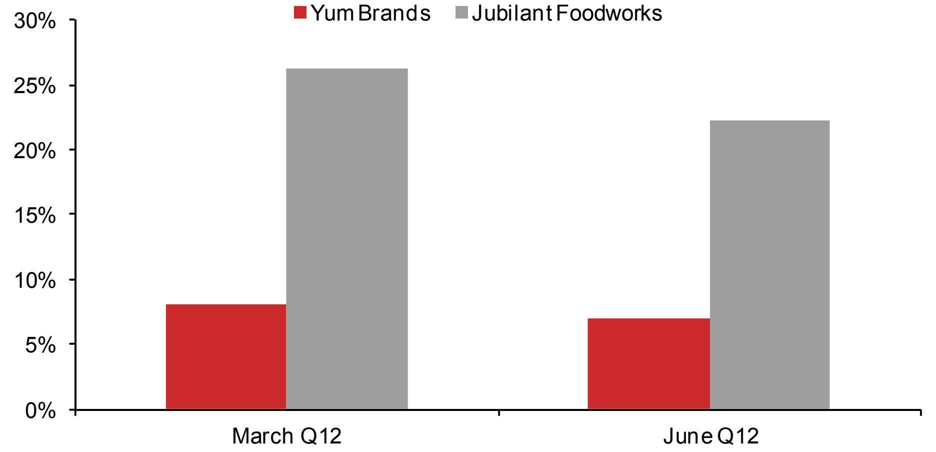
- Nestle’s volume growth was in the low single-digit range y-y;
- GSK Consumer reported 7% y-y volume growth for the domestic business;
- Asian Paints revenues were flat, even after adjusting for one-offs;
- Titan’s jewellery volumes were down 21% y-y;
- Shoppers Stop reported SSSG of only 1% y-y; and
- Raymond saw SSSG of -2-3% y-y.

As can be seen from these numbers, the slowdown in discretionary spend does not appear to be confined to a particular sector, but is spread across the board.

Jubilant outperforming peers in QSR space

Despite the decelerating SSSG at Jubilant for 1Q FY13, it remained robust and was still much better than what other players in the QSR space reported. For the quarter, Yum Brands reported 7% y-y SSSG in India and, according to news reports, McDonalds also saw its SSSG slow to high single-digits, from double digits last year (*Source: Economic Times, McDonald's, Yum, Domino's report lower growth in Q1, July 26, 2012*).

Fig. 57: Yum Brands vs Jubilant: recent quarterly SSSG comparison, y-y



Source: Company data, Nomura Research

1Q FY13 indicated some slowdown, but still largely in line with expectations

Key highlights from 1Q results

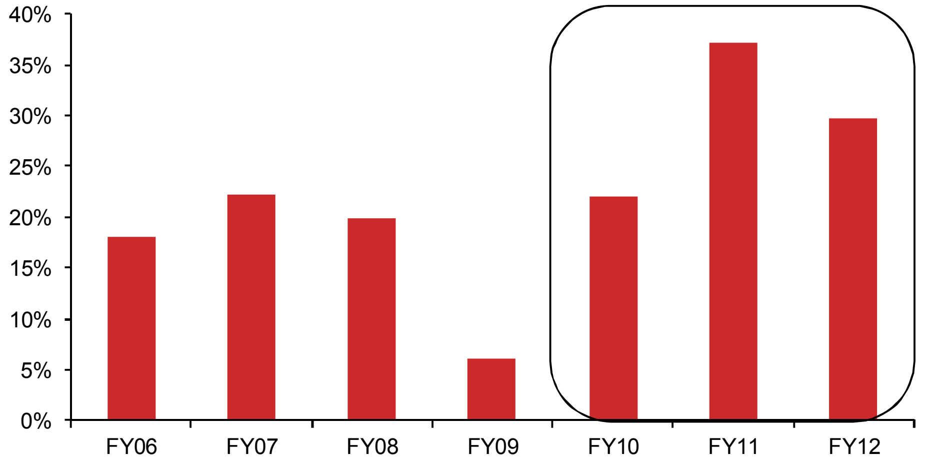
- Revenue growth during the quarter was 45% y-y, with same-store revenues up by 22.3% y-y. In an environment where consumer off-take on discretionary products has seen a slowdown, we view this as a solid performance. Moreover, the SSSG comes off a fairly high y-y base of 36.7% y-y.
- EBITDA growth during the quarter was 38.4% y-y to INR573mn, with margin narrowing by 90bps y-y to 18.2%. The majority of this was on account of a gross margin decline of 110bps, with rent also on an upward trajectory. We note that some expenses here were for the Dunkin Donut stores, which are strictly not comparable.
- PAT growth was 39.6% y-y, which was marginally below our expectations.
- Management added 24 new stores during the quarter and increased its new store guidance to 100 for FY13.

