

# Hindustan Unilever

BSE SENSEX	S&P CNX	CMP: INR552	TP: INR540	Neutral						
18,625	5,664									
Bloomberg	HUVR IN									
Equity Shares (m)	2,159.5									
52-Week Range (INR)	580/342									
1,6,12 Rel. Perf. (%)	5/24/53									
M.Cap. (INR b)	1,192									
M.Cap. (USD b)	22.2									
Year	Net Sales	PAT	EPS	EPS	P/E	P/BV	RoE	RoCE	EV/	EV/
End	(INR m)	(INR m)	(INR)	Gr. (%)	(X)	(X)	(%)	(%)	Sales	EBITDA
03/11A	197,352	21,533	10.0	3.5	-	-	81.8	103.7	-	-
03/12A	229,210	26,601	12.3	23.5	44.8	34.6	74.6	97.2	5.3	35.1
03/13E	262,323	33,530	15.5	26.0	35.5	25.6	72.1	94.3	4.4	27.6
03/14E	293,494	38,973	18.0	16.2	30.6	19.4	63.4	83.4	3.9	23.6

- Hindustan Unilever Ltd's (HUL) 2QFY13 results were broadly in line with estimates. Adj PAT of INR8.1b, up 23% (est INR7.8b), was led by strong 17% sales growth and 74bp YoY EBITDA margins expansion. Volumes grew 7% YoY (est 8-9%), a slight moderation from the recent trend of 8-10%. It was impacted by moderation in discretionary categories (premium skin care, processed foods, water) and continued weak trends in CSD, which contributes ~6% of HUL's revenues. CSD's adverse volume impact was 120bp for the company.
- Strong 190bp expansion in Soaps and Detergents (S&D) on a high base was a key positive surprise, while PP performance was below expectations with 12% and 6% revenue and EBIT growth, respectively.
- Gross margins expanded 180bp to 48.2% due to softening input costs and price hikes. Despite a 60bp increase in advertising spends and 40bp expansion in other expenses, EBITDA margins expanded by 74bp to 15.5% (est 15.3%). While EBITDA grew by 18.2%, recurring PAT rose 23%, led by a 83% increase in other financial income.
- S&D sales increased 22.5%, while EBIT rose by 41%. Margins came in at 14.3%, the highest in 13 quarters.
- Personal products sales grew 12%, disproportionately impacted by a slowdown in CSD; margins declined 130bp YoY to 24.2%. Packaged foods and beverages posted a modest 10% revenue growth.
- We do not expect S&D to sustain 20%+ revenue growth as the pricing element would fade, going forward.
- While company's 2QFY13 profitability was slightly better than our estimate, the tepid PP numbers and continued sedate performance in processed foods and beverages does pose a concern, given the present premium valuations. HUL trades at 35.5x FY13E EPS and 30.6x FY14E EPS. Maintain **Neutral**.

Y/E March	Quarterly Performance								(INR Million)	
	FY12				FY13				FY12	FY13E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Volume Growth (%)	8.3	9.8	9.1	10.0	9.0	7.0	9.0	9.0	9.3	9.0
S&D EBIT Margin (%)	9.2	12.4	10.8	11.3	12.2	14.3	11.3	11.7	11.6	12.5
PP EBIT Margin (%)	25.3	24.4	25.9	26.3	25.8	24.2	26.4	26.5	25.5	25.3
Net Sales (incl service inc)	55,889	56,101	59,561	57,659	63,788	63,108	67,000	68,427	229,210	262,323
YoY Change (%)	14.6	17.7	16.2	16.1	14.1	12.5	12.5	18.7	16.1	14.4
COGS	30,798	30,088	30,751	31,223	33,677	32,695	34,237	35,653	122,859	136,262
Gross Profit	25,091	26,014	28,810	26,437	30,110	30,414	32,763	32,774	106,351	126,061
Margin %	44.9	46.4	48.4	45.8	47.2	48.2	48.9	47.9	46.4	48.1
Operating Exp	17,548	17,747	18,921	18,103	20,446	20,646	21,239	22,366	72,318	84,697
% to sales	31.4	31.6	31.8	31.4	32.1	32.7	31.7	32.7	31.6	32.3
EBITDA	7,543	8,267	9,890	8,334	9,665	9,767	11,524	10,407	34,033	41,363
YoY Change (%)	10.8	27.8	36.4	29.8	28.1	18.2	16.5	24.9	27.1	21.5
Margins (%)	13.5	14.7	16.6	14.5	15.2	15.5	17.2	15.2	14.8	15.8
Depreciation	562	571	568	571	576	577	595	609	2,272	2,357
Interest	0	5	5	2	53	63	2	2	12	70
Other Income	506	811	801	700	2,186	1,488	910	311	2,818	4,894
PBT	7,487	8,502	10,118	8,461	11,222	10,615	11,837	10,107	34,567	43,830
Tax	1,702	1,942	2,496	1,825	2,676	2,556	2,782	2,375	7,966	10,300
Rate (%)	22.7	22.8	24.7	21.6	23.8	24.1	23.5	23.5	23.0	23.5
Adjusted PAT	5,784	6,559	7,622	6,636	8,546	8,059	9,055	7,732	26,601	33,530
YoY Change (%)	11.0	22.9	29.9	29.0	47.7	22.9	18.8	16.5	26.7	26.0

