



Index

- ◆ Stock Update >> [Hindustan Unilever](#)
- ◆ Sector Update >> [Transmission and distribution](#)

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Hindustan Unilever

Reco: Hold

Stock Update

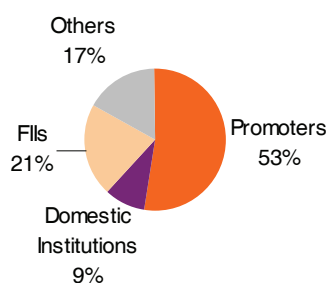
Event Update: Unilever Indonesia hikes royalty payments to Unilever

CMP: Rs520

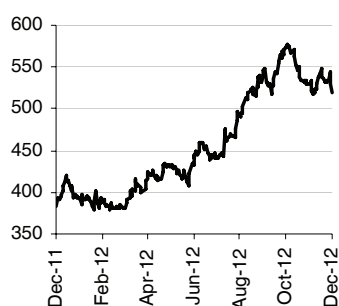
Company details

Price target:	Under review
Market cap:	Rs112,420 cr
52 week high/low:	Rs580/375
NSE volume: (no. of shares)	21.4 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Sharekhan code:	HINDUNILVR
Free float: (no. of shares)	102.7 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.0	0.2	26.5	42.7
Relative to Sensex	-3.5	-7.0	9.3	15.0

Key points

- The event—Unilever Indonesia increases royalty payment to its parent Unilever:** Unilever's Indonesian subsidiary, PT Unilever Indonesia, has approved a hike in royalty payments to its parent Unilever. Unilever Indonesia has agreed to pay a 5% fee and a maximum of 3% actual cost recovery as compared with the existing 3.5% fee.
- Fears about similar changes in HUL's royalty fee structure:** The hiking of royalty fees for Unilever Indonesia has led to fears of a similar action on Hindustan Unilever (HUL). HUL currently pays a royalty fee of 1% of the net sales for using the brands and trademarks held by Unilever. HUL has been paying 1% royalty to Unilever since August 1999 when for the first time entered it into a technical collaboration agreement with Unilever. The same was revised in December 2009, wherein additional products were added to the arrangement. The products added included product categories, where technical inputs are provided by Unilever, and products of specified categories manufactured by third-party manufacturers, where technical inputs developed by Unilever were made available to them.

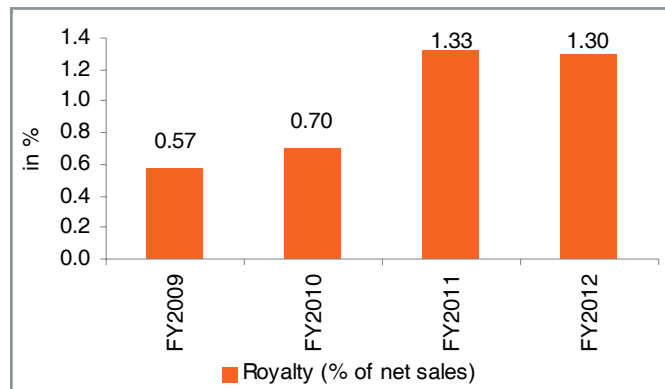
It is not necessary that a similar action will be taken with respect to HUL. However, it has dented sentiments on the stock. Any adverse development on the royalty payment issue could result in an additional pressure on the margin. We believe that in the current challenging environment, with the volume growth moderating, the company may be unable to resort to price hikes to offset the impact of royalty payments.

Valuations

Particulars	FY2011	FY2012	FY2013E	FY2014E	FY2015E
Net sales (Rs cr)	19,691.0	22,987.7	26,834.2	31,278.1	35,992.5
Net profit (Rs cr)	2,134.4	2,712.5	3,252.4	3,753.1	4,281.4
Growth Y-o-Y %	1.2	27.1	19.9	15.4	14.1
OPM (%)	12.1	13.2	13.4	13.6	14.1
Shares in issue (cr)	216.0	216.2	216.2	216.2	216.2
EPS (Rs)	9.9	12.5	15.0	17.4	19.8
PER (x)	52.6	41.4	34.6	29.9	26.3
P/BV (Rs)	40.6	30.2	21.5	15.5	11.5
EV/EBIDTA (x)	45.4	35.2	29.6	24.7	20.3
RoCE (%)	100.6	108.8	96.6	80.0	70.6
RoNW (%)	79.0	84.6	73.5	61.0	51.0

Valuation—at a premium to long-term average multiples, any negative cue creates selling pressure: At the current market price of Rs520, the stock trades at 29.9x its FY2014E earnings per share (EPS) of Rs17.4 and 26.3x its FY2015E EPS of Rs19.8. The business fundamentals remain intact but the valuation is not cheap anymore, which led to selling pressure on negative cues. However, given the strong brand equity and quality of management, we believe that the company is likely to trade at a premium. Hence, we maintain our Hold rating on the stock with price target under review.