SSSG guidance may prove conservative

Management has guided for 18-20% SSSG for FY13. Recall, this is similar to the guidance given at the start of FY12 which saw actual SSSG of closer to 30%. While we are not building in 30% SSSG for FY13, we believe the higher end of guidance (i.e. 20%) could prove to be conservative. We build in 20% SSSG for FY13 which, even after accounting for the slowdown, is still lower than what the company delivered in 1Q FY13.

If we look at the SSSG numbers the company has delivered over the past few years, we see a strong pick-up since FY10, with the period of FY10-12 seeing particularly strong revenue and profit growth. Although incrementally the pace of growth in SSSG is likely to slow, as was evidenced in 1Q FY13, this is along expected lines.

Fig. 58: Same-store-sales growth (SSSG, % y-y)



Source: Company data, Nomura research

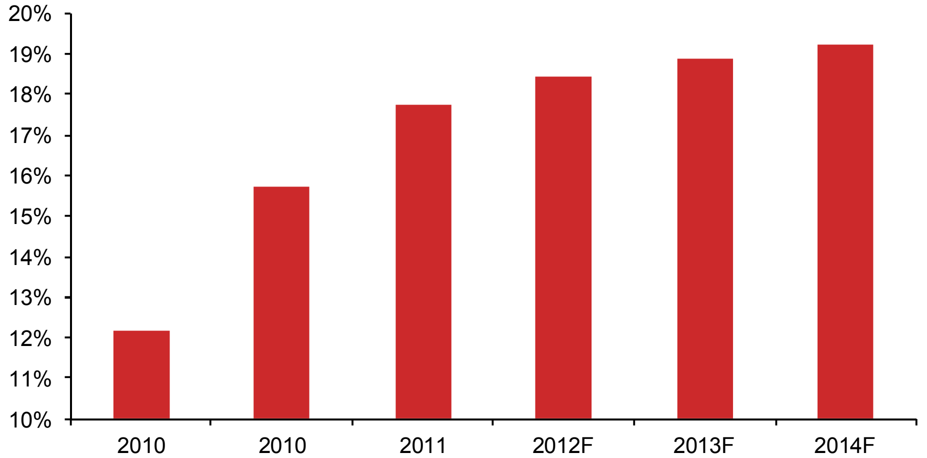
Operating leverage can still deliver margin improvement

As we have highlighted in the past, because of the inherent operating leverage in the model, upside to margins from higher SSSG is significant. This was visible in FY12 as well, with margins improving by 70bps to 18.4%. Of the 70bps margin improvement, rising raw material prices had a negative impact at the gross margin level.

Employee costs and rental expenses had a positive impact. We believe operating leverage will continue to help margins improve in the next couple of years, although our estimates do not build in a significant margin improvement from these levels.

However, we believe that the reasons behind the margin improvement from the 12.2% level in FY09 to the 18.7%-level in FY12 are still relevant. As the company continues to increase its scale, we see further scope for operating margins to improve from these levels, although our estimates are conservative at this stage.

