1 November 2011

2QFY12 Results Update | Sector: FMCG

Hindustan Unilever

BSE SENSEX	S&P CNX
17,481	5,258
Bloomberg	HUVR IN
Equity Shares (m)	2,159.5
52-Week Range (INR)	393/265
1,6,12 Rel. Perf. (%)	8/46/46
M.Cap. (INR b)	837.9
M.Cap. (USD b)	17.0

CMP: INR388 TP: INR340 Neutral

YEAR END	NET SALES (INR M)	PAT (INR M)	EPS (INR)	EPS GR. (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/10A	177,253	21,027	9.6	-16.0	40.3	32.8	81.4	105.1	4.7	29.6
03/11E	197,352	21,485	9.9	3.2	39.0	31.8	81.6	103.5	4.2	30.0
03/12E	229,205	25,379	11.8	18.1	33.0	25.3	76.6	99.5	3.6	24.7
03/13E	258,063	29,375	13.6	15.7	28.5	20.4	71.6	93.6	3.1	21.0

Key takeaways from post results conference call

- Consumer demand remains strong, with no signs of downtrading so far; premiumization trend continues.
- HUVR has increased innovation in Personal Care and Foods. It has re-launched *Lux* soap and *Vim Bar*.
- 21.8% sales growth in Soaps & Detergents has been driven by pricing. We estimate the pricing element at ~12% in Detergents and at 9-10% in Soaps. The management indicated that increase in prices does not indicate any let up in competitive intensity.
- 2QFY12 has witnessed various innovations, modern trade activation, rural expansion and benefits of an early Diwali which has boosted volume growth. HUVR has also reaped benefits of direct rural distribution expansion.
- HUVR's ad spends have been flat in 2Q and declined 8% in 1HFY12. Though ad spends have been cut in Soaps & Detergents, they are in line with the prevailing trends in the industry.
- Though input cost environment remains challenging, HUVR would be cautious in taking incremental price increases – it would not like to lose market share as had happened in 2009.

Revising estimates by 5-8%; maintain Neutral: We are revising our FY12/FY13 EPS estimates by 5-8% to factor in higher volume growth and margin expansion in Soaps & Detergents. While we expect HUVR to sustain high single digit volume growth in the medium term, we hold our view of structural adjustment in Personal Care margins in the medium term. We estimate 16.9% PAT CAGR over FY11-13 post 7.6% CAGR in the last three years. The stock trades at 33x FY12E EPS of INR11.8 and 28.5x FY13E EPS of INR13.6. Maintain **Neutral**.

QUARTERLY PERFORMANCE (INR Million)

Y/E MARCH	FY11				FY12				FY11	FY12E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Volume Growth (%)	11.0	14.0	13.0	14.0	8.3	9.8	8.4	8.5	13.0	8.8
Net Sales (incl service inc)	**48,762**	**47,647**	**51,277**	**49,666**	**55,794**	**56,105**	**60,200**	**57,106**	**197,352**	**229,205**
YoY Change (%)	8.3	11.6	12.1	13.4	14.4	17.8	17.4	15.0	11.3	16.1
COGS	24,466	23,830	25,692	26,581	30,742	30,010	31,605	30,930	100,569	123,287
Gross Profit	**24,296**	**23,817**	**25,586**	**23,085**	**25,052**	**26,095**	**28,595**	**26,176**	**96,783**	**105,918**
Margin %	49.8	50.0	49.9	46.5	44.9	46.5	47.5	45.8	49.0	46.2
Operating Exp	17,487	17,348	18,336	16,620	17,509	17,828	19,866	18,143	69,790	73,347
% to sales	35.9	36.4	35.8	33.5	31.4	31.8	33.0	31.8	35.4	32.0
EBITDA	**6,809**	**6,469**	**7,250**	**6,465**	**7,543**	**8,267**	**8,729**	**8,032**	**26,993**	**32,571**
YoY Change (%)	-4.8	-0.8	-7.9	8.6	10.8	27.8	20.4	24.2	-1.8	20.7
Margins (%)	14.0	13.6	14.1	13.0	13.5	14.7	14.5	14.1	13.7	14.2
Depreciation	535	554	563	556	562	571	590	623	2,208	2,346
Interest	1	1	1	0	0	5	0	6	2	12
Other Income	421	768	770	560	506	777	800	664	2,519	2,747
PBT	**6,695**	**6,683**	**7,456**	**6,468**	**7,487**	**8,467**	**8,939**	**8,067**	**27,302**	**32,960**
Tax	1,485	1,346	1,589	1,323	1,702	1,942	2,056	1,880	5,822	7,581
Rate (%)	22.2	20.1	21.3	20.4	22.7	22.9	23.0	23.3	21.3	23.0
Adjusted PAT	**5,210**	**5,337**	**5,867**	**5,146**	**5,784**	**6,525**	**6,883**	**6,187**	**21,480**	**25,379**
YoY Change (%)	-2.9	6.8	-2.1	21.9	11.0	22.3	17.3	20.2	4.4	18.2
Extraordinary Inc/(Exp)	122	325	508	546	0	364	0	0	1,580	364
Reported Profit	**5,332**	**5,661**	**6,375**	**5,692**	**5,784**	**6,889**	**6,883**	**6,187**	**23,060**	**25,744**