Royalty paid to Unilever (% of net sales)



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Transmission and distribution

Sector Update

Still not out of the wood; though there are signs of competition softening

Key Points

- ◆ **Relatively weaker flow YTD:** The order awarding activity of Power Grid Corporation of India Ltd (PGCIL) picked up in September at around Rs1,873 crore. However, October and November (part of Q3FY2013) have broadly recorded average ordering to the tune of ~Rs700 crore in each month. In Q3FY2013, we expect that PGCIL will find it difficult to catch up with order flow compared with that of Q3FY2012, given the year-till-date (YTD) order flow. However, going by the historical trend, significant (almost 40-50%) ordering is expected in Q4FY2013.
 - ◆ **Transmission line segment remained the highest contributor, while KPTL and KEC regained the market share:** Among segments, order from the transmission line segment remained the highest growth contributor in YTD FY2013, contributing around 35% (excluding transmission line order of high-voltage direct current [HVDC] multi-terminal system worth Rs2,500 crore during June 2012). In the transmission line segment, we observed that (KEC; 17%) and Kalpataru Power Transmission Ltd (KPTL; 14%) regained their market share YTD.
 - ◆ **Rise in share of international players; a trend or aberration?:** Overall, the domestic players dominated the PGCIL order flow for many years. However, in YTD FY2013, the market share of international players touched around 21% YTD. Even this is relative higher compared with the market share of 10% in FY2012, excluding HVDC order worth Rs2,495 crore. However, it is still early to believe that there is a change in trend.
 - ◆ **Competition still alive; though there are signs of softening:** Competition has intensified in the last couple of years but our interaction with several companies hints that the intensity is softening. We also found that in the sub-station and transmission segments, the average bidder per contract stepped down from FY2011 to FY2013. In case of the transmission line segment, the average bidders were six in YTD FY2013 compared with nine in FY2012 and seven in FY2011. In the sub-station segment, the average bidders were eight in FY2011 which dropped to six in YTD FY2013. In the conductor segment, the average bidder remained around four in YTD FY2013.
- Further, we found that the percentage of orders that received bid from more than ten participants fell from 48% in FY2011 to 12% in FY2012 and 19% in YTD FY2013. The transmission line segment also replicated the trend. However, the conductor segment defers from this trend as there is an increase in the number of bidding per contract from FY2011 to YTD FY2013.
- ◆ **Near- to medium-term order flow to taper down from PGCIL; though global opportunity visible:** Our interaction with the management of PGCIL revealed that around Rs70,000 crore of orders were already placed by the company out of the total approved investment worth Rs85,500 crore for the 12th five-year plan. Out of the approved investment, around Rs15,000 crore of ordering is pending. PGCIL would require additional orders worth Rs15,000 crore to touch the target of Rs100,000 crore. So, we believe that till the end of FY2015, ordering could be around Rs30,000 crore on the higher side from the PGCIL. Ordering from the PGCIL crossed Rs18,000 crore in FY2011 and Rs22,000 crore in FY2012, which should not be above Rs15,000 crore on an average in the next two years. Hence, we maintain our cautious stance. Nevertheless, opportunity from the international market is likely to remain buoyant driven by the aging infrastructure requiring replacement, investment driven by American Recovery and Reinvestment Act and finally due to a smart grid and focus on renewable sources.

Quarterly trend in ordering, lagging behind YTD

The order awarding activity of PGCIL picked up in September after two healthy order months in May and June, 2012. The ordering was around Rs1,873 crore in September while the remaining two months (October and November; part of Q3FY2013) were having broadly average ordering to the tune of ~Rs700 crore in each month. Orders during September were largely dominated by the

transmission line segment (~Rs1,200 crore). Looking at the historical trend, significant (almost 40-50%) ordering is expected in Q4FY2013. However, as of now, Q3FY2013 numbers look weak, unless any significant large order is placed in December.