Fig. 59: Operating margin has seen a consistent rise over the past three years



Source: Company data, Nomura estimates

Breaking it down by cost lines

We have highlighted in the past that on the cost line, employee costs will be the key number to watch given that the cost of recruiting and retaining employees will likely remain high for Jubilant Foodworks. Additionally, as we approach FY13 and beyond, this number will also include some employee costs for the Dunkin Donut stores, although with roll out of stores not being very aggressive, we believe the company will be able to manage this well. For FY13, we are building in an increase in employee costs as a percentage of sales. Raw material prices in Q1FY13 have had a significant negative impact of close to 112bps on raw materials, mainly on account of rising cheese costs. The company, however, has the benefit of scale, and with raw material prices likely to ease from the levels seen in FY13 along with planned ~5-6% price increases during the year, we expect some respite on the gross margin front.

Rental costs as a percentage of sales have come down on account of strong SSSG. We believe this will continue to be a positive cost-benefit driver for the company over the next couple of years in a scenario where SSSG is likely to remain strong.

Key risks

We acknowledge that one of the key risks for Jubilant is slowing SSSG. While there has been some slowdown from the 30%-plus levels seen in FY12, it is still at a healthy 22.3% y-y for 1Q FY13. Company guidance and our estimates build in ~20% growth for FY13, which we believe will be achieved. Some level of slowdown is expected given the pressure on discretionary spend, but the company should still be able to deliver 20% SSSG, which we believe will enable the company to sustain current valuations.

Changes to our estimates

We have made marginal changes to our estimates to account for reported FY12 numbers. Our revenue growth numbers for FY13 are largely unchanged, but for FY14, we have upgraded numbers to build in higher SSSG. Although this should mean a much higher earnings upgrade on account of operating leverage, we are now building in a much more conservative number for margin improvement for FY13 and FY14. We forecast only a 30-50bp margin improvement for each year, which is why our earnings numbers are down marginally. Additionally, we have factored in a higher depreciation charge on account of higher capex for the Dunkin Donut stores, which are also driving our earnings lower.

Increase in TP

We also raise our TP to INR1,490, from INR1,100, on our higher SSSG forecasts and rolling forward of our earnings forecasts. We continue to use a DCF-based valuation approach to arrive at our target price of INR1,490. Key underlying assumptions are 25% medium-term growth followed by 18% long-term growth and 6% terminal growth. Our cost of equity assumption is 12% and we discount back cash flows to FY13F.

At our TP, Jubilant would trade at 41.8x FY14 EPS of INR34.24. For a company with average earnings growth of more than 40% over FY10-FY12, we believe the valuation multiple still means PEG is closer to 1x vs the sector closer to 1.4x. We believe in the current scenario, where earnings predictability and solid corporate governance are being rewarded by the market in terms of higher multiples, Jubilant will continue to trade at high valuations. Also when we compare to some of the food companies in the sector like Nestle, which is trading at 30.3x CY13 for average earnings growth of 20% over the next couple of years, on our estimates, Jubilant appears reasonably valued in the current environment.

Reiterate as our key long-term holding in the consumption basket

We believe the FY12 performance again demonstrates the robust underlying performance at Jubilant, and with the company continuing to see robust consumer demand (albeit with some level of slowdown), we see Jubilant as well placed to deliver another year of strong revenue and earnings growth, which should sustain in the medium term. We reiterate Jubilant as a key long term holding in the India consumption basket.

