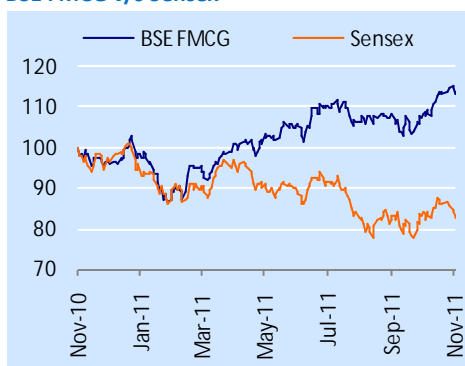


November 17, 2011

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BSE FMCG v/s Sensex



Source: Bloomberg

Stock Performance

(%)	1M	6M	12M
Sensex	(1.5)	(7.5)	(15.6)
BSE FMCG	4.9	10.8	16.4
Asian Paints	(1.3)	8.7	16.4
Colgate	0.4	11.2	13.6
Dabur India	(4.0)	(7.9)	2.2
GCPL	1.8	4.0	(7.3)
Hindustan Unilever	17.4	26.8	31.3
ITC	3.3	14.2	26.2
Marico	(5.1)	12.7	6.0
Titan Industries	(6.1)	2.8	11.7
United Spirits	(8.2)	(24.8)	(42.6)

India Consumer Staples

Q2FY12 Review: Tier I outperforms!!

Q2FY12 performance for our Consumer universe was a mixed bag, with large-caps Tier I *Hindustan Unilever (HUVR)* and *ITC* clearly outperforming the mid-tiers. While volume growth for most of the universe has remained healthy, margins continue to remain a challenge in volatile input cost regime with incremental worry of currency depreciation. Curtailment of ad-spends has helped cushion the margins, but we remain sceptical of this strategy delivering any sustainable benefit. We prefer large-caps, as mid-tiers face erosion of pricing power as well as currency risk (given high international exposure and overseas debt). **ITC** remains our top pick, notwithstanding the approaching budget and usual excise noise.

■ **Tier I outperforms; mid-tiers profitability falters:** Sales, EBITDA and PAT for our consumer universe grew 21.5%, 19.2% and 17.1% YoY v/s our expectations of 19.3%, 17% and 17.6%, respectively. However, dispersion in performance was significant as HUVR and ITC singularly drove the above performance, with ~18% and ~22% sales and PAT growth. Mid-tiers reported subdued profitability despite reduction in ad-spends, though volumes remained healthy. Entire coverage universe reported gross margin decline, while 5 out of 8 reported operating margin decline; HUVR, ITC and Godrej Consumer Products (GCPL) expanded their operating margins YoY. Except Colgate (CLGT) and Asian Paints (APNT), ad-spends declined as % of sales for the rest.

■ **Broad takeaways from management calls:** A) Though demand has remained intact as yet and benefits of good monsoon can be seen in the subsequent quarters, impact of food inflation on urban wallets, leading to down-trading, is a threat. B) Competitive intensity remains high and ad-spends should move up in H2FY12e. C) Currency depreciation will impact input costs in H2FY12e.

■ **What surprised us? Positives:** 1) Volume growth of 9.8%, 8% and 14% reported by HUVR, ITC and Marico 2) HUVR's operating margin expansion of ~100bps. **Negatives:** 1) Dabur's subdued volume performance. 2) Fourth consecutive quarter of PAT decline in CLGT. 3) Sharp operating margin decline in APNT (~400bps).