Quarter order flow

Rs cr

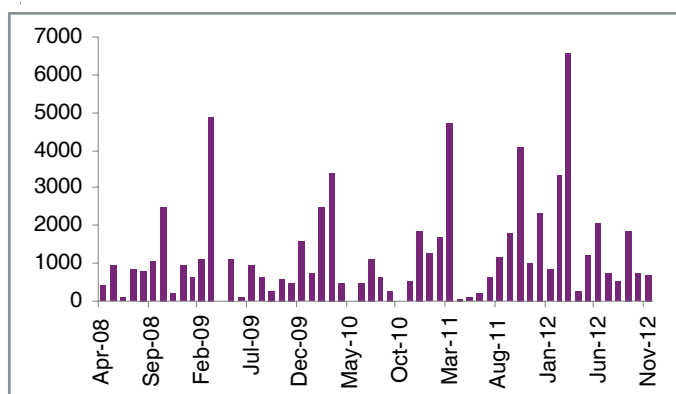
Particulars	Q1	Q2	Q3	Q4	Total
FY2009	1,475	2,684	3,602	6,623	14,384
FY2010	1,204	1,806	2,679	6,606	12,295
FY2011	958	1,997	2,436	7,663	13,054
FY2012	329	3,618	7,415	10,791	22,152
FY2013	3,582	3,118	1,415	-	8,115

Percentage of orde flow

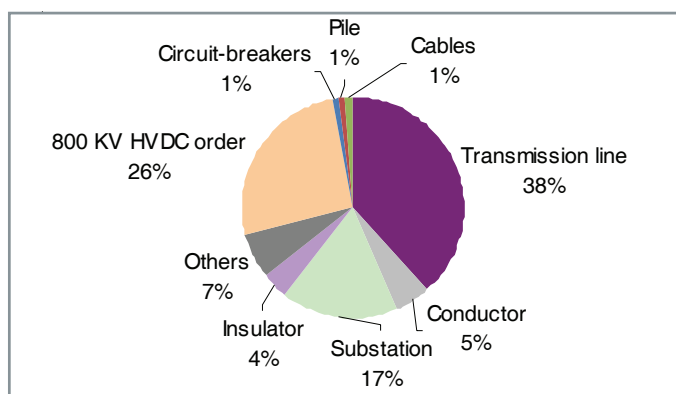
As a % of yearly orders	Q1	Q2	Q3	Q4
FY2009	10	19	25	46
FY2010	10	15	22	54
FY2011	7	15	19	59
FY2012	1	16	33	49
FY2013	44	38	17	-

MoM trend in PGCIL orders

Rs cr



Market share across segment



Product-wise transmission line retained top slot

The transmission line segment, which was the highest contributor in FY2012, retained the top position in YTFY2013, contributing around 35% (excluding transmission line order of HVDC multi-terminal system worth Rs2,500 crore during June 2012). However, orders for conductor, transformer and reactor remained low YTD. Till date, sub-station segment order holds the second position after transmission line segment. The share of the 765-kV category orders YTD remains at 42%, broadly in line with previous year trend.

Segmental break-up of order flow

Particulars	FY09	FY10	FY11	FY12	YTFY13
Transmission line	4,587	4,756	6,453	9,735	3,701
Conductor	3,713	1,484	2,984	5,339	511
Sub-station	2,628	2,059	1,830	2,953	1,643
Insulator	394	962	328	558	385
Transformer & reactor	1,318	2,411	1,034	2,646	806
HVDC multi-terminal system package			5,325	-	2,495
Communication equipment	11	99	63	404	124
Pile	30	126	358	130	101
REC	1,309	267	-	-	-
Cables	76	23	-	56	97
Circuit breakers					90
Others	320	107	4	333	657
Total order flow	14,385	12,295	18,378	22,154	10,610

Market share of 765kV across segment (%)

Particulars	FY09	FY10	FY11	FY12	FY13
765kV (as a % of total)	24	33	29	46	44
Tower	34	24	53	36	67
Conductor	16	20	15	44	34
Sub-station	27	32	40	56	63
Insulator	23	1	24	57	34
Transformer & reactor	39	79	61	83	67
Pile	100				
Circuit breakers					99
Others				27	32