E: MOSL Estimates, PFAD - 1QFY08 as 100 with 3month lag

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Conference call takeaways: Consumer demand intact; input cost inflation challenging

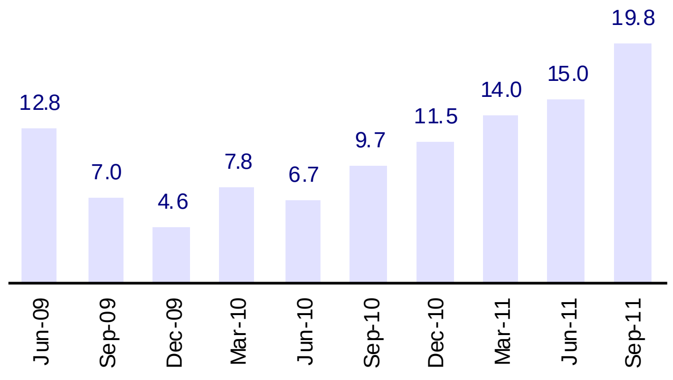
The management of HUVR seems cautiously optimistic for 2HFY12, as high inflation and rupee depreciation are a drag in an environment of sustained consumer demand. We expect gross margin pressure to sustain while lower ad spends and overheads increase EBITDA margin and PAT growth. We present below our key takeaways.

- **Consumer demand intact; no downtrading seen so far:** Consumer demand remains strong, with no signs of downtrading so far. For HUVR, rural demand is growing faster than urban demand. Premiumization trend continues across categories. HUVR has grown above market growth rate in most categories except Hair Care.
- **Increased innovation in Foods and Personal Care:** HUVR has increased innovation in Personal Care and Foods, with the re-launch of *Kissan Jam*, *Knorr Soupy Noodles* (INR5 pack), *Pure IT Marvella*, *Dove Shampoo* (INR1 sachet), Dove Face Wash and *Ponds White Beauty Naturals*. It has also re-launched *Lux Soap* and *Vim Bar*.
- **Soaps & Detergents growth driven by pricing; competitive intensity sustains:** 21.8% sales growth in Soaps & Detergents has been driven by pricing. We estimate the pricing element at ~12% in Detergents and at 9-10% in Soaps. The management indicated that increase in prices does not indicate any let up in competitive intensity.
- **Volume growth led by innovation, modern trade activation and rural distribution expansion:** 2QFY12 has been an important quarter for various innovations across segments. In addition, modern trade activation around 15 August and benefits of an early Diwali have boosted volume growth. HUVR has also reaped benefits of direct rural distribution expansion by 0.5m outlets in FY11.
- **Ad spends at competitive levels; cut by ~20% for Soaps & Detergents in 1HFY12:** HUVR's ad spends have been flat in 2Q and declined 8% in 1HFY12. We estimate that ad spends have declined 20% for Soaps & Detergents but have increased 10% for Personal Care and Foods. Though ad spends have been cut in Soaps & Detergents, they are in line with the prevailing trends in the industry.
- **Input cost environment remains challenging; rupee depreciation impact likely from 3QFY12:** The input cost environment remains challenging, as palm oil prices are up 20% YoY, crude prices are up 45% YoY and coffee prices are up 52% YoY. Though there has been some softening in the prices of palm oil and other inputs, this has been mitigated partially by ~10% rupee depreciation, which will start reflecting in performance from 3QFY12. Despite the input cost pressure, HUVR would be cautious in taking incremental price increases – it would not like to lose market share as had happened in 2009.