Fig. 60: Sector valuations

Company	Ticker	Rating	Price Rs.	EPS growth FY14E %	FY13E P/E	FY14E P/E	FY14E PEG
Food and Beverages							
Nestle *	NEST IN	Neutral	4,489	22%	35.9x	29.4x	1.3x
GSK Consumer *	SKB IN	Buy	3,070	20%	30.3x	25.2x	1.2x
Jubilant Foodworks	JUBI IN	Buy	1,235	38%	49.9x	36.1x	0.9x
United Spirits	UNSP IN	Neutral	928	20%	33.5x	27.8x	1.4x
Average					**36.1x**	**29.1x**	
HPC							
Colgate Palmolive	CLGT IN	Reduce	1,244	14%	33.2x	29.0x	2.0x
Dabur	DABUR IN	Buy	127	20%	28.8x	23.9x	1.2x
Godrej Consumer	GCPL IN	Buy	659	24%	29.0x	23.3x	1.0x
Hindustan Unilever	HUVR IN	Neutral	548	16%	36.9x	31.7x	2.0x
Marico	MRCO IN	Reduce	198	16%	31.3x	26.9x	1.7x
Average					**34.3x**	**29.3x**	
Tobacco							
ITC	ITC IN	Buy	268	18%	28.8x	24.5x	1.4x
Paints							
Asian Paints	APNT IN	Neutral	3,901	20%	33.9x	28.2x	1.4x
Retail							
Titan Industries	TTAN IN	Buy	241	28%	26.2x	20.6x	0.7x

Note: Pricing as of September 14, 2012; * indicated Calendar year based numbers

Source: Bloomberg, Nomura Research

Appendix A-1

Analyst Certification

We, Manish Jain and Anup Sudhendranath, hereby certify (1) that the views expressed in this Research report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of our compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Godrej Consumer	GCPL IN	INR 649	18-Sep-2012	Buy	Not rated	
Hindustan Unilever	HUVR IN	INR 532	18-Sep-2012	Neutral	Not rated	
ITC	ITC IN	INR 254	18-Sep-2012	Buy	Not rated	
Jubilant Foodworks	JUBI IN	INR 1286	18-Sep-2012	Buy	Not rated	

Previous Rating

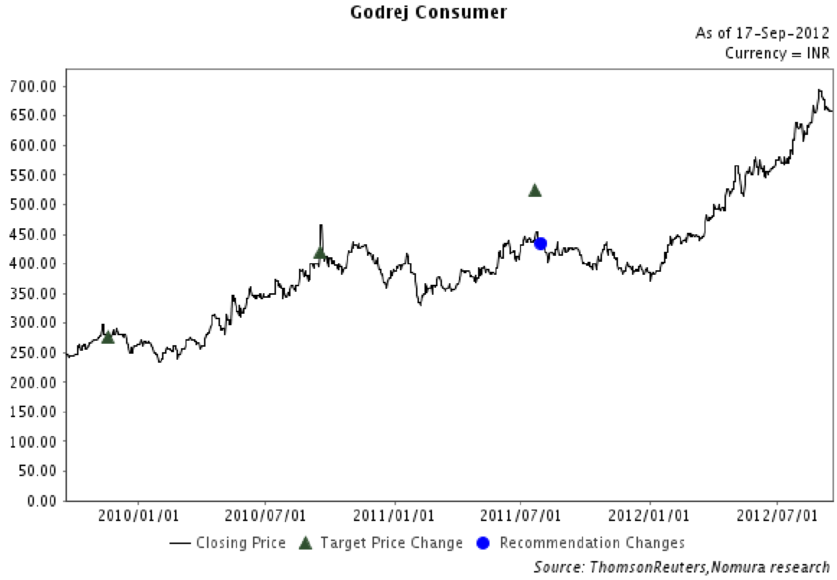
Issuer name	Previous Rating	Date of change
Godrej Consumer	Neutral	21-Jul-2011
Hindustan Unilever	Reduce	19-Sep-2012
ITC	Neutral	29-Oct-2009
Jubilant Foodworks	Not Rated	21-Feb-2011

Rating and target price changes

	Ticker	Old stock rating	New stock rating	Old target price	New target price
Godrej Consumer	GCPL IN	Buy	Buy	INR 524	INR 800
Hindustan Unilever	HUVR IN	Reduce	Neutral	INR 327	INR 527
ITC	ITC IN	Buy	Buy	INR 246	INR 310
Jubilant Foodworks	JUBI IN	Buy	Buy	INR 1100	INR 1490