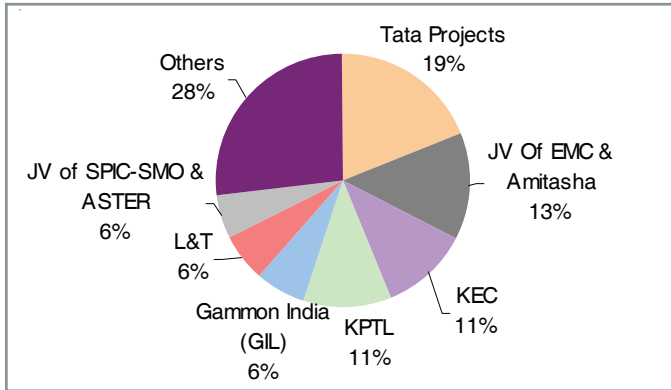
Player-wise analysis

Transmission in line, leading domestic players gaining share

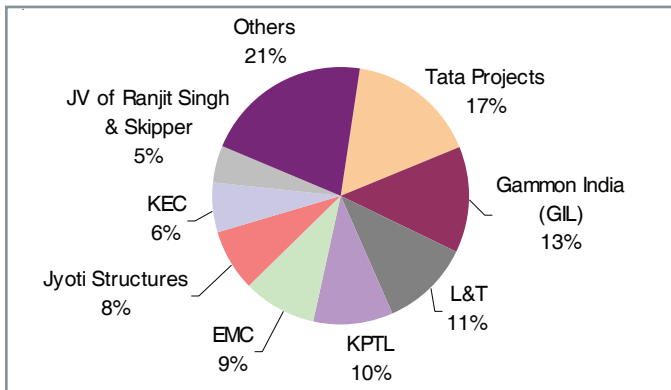
The total order of the transmission towers is around Rs6,196 crore YTD, where KEC got the highest market share, with ~17% of total order awarded, while KPTL got the second highest market share, with 14% of total order

awarded, However, Jyoti Structures got only 1% of the market share. Players like Larsen & Toubro (L&T), Gammon India, Bajaj Electricals, joint venture (JV) of NCC Power Projects and Unitech Power Transmission, and JV of Aster and Deepak Cables have grabbed around 3-4% share each. Even though this segment is largely dominated by the domestic players, Alstom Grid UK won a large piece of order for HVDC transmission line worth Rs2,500 crore, which is almost 40% of the total order awarded.

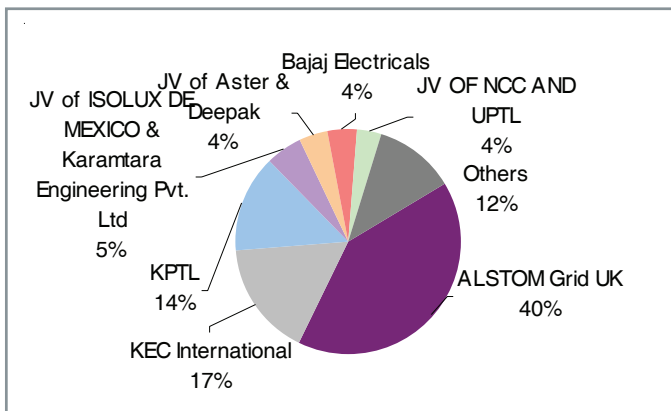
Transmission line projects in FY2011; market share



Transmission line projects in FY2012; market share



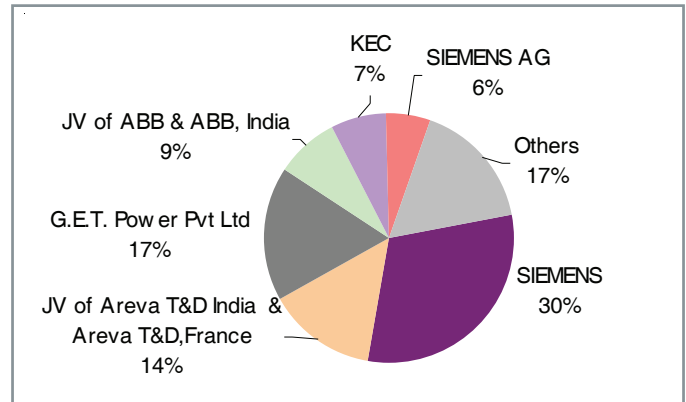
Transmission line projects in YTFY2013; market share