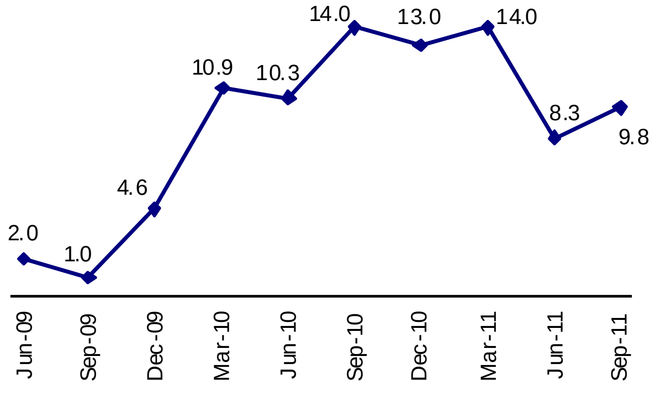
2QFY12 Volumes up 9.8%; gross margin down 350bp; adjusted PAT up 22.3%

Net revenue grew 18% to INR56.1b (v/s our estimate of INR54.2b), led by 9.8% volume growth. Gross margin contracted 350bp to 46.5% (v/s our estimate of 47.2%), as price increases did not adequately compensate for input cost inflation. Flat ad spends (down 200bp) and other expenses (down 265bp) enabled 28% growth in EBITDA. PAT increased 22.3%, as tax rate increased 280bp. Domestic FMCG sales grew 19.8%, the highest growth in 11 quarters, led by strong volume growth and price increases across segments.

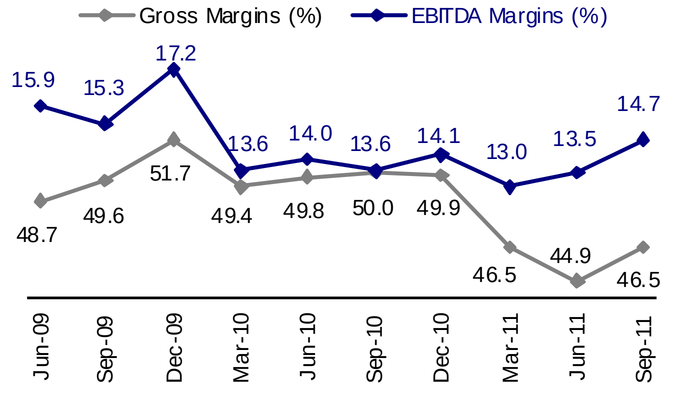
Domestic FMCG sales growth at highest levels in 11 quarters



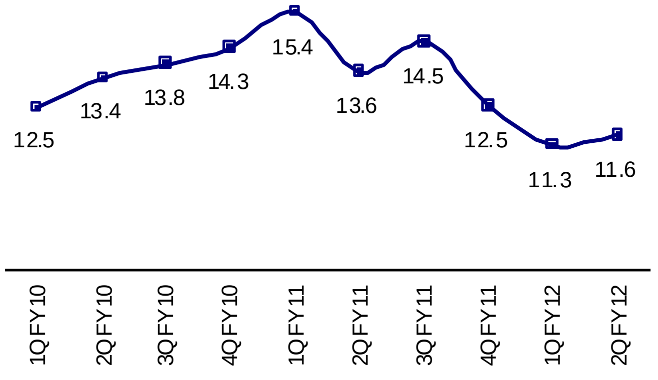
Volume growth at 9.8%; up from 1QFY12 levels



