

Hindustan Lever

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Shareholding (%)

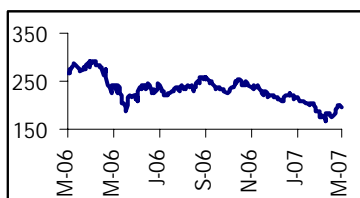
Promoters	51.4
FII's	12.9
MFs	3.3
Insurance Co.	12.5
Others	19.9

Share price performance

52-week high/low (Rs)	296/165		
	-1m	-3m	-12m
Abs (%)	12.1	-10.3	-26.2
Rel* (%)	11.7	-5.0	-39.3

*to Nifty

Stock chart



We recently met the management of HLL. We believe that it is difficult for HLL to grow organically at a faster rate considering its sheer size and mature status of categories in which it is present. Delay in entering new categories and lack of inorganic growth is also a cause for concern. Key takeaways from the meeting are as follows:

- ▲ Macro-environment remains strong with both urban as well as rural areas contributing to FMCG sector's growth.
- ▲ HLL has finally rolled out its water purifier *Pure-it*, after test launching the same a couple of years back. The company will gradually scale up the business and take it national after building the required infrastructure.
- ▲ Rising input costs are likely to put pressure on HLL's operating margin going forward. Increase in crude oil and vegetable oil prices, main raw materials for detergents and soaps, respectively, are a cause for concern.
- ▲ Currently, the entire EBIT margin of soaps and detergent business accrue only from the soap segment; detergent is a zero margin business. While the company has been able to increase detergent prices gradually, the increase is more to offset rising input costs. Detergent prices are still significantly lower than what they were before the pricing war started between HLL and P&G in 2004.
- ▲ Advertising & sales promotion (A&SP) expenses grew 26.6% in 2006 compared to sales growth of 9.4%. A&SP expense as a percentage of sales increased from 9.1% to 10.6%. Increase in A&SP expenditure has been due to increased investments in brands and advertising inflation of around 10%. The company expects to maintain A&SP expense to sales ratio going forward.
- ▲ The Shakti venture now has over 31,000 entrepreneurs covering 1,00,000 villages. Over the next few years, HLL aims to cover more villages that are devoid of traditional modes of advertising.
- ▲ HLL feels that modern trade is more of an opportunity than a threat. It provides better shopping experience to the consumers, as it enables them to touch and feel the products; unlike the traditional *kirana* shops where brands have to fight for shelf space. However, there is likely to be some level of pressure due to higher retailer margins. This is likely to be partially offset by the fact that only higher size SKU are available in modern retail, which provide better margins to the company.

Neutral

Rs205

March 29, 2007

Market cap

Rs bn 452

US\$ bn 10

Avg 3m daily volume

4,328,990

Avg 3m daily value

USD mn 20

Shares outstanding (mn)

2207

Reuters

HLL.BO/HINDLEVER.NS

Bloomberg

HLVR IN

Sensex

12,980

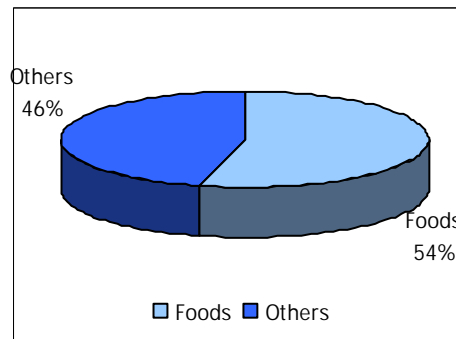
Nifty

3,798

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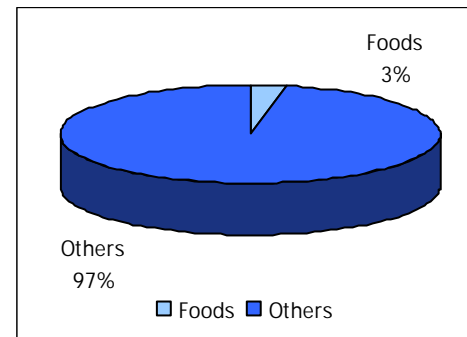
- ▲ HLL has not been able to successfully scale up new products nor enter new categories in the last few years. While the company was earlier focussed on entering the mass market segment, it has now shifted focus on niche categories and products such as anti-aging products (*Ponds Age Miracle*), *Dove International* range and *Lux body wash*.
- ▲ The company has identified food as a major growth driver going forward. We believe that the company missed the opportunity of entering categories like biscuits and snacks. While Unilever is more of a food company, with 54% of its revenues and EBIT accruing from the food division: HLL's presence in food is restricted to categories like jams, soups, ketchup and Atta, which contribute just 3.1% to its revenue and 0.7% to its EBIT. HLL believes that it would not enter segments that are low on margin, similar to a commodity business. Chart 1 and 2 show the distribution of Unilever and HLL's revenue in 'food' and 'others' category. Unilever has several one-billion Euro food brands, such as *Beceel*, *Blue Band* and *Hellmanns*. These brands don't have any presence in the Indian markets.