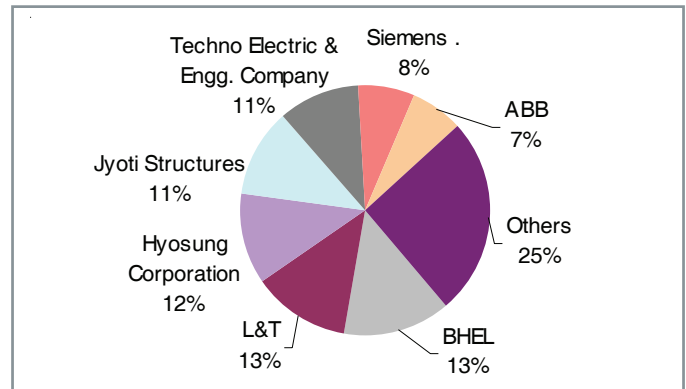
Sub-station order dominated by Chinese players YTD

In the sub-station segment, a new entrant (Chinese player), New Northeast Electric Group High Voltage Switchgear, won a significant order in YTFY2013 which, was almost 31% of the total sub-station order awarded till date. Among the regular participants, Hyosung won a sizeable order in the sub-station segment as it has been a regular participant and winner for the last couple of years. Among the domestic players, L&T won projects worth Rs135 crore (8% of the total order awarded till YTD), while ABB and Siemens won around 5% of the total order YTD.

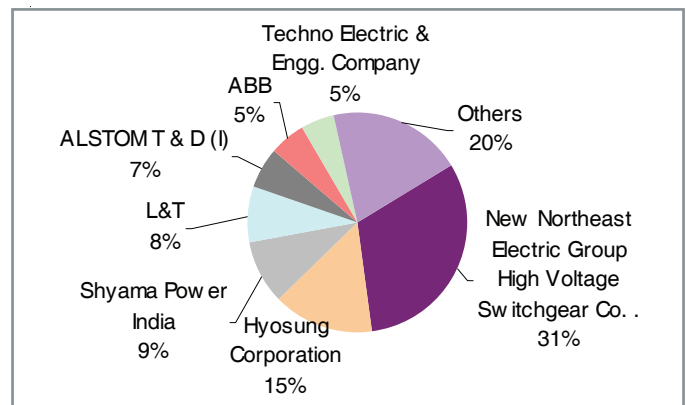
Sub-station projects in FY2011; market share



Sub-station projects in FY2012; market share



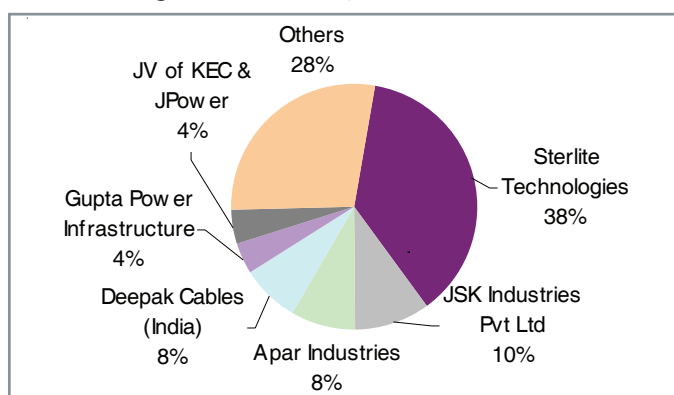
Sub-station projects in YTFY2013; market share



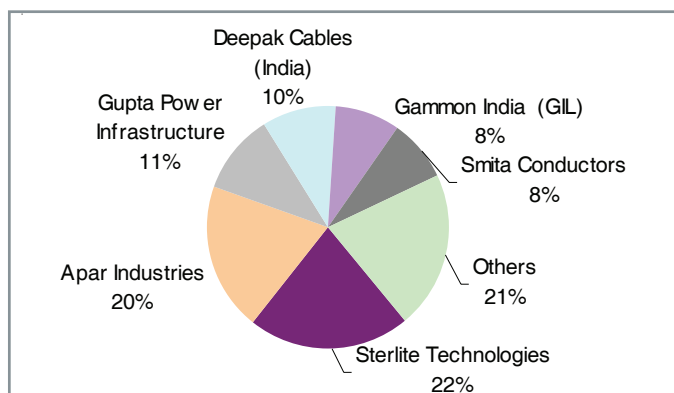
Conductors

The order awarding for the conductor segment has been low YTD, with orders worth ~Rs500 crore placed in the first eight months of FY2013 compared with around 5,000 crore in FY2012 and Rs2,500 crore in FY2011. In this segment, Sterlite Technologies bagged a significant share (26%) retaining its historical trend of winning 25-35% of the market share in the last three to four years. Following this, Gupta Power Infrastructure, who has been a consistent winner in the past, also won an order worth Rs131 crore (22% till date). Nevertheless, two new entrants were observed in this segment, namely Lamfil nv and Sturdy Industries.