Gross margin declines 350bp



200bp decline in ad spends boosts EBITDA margin



Source: Company/MOSL

Margins expand 70bp in Soaps & Detergents; up 140bp in Personal Care

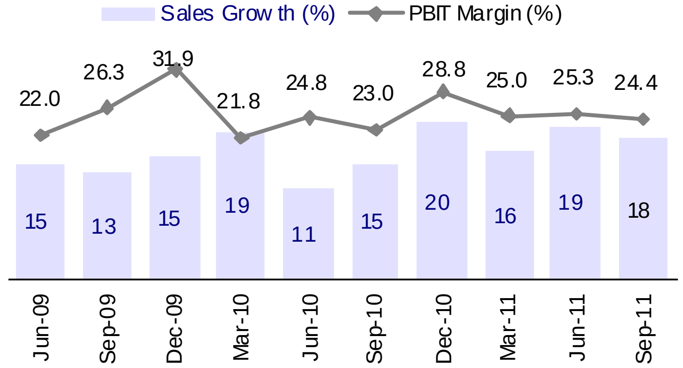
- **Soaps & Detergents:** Sales grew 21.8% while margins increased 70bp (320bp QoQ) to 12.4%. EBIT increased 28% on a low base. All key detergent brands like *Surf*, *Rin* and *Wheel* reported double-digit growth. HUVR has re-launched two key brands, *Lux* and *Vim*, which might have boosted volumes. We do not expect volume growth to sustain.
- **Personal Products:** Sales grew 18%, as all product segments sustained strong volumes. EBIT grew 25.5%, as margins expanded 140bp to 24.4%. *FAL*, *Vaseline* and *Ponds* reported double-digit growth. HUVR launched *Vaseline Total Moisture* and *Ponds White Beauty* during the quarter.
- **Beverages:** Sales grew 14.6%. EBIT was flat, as margins declined 200bp. We believe that strong tea and coffee prices have impacted margins in this segment.
- **Foods:** Sales grew 20.9% (17.8% in 1QFY12); EBIT increased just 6%, as margins declined 70bp. *Kissan* was launched with a new brand visual, *Knorr* was extended in INR5 packs while *Kwality Walls* maintained strong momentum.

Segmental snapshot: Soaps & Detergents margins up 70bp (320bp QoQ)

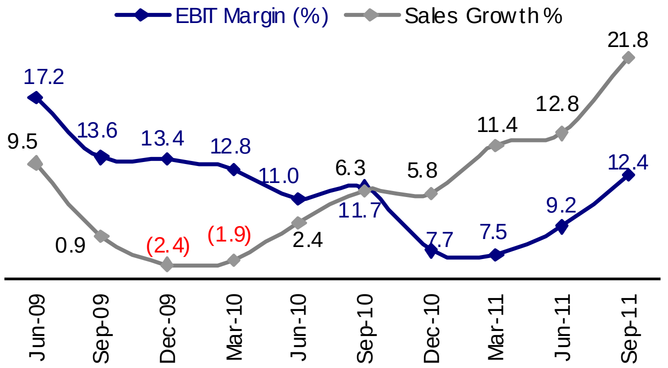
Segmental	1QFY12	1QFY11	2QFY12	2QFY11	Change %
Net Sales (INR Mn)					
Soaps and Detergents	25,550	22,645	25,926	21,294	21.8
Personal Products	16,307	13,655	16,126	13,649	18.2
Beverages	6,086	5,378	6,533	5,700	14.6
Processed Foods	3,721	3,158	3,318	2,744	20.9
Exports	3,063	2,648	2,909	2,647	9.9
EBIT (INR M)					
Soaps and Detergents	2,361	2,488	3,212	2,501	28.4
Personal Products	4,133	3,388	3,940	3,140	25.5
Beverages	754	695	877	876	0.2
Processed Foods	174	259	165	155	6.2
Exports	237	227	240	189	27.0
EBIT Margin (%)					
Soaps and Detergents	9.2	11.0	12.4	11.7	
Personal Products	25.3	24.8	24.4	23.0	
Beverages	12.4	12.9	13.4	15.4	
Processed Foods	4.7	8.2	5.0	5.7	
Exports	7.7	8.6	8.3	7.1	