E: MOSL Estimates

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**2QFY13 con-call highlights**

- Soaps & Detergents growth continues to be pricing led.
- Moderation in discretionary categories volume growth.
- Effective tax rate for FY13 – 24-25%. For FY14e – 27%. FY15e – 30%+
- Inflation and rising competitive intensity – near term challenges.
- Packaging norms: Ready with revised packs. Don't expect material impact on margins either ways. Most of the revised portfolio is already in the market.

**Personal Products**

- Skin – F&L – re-launch in last qtr with price increase – Price increase in F&L sachet from INR 7 to INR 8 - response good but transition is taking time. Takes couple of quarters for pricing to stabilize.
- Hair - Clinic plus re-launched, TRESemme launched. Not worried about the cannibalization possibility as the market development potential is attractive.
- Oral – actions taken to get back to competitive growth showing results – more needs to be done
- CSD – Accounts for 6% of HUL business. Impact of CSD on 2Q volume growth is 120bp with substantially higher impact on PP (240bp)
- Margins declined 130bp YoY to 24.2% - no specific reason ascribed except that quarterly margins is not the focus.

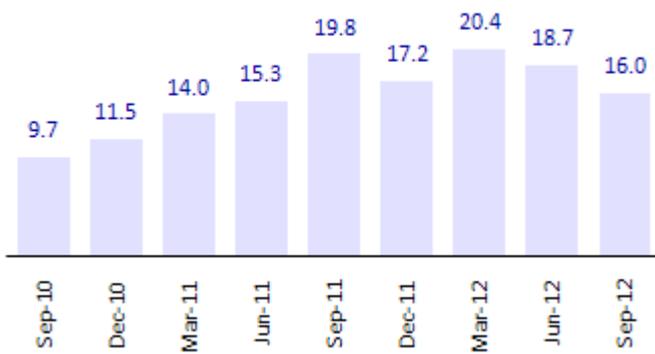
**Soaps and Detergents**

- Price growth > Volume growth.
- Media intensity heightens – could be because of softening in input costs (Palm FAD).
- Expect more local players to be active in S&D.

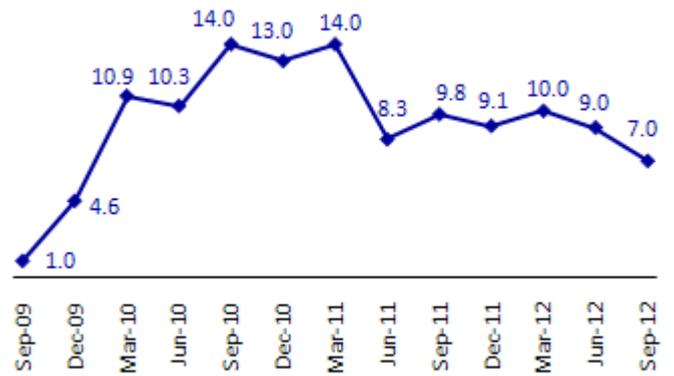
**2Q volumes up 7%; gross margin expansion of 180bp YoY positive; higher ad spends, other expenses curtail EBITDA margin expansion to 74bp**