Godrej Consumer (GCPL IN) **INR 649 (18-Sep-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
21-Jul-11	Buy		444.50
21-Jul-11		524.00	444.50
17-Sep-10		419.00	465.50
17-Nov-09		276.00	275.15

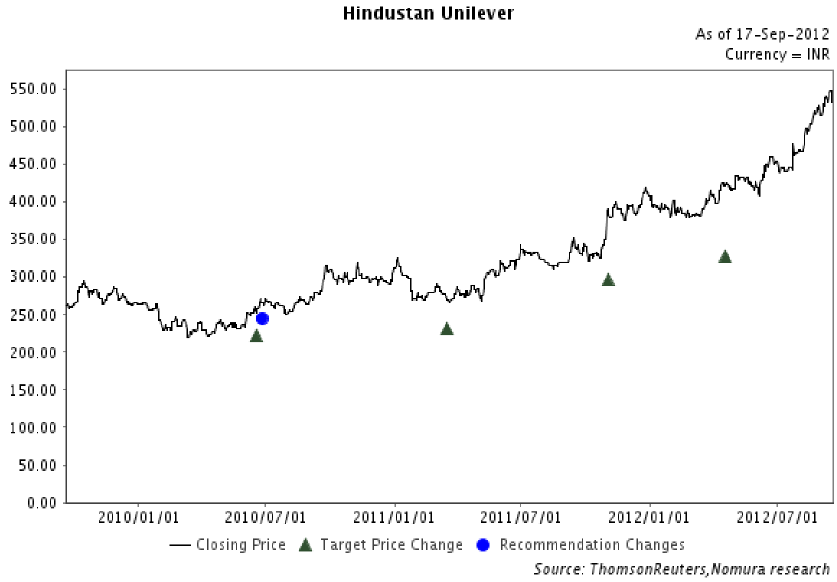
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our target price of INR800 is based on a P/E multiple of 25x applied to average FY14F and FY15F EPS of 31.7

Risks that may impede the achievement of the target price 1) Underperformance of acquisitions, particularly Megasari and Godrej Household Products business (GHPL), is a risk to our estimates and 2) rising raw material prices are a risk to our numbers.

Hindustan Unilever (HUVR IN) **INR 532 (18-Sep-2012)** Neutral (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
18-Apr-12		327.00	422.85
02-Nov-11		296.00	390.05
17-Mar-11		232.00	270.70
17-Jun-10	Reduce		253.00
17-Jun-10		222.00	253.00

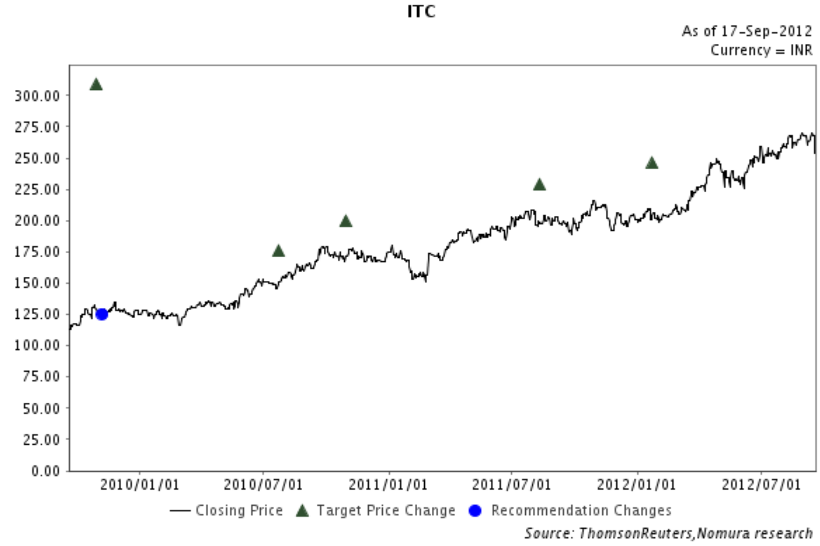
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our target price of INR527 values HUVR at 28x our average of FY14F and FY15F earnings estimate at INR18.8. We have assigned the same multiple on Nestle.