Source: Company/MOSL

Personal Products margins expand 140bp



Soaps & Detergents margins up 70bp YoY

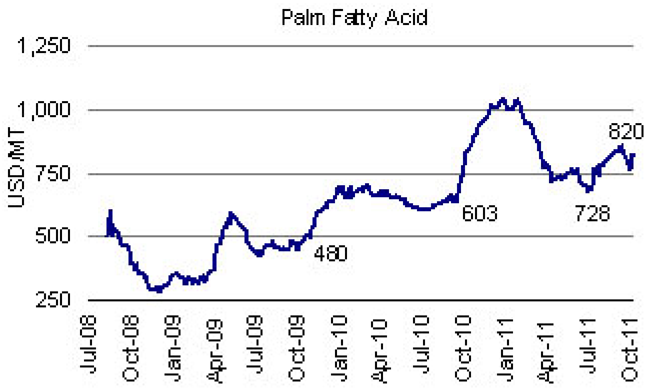


Source: Company/MOSL

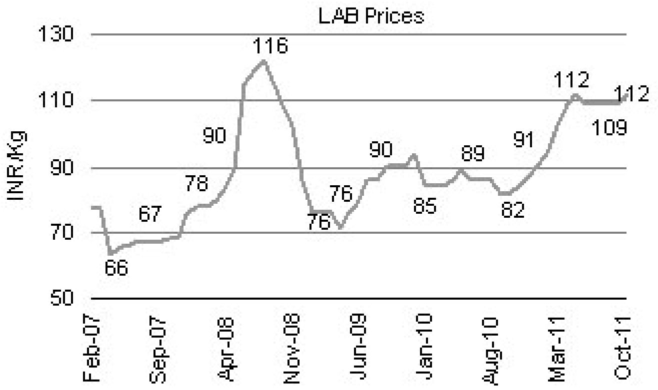
PFAD prices down 20% from peak; LAB prices up 24% YoY

PFAD prices have declined by 20% from the peak although they are up 10% from recent lows. We believe that rupee depreciation will increase landed cost further. LAB prices are ruling steady and are up 24% YoY; we do not expect any near-term respite unless crude prices decline meaningfully. Prices of other inputs like tea, coffee, vegetable oil and packaging, though down 15-20% from the peak, are still up YoY.

PFAD prices down 20% from peak; up 10% recently



LAB prices ruling steady; up 24% YoY



Major acceleration in volume growth unlikely

HUVR has taken 8-22% price increase in Detergents and 5-12% price increase in Soaps, which has enabled margin expansion QoQ. We note that input costs will harden QoQ due to rupee depreciation. However, the recent price increases and low base effect would ensure that decline in gross margins is lower in the coming quarters. Monsoons have been positive and recent increase in MSP of wheat and other crops augurs well for rural demand. In contrast, high food inflation, rising competitive activity and slowdown in the economy will prevent any major acceleration in volume growth, in our view.

Revising estimates by 5-8%; maintain Neutral

- We are revising our FY12/FY13 EPS estimates by 5-8% to factor in higher volume growth and margin expansion in Soaps & Detergents. We are increasing our volume growth estimate from 8% to 8.8% for FY12, while retaining our 8% volume growth estimate for FY13.
- We are reducing our gross margin estimates from 48% to 46.2% for FY12 and from 48.3% to 47% for FY13. This follows 420bp decline in gross margin in 1HFY12; the impact of rupee depreciation is likely to get reflected in the coming quarter. We factor in 280bp decline in gross margin in FY12 and an increase of 80bp in FY13.
- We are reducing our ad spend estimates from 13% to 12.1% for FY12, and from 13.2% to 12.5% for FY13. We are also cutting overheads by 120bp for FY12 and FY13. Consequently, our EBITDA margin estimates are higher by 30bp for FY12 and by 50bp for FY13. We revise our PAT growth estimates by 5% for FY12 and by 7.5% for FY13.
- We believe that the volume growth environment remains challenging, given high food inflation and aggressive pricing and promotions in select categories like Soaps, Shampoos and Oral Care, and likely slowdown in the economy.
- HUVR has the advantage of high ad spends in 3QFY12 due to base effect (14.5% of sales); however, the base effect advantage will no longer exist from 4QFY12 (ad spends at 12.5%).
- HUVR has seen a sharp re-rating on the back of steady volume growth in the last five quarters and cost rationalization-led margin recovery in 2QFY12. While we expect HUVR to sustain high single digit volume growth in the medium term, we hold our view of structural adjustment in Personal Care margins in the medium term. We estimate 16.9% PAT CAGR over FY11-13 post 7.6% CAGR in the last three years. The stock trades at 33x FY12E EPS of INR11.8 and 28.5x FY13E EPS of INR13.6 as against the 5-year average of 24.2x 12-month forward EPS. Maintain **Neutral**.

Hindustan Unilever: an investment profile

Company description

HUVR is the largest company in the FMCG industry, with market leadership in Soaps, Detergents and Personal Care categories. It has a wide distribution network with direct reach of over 1m retail outlets. The company is a subsidiary of Anglo Dutch FMCG giant, Unilever.