- Net revenues (like-to-like after excluding exports from the base) grew 16.9% to INR61.6b, led by a volume growth of 7% (est 8-9%). Gross margin expanded 180bp to 48.2% on the back of lower input costs, price increases and premiumization. Ad spends rose by 60bp YoY to 12.2%.
- Moderation in volume growth is exacerbated by significant decline in CSD revenues (6% of HUL sales). It impacted company's volumes by 120bp.
- EBITDA increased by 18.2% to INR9.7b (est INR9.8b) as margins expanded 74bp to 15.5% (est 15.3%). Higher ad spends (up 60bp) and other expenses (up 40bp) curtailed margin expansion.
- Other financial income rose 83% YoY to INR1,488m (est INR900m) due to an increase in cash balance.
- Consequently, Adj PAT increased 23% to INR8.1b, higher than our estimate of INR7.8b.

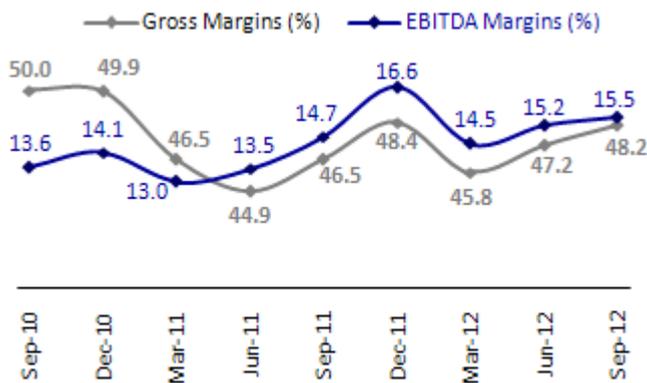
**Domestic FMCG sales up 17%...**



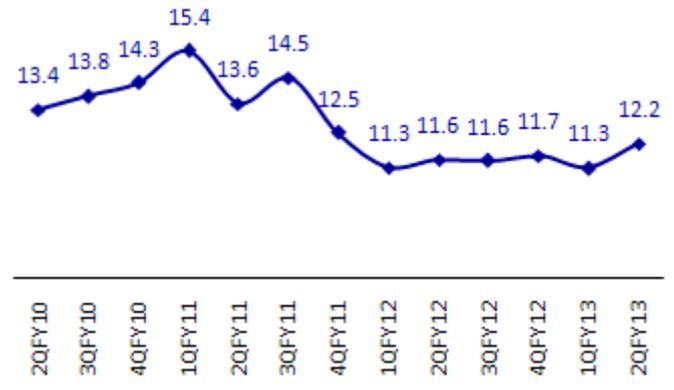
**...driven by 7% volume growth**



**Gross margin up 180bp, op margin increases 80bp...**



**...ASP rises 60bp YoY**



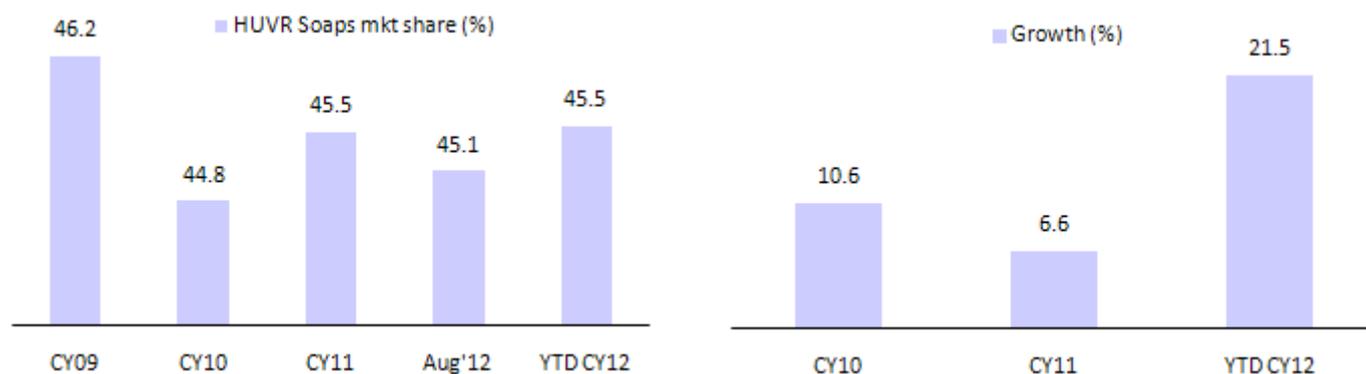
Source: Company, MOSL

**Soaps, detergents margin increase 190bp YoY; PP margin declines 130bp YoY**

- **Soaps and detergents:** Sales grew 22.5%, while margins increased 190bp YoY to 14.3%. The segment EBIT growth of 41% YoY is driven by price hikes and operating leverage.
- HUL's key laundry brands and peers took 20-25% price hikes in the past 12 months. We expect the impact of pricing component to fade, going forward.
- *Surf* and *Rin* registered double digit volume growth, *Dove* and *Pears* led to premiumization in skin cleansing, while *Lifebuoy* registered one of the strongest quarters.
- Company launched *Comfort One Rinse* during the quarter.
- Soaps and detergents' competitive intensity increased sharply QoQ as shown in the GRP chart below. This is a reflection of rising local competition due to softening input costs. Management expects local competition to increase in the near term.