Risks that may impede the achievement of the target price A sharp decrease in input prices would improve gross margins significantly, which would be a risk to our numbers.

ITC (ITC IN) **INR 254 (18-Sep-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
23-Jan-12		246.00	204.60
10-Aug-11		229.00	197.10
29-Oct-10		200.00	171.20
23-Jul-10		176.00	150.82
29-Oct-09	Buy		129.65
29-Oct-09		309.00	129.65

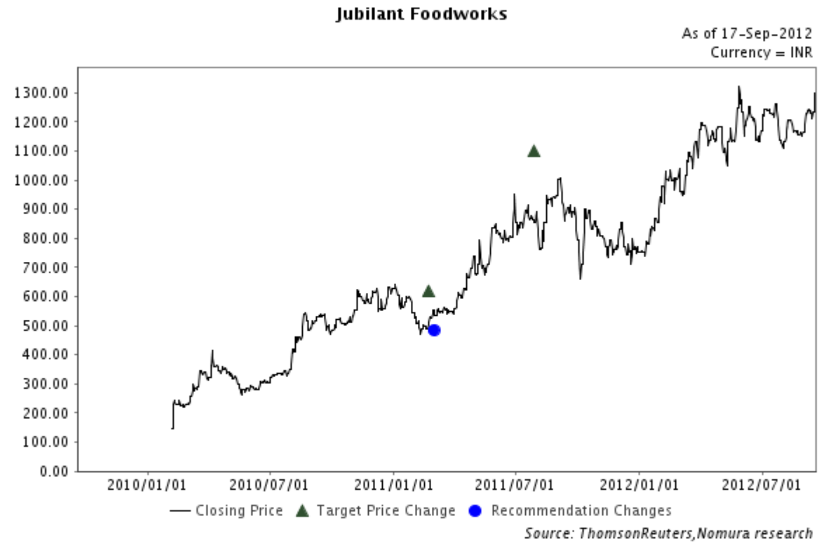
For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our target price is INR 310. We value the company using a sum-of-the-parts valuation methodology. We value the core cigarettes business at INR 221 per share based on a P/E multiple of 25x on four rolling forward quarters. Other SoTP valuations: Hotels business at 22x, which gives a value of INR 7 per share; the Paper Business EV/EBIT of 8x, which gives a value of INR 13 per share; New Ventures at 4x sales, which gives a value of INR 53 per share; the Agri Business at 1x sales, which gives a value of INR 6 per share; and the Cash and Liquid assets of INR 11 per share.

Risks that may impede the achievement of the target price Policy directives from the union government form the biggest risk to our investment view. The tobacco sector is highly levered to policy decision from the central and state governments. Any changes in the tax structure could prove to be a negative for the company. Stricter laws against smoking and potential changes to include plain packaging could also have a negative impact on ITC's earnings and thus our target price. ITC has a dominant 70% market share by volume in India's cigarette sector, with the cigarette business accounting for over 80% of ITC's profits. Any potential opening up of the sector to foreign companies would increase competition, which could hurt ITC's dominant position in the market. Additionally, continuing losses in the FMCG business is a risk.

Jubilant Foodworks (JUBI IN) **INR 1286 (18-Sep-2012)** Buy (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
28-Jul-11		1,100.00	863.45
21-Feb-11	Buy		503.10
21-Feb-11		620.00	503.10

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We use a DCF-based valuation approach to arrive at our target price of INR1,490. Key underlying assumptions are 25% medium-term growth followed by 18% long-term growth and 6% terminal growth. Our cost of equity assumption is 12% and we discount back cashflows to FY13F.

Risks that may impede the achievement of the target price **Higher-than-expected raw material prices and slowing same-store sales growth are key risks.**

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