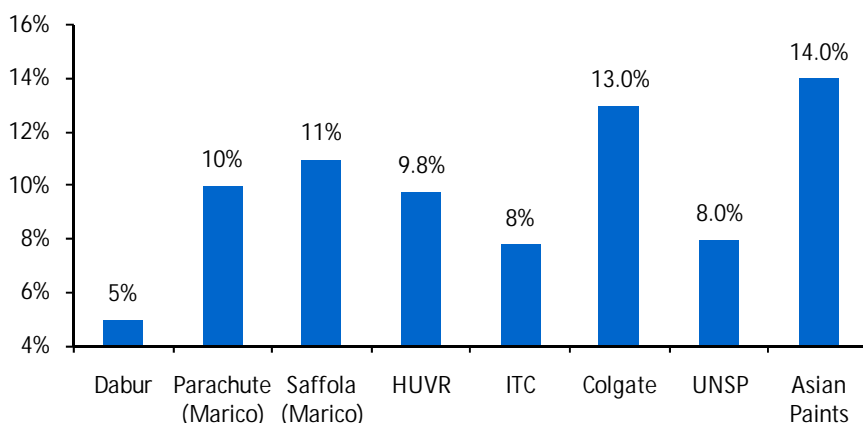
■ **What lies ahead?** 1) Possible moderation in volume growth owing to a) fading impact of government social spending schemes in rural areas and b) sustained high inflation leading to down-trading in urban markets 2) We believe pricing power will continue to be tested in an environment of high input costs, sticky food inflation and elevated competitive intensity. Price hikes taken so far haven't neutralized gross margin pressure and further price hikes will be essential to sustain brand investments. 3) Current strategy of reducing ad-spends to manage operating margins is not sustainable in our view and will impact volumes, going forward.

■ **ITC remains our top pick:** We expect large-caps to continue to outshine mid-tiers, given the high international business salience and currency depreciation risk pertaining to overseas debt. Premium valuations and outperformance will limit absolute upside for the sector in our view; however, broader market concerns and volatility continues to provide relative comfort.

Exhibit 1: Q2FY12 & H1FY12 Result Overview (Rs m)

Company		Q2FY12	Q2FY11	YoY gr. (%)	Q1FY12	QoQ gr. (%)	Q1FY11	H1FY12	H1FY11	YoY gr. (%)
Dabur India	Sales	12,623	9,728	29.8	12,046	4.8	9,165	24,669	18,893	30.6
	EBITDA	2,366	2,031	16.5	1,708	38.5	1,369	4,073	3,400	19.8
	Margins	18.7	20.9		14.2		14.9	16.5	18.0	
	PAT	1,739	1,603	8.4	1,277	36.1	1,068	3,016	2,671	12.9
Marico	Sales	9,745	7,758	25.6	10,486	(7.1)	7,901	20,231	15,660	29.2
	EBITDA	1,167	991	17.7	1,251	(6.8)	1,055	2,418	2,046	18.2
	Margins	12.0	12.8		11.9		13.3	12.0	13.1	
	PAT	783	715	9.5	850	(7.9)	737	1,633	1,453	12.4
Hindustan Unilever	Sales	56,105	47,647	17.8	55,039	1.9	47,939	111,144	95,586	16.3
	EBITDA	8,267	6,469	27.8	6,788	21.8	5,986	15,055	12,455	20.9
	Margins	14.7	13.6		12.3		12.5	13.5	13.0	
	PAT	6,525	5,337	22.3	5,784	12.8	5,124	12,309	10,460	17.7
ITC	Sales	59,742	50,835	17.5	57,675	3.6	48,166	117,417	99,001	18.6
	EBITDA	21,080	17,880	17.9	18,834	11.9	16,070	39,913	33,950	17.6
	Margins	35.3	35.2		32.7		33.4	34.0	34.3	
	PAT	15,143	12,467	21.5	13,327	13.6	10,703	28,470	23,171	22.9
United Spirits	Sales	18,663	13,655	36.7	19,445	(4.0)	14,706	38,108	28,361	34.4
	EBITDA	3,317	2,304	43.9	3,394	(2.3)	2,888	6,710	5,192	29.2
	Margins	17.8	16.9		17.5		19.6	17.6	18.3	
	PAT	1115	746	49.4	1377	(19.1)	1211	2,492	1,957	27.4
Colgate Palmolive	Sales	6,572	5,518	19.1	6,111	7.6	5,288	12,683	10,806	17.4
	EBITDA	1,125	1,122	0.3	1,173	(4.1)	1,389	2,298	2,511	(8.5)
	Margins	17.1	20.3		19.2		26.3	18.1	23.2	
	PAT	997	1003	(0.6)	1004	(0.8)	1219	2,001	2,222	(9.9)
Asian Paints	Sales	22,508	18,108	24.3	22,604	-0.4	18,302	45,112	36,410	23.9
	EBITDA	3,229	3,315	(2.6)	3,922	(17.7)	3,471	7,151	6,786	5.4
	Margins	14.3	18.3		17.3		19.0	15.9	18.6	
	PAT	2,087	2,147	(2.8)	2,637	(20.8)	2,222	4,724	4,369	8.1
Godrej Consumer Products	Sales	11,860	9,615	23.3	9,978	18.9	6,431	21,838	16,046	36.1
	EBITDA	2,088	1,670	25.1	1,428	46.2	1,191	3,516	2,861	22.9
	Margins	17.6	17.4		14.3		18.5	16.1	17.8	
	PAT	1,277	1,311	(2.6)	1,025	24.6	876	2,302	2,186	5.3
Total	Sales	197,818	162,864	21.5	193,384	2.3	157,899	391,201	320,763	22.0
	EBITDA	42,638	35,781	19.2	38,497	10.8	33,420	81,134	69,201	17.2
	Margins	21.6	22.0		19.9		21.2	20.7	21.6	
	PAT	29,665	25,329	17.1	27,282	8.7	23,159	56,947	48,488	17.4