- Due to sharp price hikes in laundry products in the past 12 months, both HUL and P&G increased their value market shares by 40bp and 220bp, respectively post CY11.

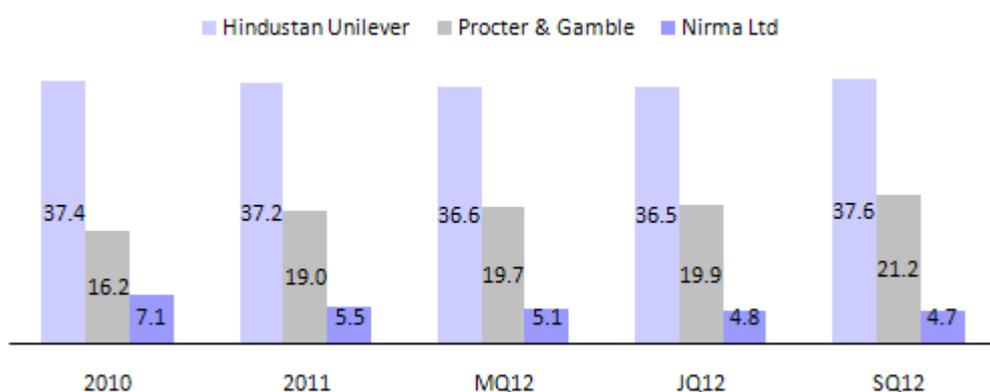
## HUL's soaps market share remained flat...

## Soaps category grows at 20%+ in CY12



Source: Company, MOSL

## HUL, P&amp;G increase detergents' value mkt share by 40bp and 220bp in YTD12



Source: Industry ,MOSL

- Personal products:** Sales grew by 12%, one of the lowest in 8 quarters due to modest growth in skin care. Skin care was impacted due to the recent 14% price increase in *Fair & Lovely* from INR7 to INR8. According to the management, such pricing transition in the past took time to stabilize. Rest of the portfolio performed well with double digit growth in *Ponds*, *Vaseline* and *Dove*. Oral care posted double digit growth in both *Close-Up* and *Pepsodent*. Hair care also registered double digit growth. HUL launched *TRESemme* shampoo during the quarter, positioned as Salon Style Hair. In oral care, it relaunched *Close-Up*. PP's poor performance was aggravated by the disproportionate fall in CSD segment. Though CSD adversely impacted company's consolidated volume growth by 120bp, in PP the impact was almost double, according to management. In our view, EBIT growth of 6% was well below our expectations due to higher investment in brands.
- Beverages:** Sales grew 10%, with double digit growth in premium tea and healthy performance in coffee. EBIT grew 17.5% as margins expanded by 90bp; *Taaza* was relaunched during the quarter.
- Processed foods:** Sales grew 10.2% led by *Kissan*, *Knorr* and *Kwality Walls*, all of which posted double digit growth. *Kissan Ketchup* posted the 12th consecutive quarter of double digit growth. Corrective actions are underway to improve HUL's position in instant noodles. Margins in processed foods continue to remain volatile and barely managed to break even, with 0.2% EBIT margin.