Key investment arguments

- Market leader in most categories; has strong brands.
- Wide product range across product categories, with presence at all price points.
- Decline in raw material prices would result in higher margins.

Key Investment risks

- Loss in market share has forced HUVR to pass on significant benefits from reduction in raw material prices.
- Competitive pressure has intensified with more companies entering Personal Care, Toilet Soaps and Detergents, which account for 80% of HUVR's profits.

Recent developments

- HUVR has effected price increases in its key brands of Detergents and Soaps.
- During the quarter, the company launched new products in Personal Care and Processed Foods, and re-launched the *Lux* range of soaps.

Valuation and view

- We raise our FY12/FY13 EPS estimates by 5-8%. Our EPS estimates are now INR11.8 for FY12 and INR13.6 for FY13.
- The stock trades 33x FY12E and 28.5x FY13E EPS. Maintain **Neutral**.

Sector view

- We have a cautious view on the sector in light of the inflationary pressure in the economy.
- Companies with strong competitive position (Dabur being a follower in bigger categories) would be better placed to withstand any slowdown in a particular segment.
- Longer term prospects bright, given rising incomes and low penetration.

Comparative valuations

		HLL	ITC	Nestle
P/E (x)	FY12E	33.0	26.8	42.1
	FY13E	28.5	22.7	35.4
EV/EBITDA (x)	FY12E	24.7	17.0	27.5
	FY13E	21.0	14.3	22.4
EV/Sales (x)	FY12E	3.6	6.1	5.5
	FY13E	3.1	5.2	4.5
P/BV (x)	FY12E	25.3	8.6	33.8
	FY13E	20.4	7.3	25.0

Shareholding Pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	52.5	52.5	52.0
Domestic Inst	12.1	11.8	12.9
Foreign	18.0	18.7	17.5
Others	17.4	17.0	17.6

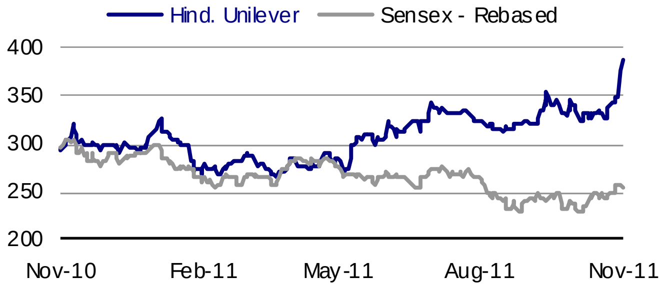
EPS: MOSL forecast v/s Consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY12	11.8	11.2	5.2
FY13	13.6	12.8	6.0

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
388	340	-12.4	Neutral

Stock performance



Financials and Valuations

Income Statement				(INR Million)
Y/E March	FY10	FY11	FY12E	FY13E
Net Sales	**175,238**	**194,011**	**225,670**	**253,927**
Other Operating Income	2,015	3,341	3,535	4,136
Total Revenue	**177,253**	**197,352**	**229,205**	**258,063**
Change (%)	-14.0	11.3	16.1	12.6
COGS	88,779	100,569	123,287	136,753
Gross Profit	**88,474**	**96,783**	**105,918**	**121,310**
Gros Margin	49.9	49.0	46.2	47.0
Operating Exp	60,975	69,790	73,347	83,484
% of sales	34.4	35.4	32.0	32.4
EBIDTA	**27,500**	**26,945**	**32,571**	**37,826**
Change (%)	-9.5	-2.0	20.9	16.1
Margin (%)	15.5	13.7	14.2	14.7
Depreciation	1,840	2,208	2,346	2,541
Int. and Fin. Charges	70	2	12	10
Other Income - Recurring	1,481	2,520	2,747	3,123
Profit before Taxes	**27,071**	**27,254**	**32,960**	**38,398**
Change (%)	-10.5	0.7	20.9	16.5
Margin (%)	15.4	14.0	14.6	15.1
Tax	5,823	5,488	7,251	8,640
Deferred Tax	221	281	330	384
Tax Rate (%)	22.3	21.2	23.0	23.5
Profit after Taxes	**21,027**	**21,485**	**25,379**	**29,375**
Change (%)	-15.9	2.2	18.1	15.7
Margin (%)	12.0	11.1	11.2	11.6
Non-rec. (Exp)/Income	994	1,527	364	0
Reported PAT	**22,020**	**23,012**	**25,744**	**29,375**