Source: Company Data, PL Research

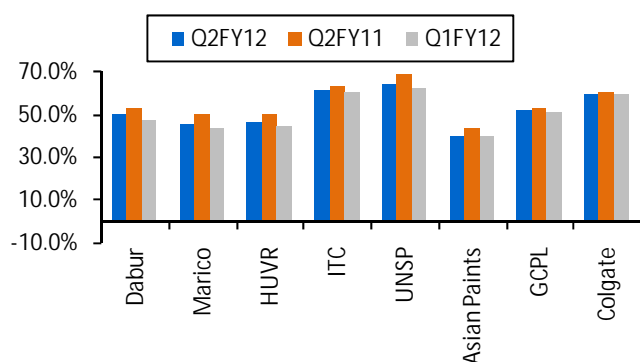
Exhibit 2: Healthy volume growth in Q2FY12


Source: Company Data, PL Research

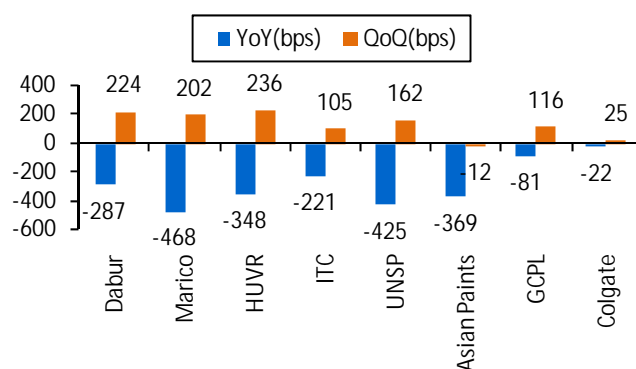
Exhibit 3: Volume growth has been broadly steady in the last 6 quarters

Volume growth	Q1FY11	Q2FY11	Q3FY11	Q4FY11	Q1FY12	Q2FY12
Dabur	18%	12%	10%	9.3%	9%	5%
Parachute (Marico)	14%	11%	5%	5%	10%	10%
Saffola (Marico)	18%	18%	13%	14%	15%	11%
HUVR	11.0%	14.0%	13.0%	14.0%	8.3%	9.8%
ITC	-4%	-1%	2%	-2%	8%	8%
Colgate	14.0%	12.0%	13.0%	13.0%	14.0%	13.0%
UNSP	6.0%	16.6%	14.0%	12.0%	15.0%	8.0%
Asian Paints	24.0%	0.0%	30.0%	15.0%	17.0%	14.0%

Source: Company Data, PL Research

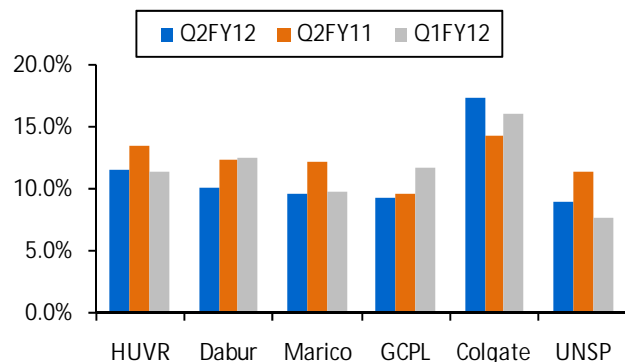
Exhibit 4: Gross margins declined YoY for entire coverage universe...