Conductor segment in FY2011; market share



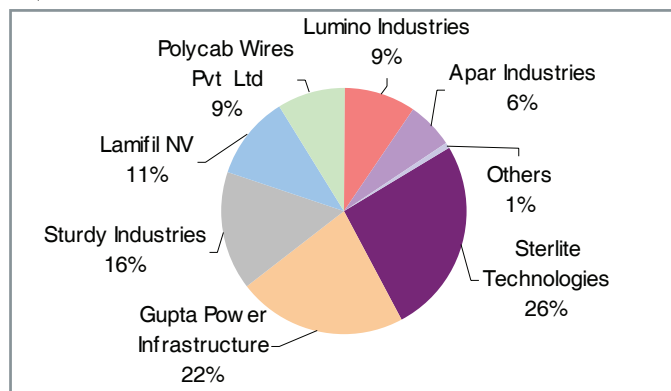
Conductor segment in FY2012; market share



Rise in share of international players; a trend or aberration?

Overall picture	FY2009		FY2010		FY2011		FY2012		FY2013	
	(in Rs cr)	(%)	(in Rs cr)	(%)	(in Rs cr)	(%)	(in Rs cr)	(%)	(in Rs cr)	(%)
Domestic-single bidder	12,081	84	7,621	62	9,444	72	17,920	81	5,323	50
JV (India + India)	1,024	7	788	6	1,789	14	1,175	5	374	4
Domestic total	13,105	91	8,409	68	11,233	86	19,095	86	5,696	54
International	801	6	2,320	19	776	6	2,126	10	4,200	40
JV (India + foreign)	479	3	1,566	13	1,045	8	934	4	714	7
Total	14,385	100	12,295	100	13,054	100	22,154	100	10,610	100
800-kV HVDC terminal system package					5,325				2,495	19
Total	14,385		12,295		18,378		22,154		13,105	

Conductor segment in YTFDY2013; market share



Domestic players dominated PGCIL order flow for many years. The market share of the domestic players ranged from 91% in FY2009 to 86% in FY2012. However, in the current year, we could see a different picture as the market share of the domestic players fell to 54%. Similarly, foreign players increased their market share from 6% in FY2009 to 40% in YTFDY2013. In the current year, Alstom Grid UK, with its own Indian partner Areva T&D India, won a major order for an 800-kV HVDC terminal package worth Rs2,495 crore. This dominated the share of international players. However, orders of HVDC are relatively new and infrequent. Therefore, if we exclude this particular order, the market share of the international players touches around 21% YTD. Even this is relative higher compared with 10% in FY2012. As significant sizes of the annual orders usually flow in the last quarter, it is still early to believe that there is a change in trend.

Competition still alive; though there are signs of softening

Competition has intensified in the last couple of years but our interaction with several companies hints that the intensity is softening. We learned from the interaction with some of our covered companies that the number of bidders is relatively lower in the last one year or so. We also found that in the sub-station and transmission

segments, the average bidder per contract stepped down from FY2011 to FY2013. In case of the transmission line segment, the average bidders were six in YDFY2013 compared with nine in FY2012 and seven in FY2011. In the sub-station segment, the average bidders were eight in FY2011 which dropped to six in YDFY2013. Similarly, in the conductor segment, the average bidder remained around four in YDFY2013. We expect the average bidding to remain at the similar level during the rest of the year in the sub-station and conductor segments.

Average bidder per contract

Years	Avg. bidder per contract		
	FY2011	FY2012	FY2013*
Sub-station	8	6	6
Transmission line	7	9	6
Conductors**	4	5	4

* YTD

** No. of players more than five

Though the trend of the average bidders shows an overall picture, to dig more in the competition intensity, we have tried to find out the percentage of projects which received participation by significantly large (ten or more) players. In sub-station segment, ~48% of the total projects received bid from more than ten participants in FY2011, while the same is around 12% in FY2012 and 19% in YTD FY2013. The transmission line segment also replicated the trend. However, the conductor segment defers from this trend as there is an increase in the number of bidding per contract from FY2011 to YDFY2013.