Balance Sheet				(INR Million)
Y/E March	FY10	FY11	FY12E	FY13E
Share Capital	2,182	2,160	2,160	2,160
Reserves	23,653	24,180	30,974	38,872
Net Worth	**25,835**	**26,339**	**33,133**	**41,032**
Loans	0	0	0	0
Capital Employed	**25,835**	**26,339**	**33,133**	**41,032**
Gross Block	35,820	37,596	40,596	44,096
Less: Accum. Depn.	-14,199	-15,905	-18,250	-20,791
Net Fixed Assets	**21,621**	**21,692**	**22,346**	**23,305**
Capital WIP	2,740	2,991	2,500	2,500
Investments	29,249	26,188	32,571	41,223
Deferred Charges	2,488	2,097	2,243	2,399
Curr. Assets, L&A	**37,854**	**47,371**	**52,246**	**58,215**
Inventory	21,799	28,113	31,343	35,024
Account Receivables	6,716	9,432	11,129	12,522
Cash and Bank Balance	2,314	2,819	2,434	2,950
Others	7,025	7,007	7,340	7,718
Curr. Liab. and Prov.	**67,332**	**73,999**	**78,772**	**86,610**
Account Payables	43,737	47,262	52,708	58,130
Other Liabilities	15,374	19,178	17,427	18,762
Provisions	8,221	7,558	8,638	9,718
Net Current Assets	**-29,478**	**-26,628**	**-26,526**	**-28,396**
Application of Funds	**26,620**	**26,339**	**33,133**	**41,031**

E: MOSL Estimates

Ratios				
Y/E March	FY10	FY11E	FY12E	FY13E
Basic (Rs)				
EPS	**9.6**	**9.9**	**11.8**	**13.6**
Cash EPS	10.5	11.0	12.8	14.8
BV/Share	11.8	12.2	15.3	19.0
DPS	6.5	6.5	7.5	8.5
Payout %	67.4	65.7	63.8	62.5
Valuation (x)				
P/E	40.3	39.0	33.0	28.5
Cash P/E	37.0	35.3	30.2	26.3
EV/Sales	4.7	4.2	3.6	3.1
EV/EBITDA	29.6	30.0	24.7	21.0
P/BV	32.8	31.8	25.3	20.4
Dividend Yield (%)	1.7	1.7	1.9	2.2
Return Ratios (%)				
RoE	81.4	81.6	76.6	71.6
RoCE	105.1	103.5	99.5	93.6
Working Capital Ratios				
Debtor (Days)	14	18	18	18
Asset Turnover (x)	6.8	7.4	6.8	6.2
Leverage Ratio				
Debt/Equity (x)	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT				(INR MILLION)
Y/E March	FY10	FY11E	FY12E	FY13E
OP/(loss) before Tax	27,500	26,945	32,571	37,826
Int./Div. Received	1,481	2,520	2,747	3,123
Interest Paid	-70	-2	-12	-10
Direct Taxes Paid	-5,823	-5,488	-7,251	-8,640
(Incr)/Decr in WC	12,190	-2,345	-487	2,386
Change in Deff	60	392	-146	-156
CF from Operations	**35,338**	**22,020**	**27,422**	**34,529**
Extraordinary Items	994	1,527	364	0
(Incr)/Decr in FA	-5,021	-2,028	-2,509	-3,500
(Pur)/Sale of Investments	-10,055	3,062	-6,383	-8,652
CF from Invest.	**-14,083**	**2,561**	**-8,528**	**-12,152**
Change in Networth	-240	-6,088	0	0
change in equity	2	-22	0	0
change in reserves	-242	-6,066	0	0
(Incr)/Decr in Debt	-4,219	0	0	0
Dividend Paid	-16,560	-16,420	-18,950	-21,476
Others	172	-1,568	-318	-362
CF from Fin. Activity	**-20,848**	**-24,076**	**-19,268**	**-21,838**
Incr/Decr of Cash	**407**	**506**	**-374**	**538**
Add: Opening Balance	1,906	2,314	2,819	2,434
Closing Balance	**2,313**	**2,819**	**2,445**	**2,972**

FY09 Fifteen month ending (March)

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