**Segmental snapshot; soaps and detergents lift overall performance**

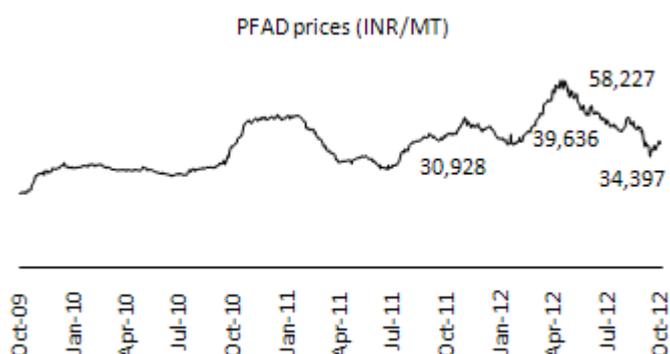
	1QFY13	2QFY13	2QFY12	Chg. %
<b>Net Sales (INR m)</b>				
Soaps and Detergents	31,631	31,762	25,926	22.5
Personal Products	18,471	17,445	15,562	12.1
Beverages	6,541	7,196	6,542	10.0
Processed Foods	4,370	3,663	3,323	10.2
Others	2,640	2,884	4,662	-38.1
<b>EBIT (INR m)</b>				
Soaps and Detergents	3,852	4,536	3,212	41.2
Personal Products	4,757	4,226	3,965	6.6
Beverages	950	1,031	877	17.5
Processed Foods	248	9	165	-94.5
Others	-43	21	-634	-103.2
<b>EBIT Margin (%)</b>				
Soaps and Detergents	12.2	14.3	12.4	1.9
Personal Products	25.8	24.2	25.5	-1.3
Beverages	14.5	14.3	13.4	0.9
Processed Foods	5.7	0.2	5.0	-4.7

Source: Company, MOSL

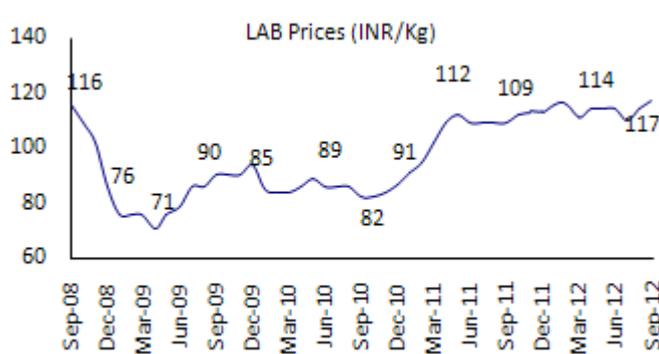
**Raw material prices ease, but currency remains a concern**

- PFAD prices are off 33% from its peak. With INR appreciating from its recent lows, it augurs well for near term gross margins.
- However, LAB prices have been ruling high for some time now.
- We do not expect further margin expansion in S&D as the pricing component would fade going forward and deflation in input costs precludes the possibility of further price hikes. Also, the increasing media intensity in S&D indicates growing local competition as input costs soften.