Source: Company Data, PL Research

Exhibit 5:however, sequential improvement seen everywhere


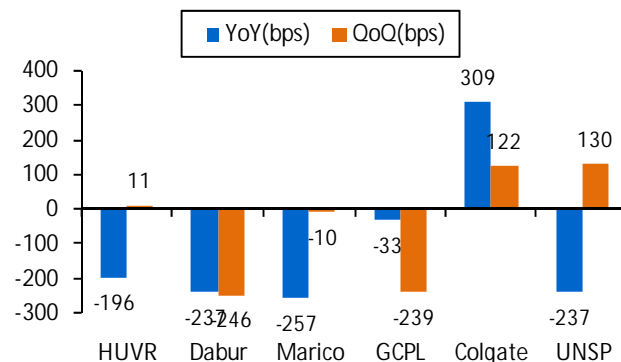
Source: Company Data, PL Research

Exhibit 6: Ad-spend cuts cushioned gross margin deterioration...



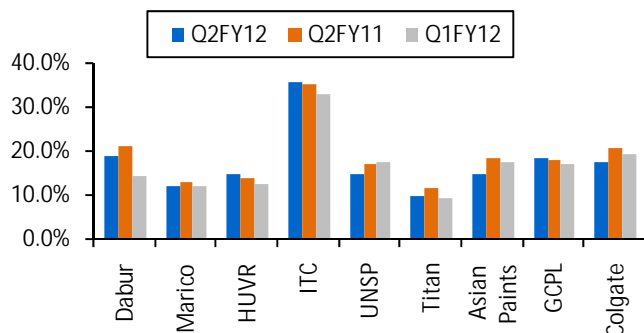
Source: Company Data, PL Research

Exhibit 7: ...except for Colgate, which expanded ASP YoY



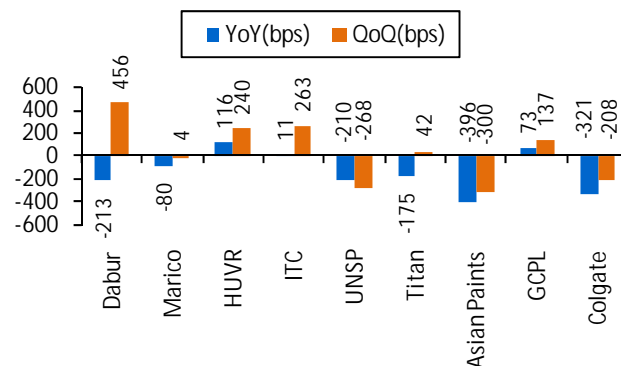
Source: Company Data, PL Research

Exhibit 8: Five out of eight reported YoY EBITDA compression...



Source: Company Data, PL Research

Exhibit 9:sequential recovery seen in some



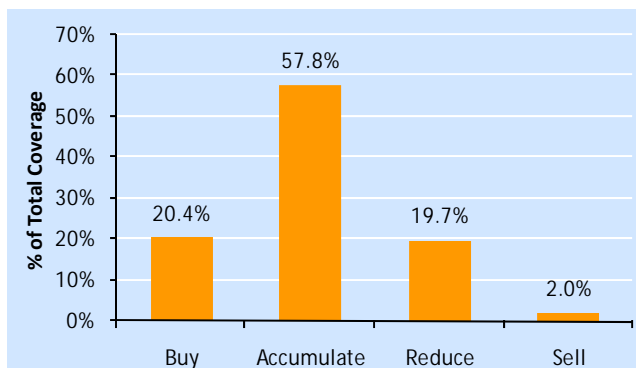
Source: Company Data, PL Research

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Reduce	: Underperformance to Sensex over 12-months	Sell	: Over 15% underperformance to Sensex over 12-months
Trading Buy	: Over 10% absolute upside in 1-month	Trading Sell	: Over 10% absolute decline in 1-month
Not Rated (NR)	: No specific call on the stock	Under Review (UR)	: Rating likely to change shortly

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