Chart 1. Unilever portfolio



Source: IISL research, company

Chart 2. HLL Portfolio



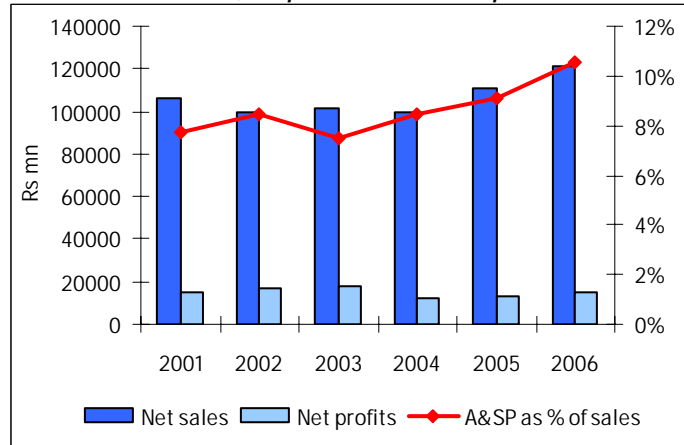
Source: IIL research, company

- ▲ HLL has not been successful in pursuing inorganic growth as a strategy. Their last major acquisition, Modern Foods, was in January 2000; after which it has not been able to identify any potential takeover target in India or abroad. According to the management, it is looking at inorganic growth as an ongoing process; however, steep valuations have acted as hindrance in acquiring brands, especially in the Indian markets.
- ▲ We believe for a behemoth like HLL, the only way to grow at a faster rate is either through entering new categories or through an inorganic growth strategy. At this point, we believe that HLL is following neither of these.

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Chart 3 shows the growth trend in net sales, profits and A&SP expenses over the last six years. Since CY2001, HLLs net sales have grown at a CAGR of 2.6%, while A&SP expenses have increased at a CAGR of 9.1%. Net profits on the other hand have grown at a CAGR of 0.4%.

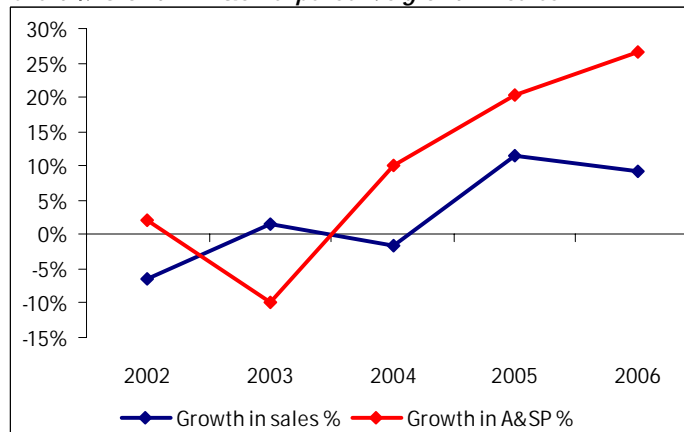
Chart 3. Trend in sales, net profits and A&SP expenses



Source: IISL research, company

Chart 4 depicts the rate at which A&SP expenses and sales have grown over the last five years. We can see the gap between the two has been increasing since 2004. In CY2006, A&SP expenses grew 26.6% in comparison to a sales growth of 9.4%.

Chart 4. Growth in A&SP expense v/s growth in sales



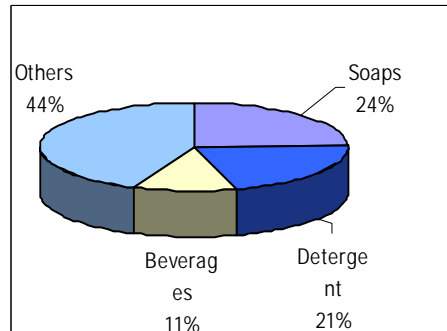
Source: IISL research, company

Chart 5 depicts the importance of categories like soaps, detergents and beverages in HLL's portfolio. These products have major bearing on HLL's portfolio accounting for 56% of HLL's revenue in CY2006. Our major concern is that all these

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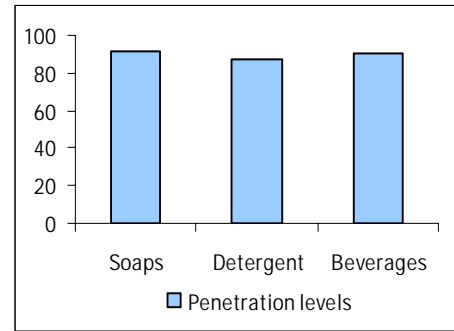
three products have high penetration levels of close to 90% (graphically presented in chart 6). Also the company is a market leader in each of these categories.