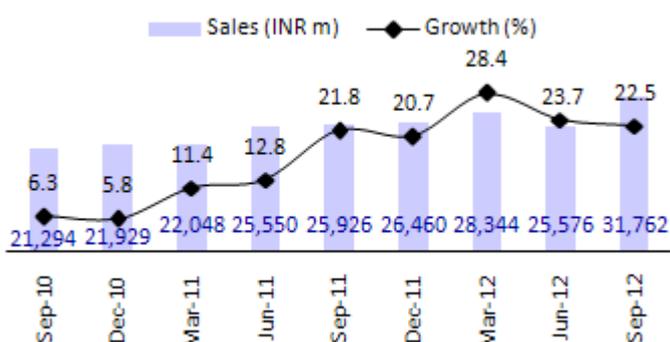
**PFAD prices down 33% from peak...**



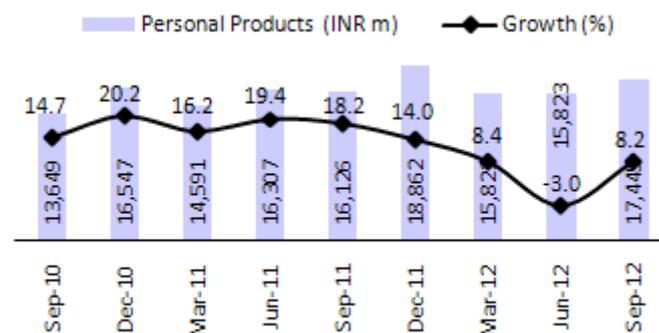
**...LAB prices remain high**

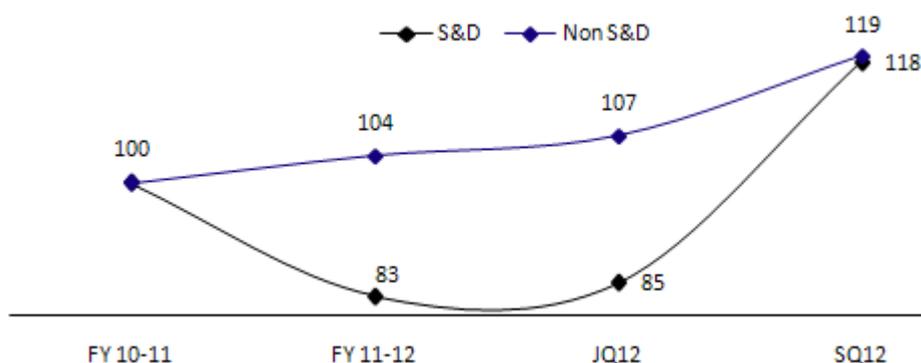


**S&D revenues up 22.5% led by pricing...**



**PP revenue growth is lowest in 8 quarters...**



**Industry GRP (media intensity) increases sharply, mainly S&D**

Source: Company, MOSL

**Valuation and view: premium valuation, maintain estimates and Neutral rating**

- We do not expect S&D to sustain 20%+ revenue growth as the pricing element would fade, going forward. We note that media intensity in S&D has increased sharply QoQ (at the highest level in 15 quarters), and local competition is picking up driven by softening input costs. Hence, we do not assume further margin gains in S&D and maintain our estimates.
- While company's 2QFY13 performance was slightly better than our estimate, the tepid PP numbers and continued sedate performance in processed foods and beverage pose a concern due to the premium valuation.
- The stock trades at 35.5x FY13E EPS and 30.6x FY14E EPS and has outperformed the Sensex by 15%. We maintain a Neutral rating (on premium valuation), with a revised target price of INR540 (30x FY14 EPS). A slowdown in volume growth and increase in competitive intensity are the key risks.

## Hindustan Unilever: an investment profile

### Company description

HUL 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 argument

- Market leader in most of the categories and has a strong brands.
- Wide product range across product categories with presence at all the price points.
- Decline in raw material prices would result in improvement in margins.

### Key Investment risk

- Loss in market share has forced HUL to pass on significant benefit from reduction in raw material prices.
- Competitive pressure has intensified with more companies entering personal care and toilet soap and detergents which account for 80% of HUL' profits.

### Recent developments

- HUL has effected price increases in its key brands of Detergents and soaps.
- During the quarter, the company launches were focused at personal products and processed foods as well as the relaunch of Lux range of soaps.

### Valuation and view

- HUL has launched TRESemme Shampoo from its global portfolio during the quarter.
- Taken 14% price increase in F&L sachet. Maintain **Neutral**.

### Sector view

- We have a cautious view on the sector on back of the inflationary pressure in the economy.
- Companies with competitive position 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)	FY13E	29.7	27.0	36.3
	FY14E	25.8	22.9	30.1
EV/EBITDA (x)	FY13E	22.9	17.5	23.4
	FY14E	19.8	14.6	18.7
EV/Sales (x)	FY13E	3.6	6.4	4.8
	FY14E	3.1	5.4	3.9
P/BV (x)	FY13E	21.2	8.7	23.8
	FY14E	16.4	7.4	18.5

### EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	15.5	14.6	6.5
FY14	18.0	16.9	6.3

### Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
552	540	-2.2	Neutral

### Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	52.5	52.5	52.5
Domestic Inst	9.0	9.9	12.1
Foreign	21.4	20.4	18.0
Others	17.0	17.2	17.4

### Stock performance (one year)





**N O T E S**

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### Hindustan Unilever

- |   |    |
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| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
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