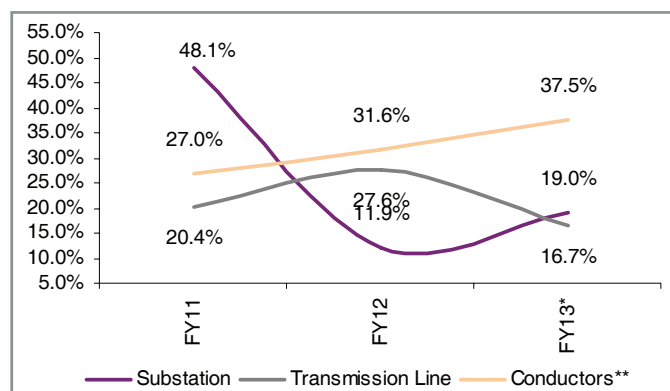
Percentage of top players

Years	Top players in %		
	FY2011	FY2012	FY2013*
Sub-station	48.1	11.9	19.0
Transmission line	20.4	27.6	16.7
Conductors**	27.0	31.6	37.5

* YTD

** No. of players more than five

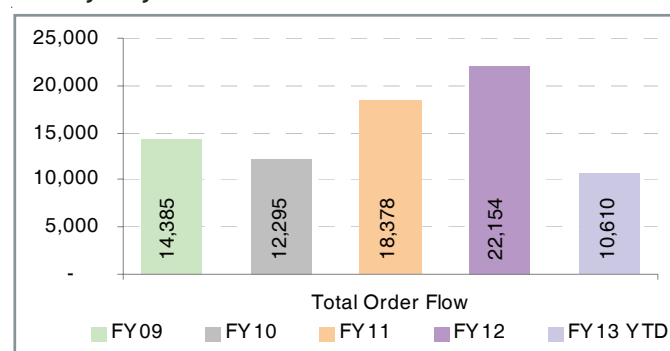
Percentage share of top players across segment



Near- to medium-term order flow to taper down from PGCIL; though global opportunity visible

Our interaction with the management of PGCIL revealed that around Rs70,000 crore of orders were already placed by the company out of the total approved investment worth Rs85,500 crore for the 12th five-year plan. Out of the approved investment, around Rs15,000 crore of ordering is pending. PGCIL would require additional orders worth Rs15,000 crore to touch the target of Rs100,000 crore. So, we believe that till the end of FY2015, ordering could be around Rs30,000 crore on the higher side from the PGCIL. Ordering from the PGCIL crossed Rs18,000 crore in FY2011 and Rs22,000 crore in FY2012, which should not be above Rs15,000 crore on an average in the next two years. Hence, we maintain our cautious stance. Nevertheless, opportunity from the international market is likely to remain buoyant driven by the aging transmission and distribution infrastructure requiring replacement, investment driven by American Recovery and Reinvestment Act and finally due to a smart grid and focus on renewable sources.

PGCIL yearly order flow



Valuation

Particulars	CMP Rs	Mkt cap (Rs cr)	Sales (Rs cr)			EPS Adj (Rs)			CAGR % FY12-14E	P/E (x)		
			FY12	FY13E	FY14E	FY12	FY13E	FY14E		FY12	FY13E	FY14E
ABB*	705	14,958	7,373	7,783	9,668	8.7	9.3	16.3	14.5	81.0	76.2	43.3
Siemens#	687	24,172	12,752	13,137	14,483	25.0	21.2	25.1	6.6	27.5	32.4	27.4
Alstom T&D	200	4,776	3,111	3,407	4,061	5.6	5.3	7.7	14.3	35.7	38.0	26.1
Crompton	111	7,139	11,249	12,436	14,090	5.7	5.1	10.1	11.9	19.5	21.8	11.0
BHEL	228	55,817	47,224	45,172	41,048	28.8	27.1	25.0	(6.8)	7.9	8.4	9.1
KEC	65	1,658	5,697	6,879	7,580	8.1	7.1	9.3	15.3	8.0	9.1	7.0
Kalpataru	87	1,328	5,308	6,499	7,723	12.3	12.4	14.0	20.6	7.1	7.0	6.2

September ending company

* December ending company

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