Chart 5. CY2006 Revenue distribution



Source: IISL research, company

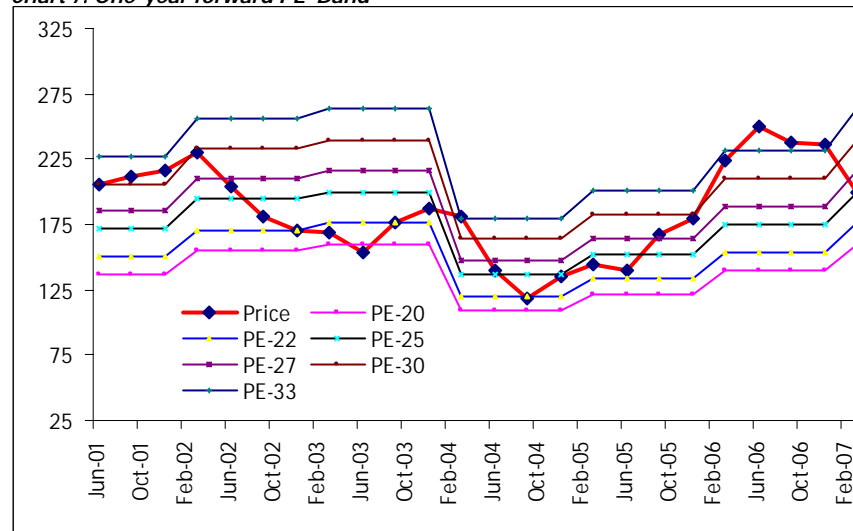
Chart 6. Penetration levels



Source: IIL research, company

HLL is currently trading at Rs205, which is 31% below its 52-week high price of Rs296. As seen in chart 7, the company is trading at a one-year forward P/E of 25x, which makes it look cheap, compared to historical multiples at which it has been trading. However, on fundamental basis, we are still not enthused by the prospects of the company going forward. The stock looks expensive on PEG basis. It is trading at PEG of 2.0 and 1.9 for CY2007 and CY2008 respectively.

Chart 7. One-year forward PE Band

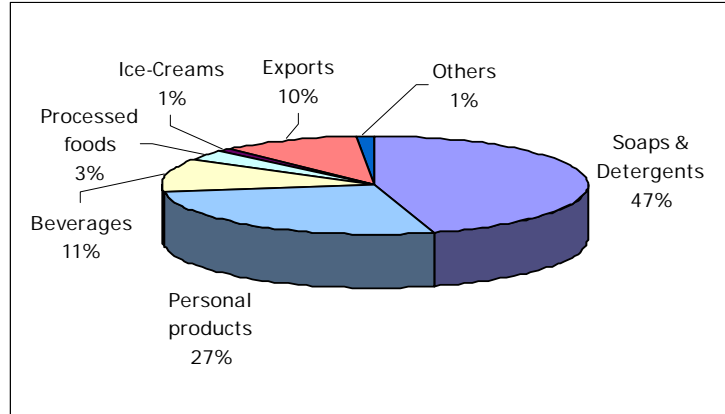


Source: IISL research

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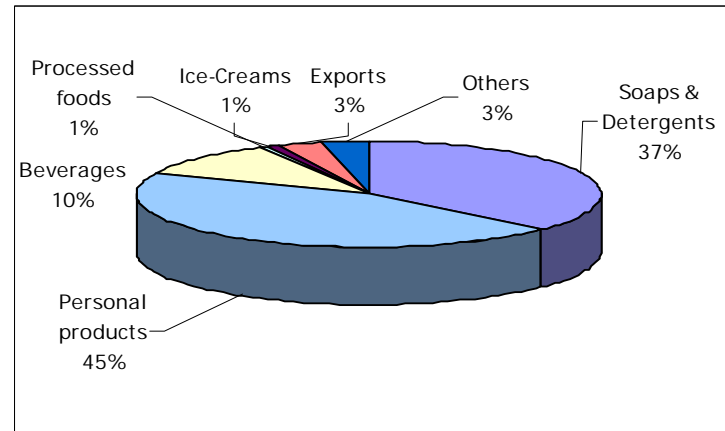
Chart8 and Chart9 show the contribution of different categories to HLL's revenues and EBIT in CY2006.

Chart 8. Contribution to revenue



Source: IISL research, company

Chart 9. Contribution to EBIT



Source: IISL research, company

Table 1. Estimates

Rs mn	CY06	CY07E	CY08E
Net sales	121033.9	134496.8	148509.2
growth %	9.4	11.1	10.4
EBITDA	16480.5	18413.9	20650.6
EBITDA margin %	13.6	13.7	13.9
Net profit	15396.7	17371.7	19492.8
growth %	13.7	12.8	12.2
NPM %	12.6	12.7	13.0
EPS (Rs)	7.0	7.9	8.8
PE Ratio	29.3	25.9	23.3

Source: IISL research

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