Q2FY12 Result Update

November 14, 2011

HDFC Sec Scrip code	Industry	CMP (Rs.)	Recommended Action	Price Band (Rs.)	Target (Rs.)	Time Horizon
HLLLTDEQNR	FMCG	396.2	Buy on dips	347-360	411	3 months

Hindustan Unilever Limited (HUL) is India's largest fast moving consumer goods company, with leadership in Home & Personal Care Products. It is the market leader across diverse FMCG categories and has powerful brands like Rin, Surf Excel, Lux, Lifebuoy, and Ponds in its portfolio.

We present an update on the company after the Q2FY12 results:

Q2FY12 Results Review

Y-o-Y

- Net sales grew by 18% Y-o-Y to Rs. 55.2 bn [Q2FY11: Rs. 46.8 bn]. Domestic Consumer business increased by 18.5% Y-o-Y (highest growth in 11 quarters), with strong underlying volume growth of 9.8%. HPC & Foods categories reported good growth of 20.3% & 16.7% (Y-o-Y) respectively. Growth in HPC was led by both Soaps & Detergents and Personal Products segment, which rose 21.8% & 18.2% Y-o-Y, driven by both price & volume growth (price growth was relatively higher in soaps & detergents). Soaps & Detergents performed relatively much better compared to the previous quarters (growth in Q1FY12: 12.8% Q4FY11: 11.4%; Q3FY11: 5.8%; Q2FY11: 6.3%; Q1FY11: 2.4%). The segment contributed 46.3% to total revenues & 61.7% to the HPC business in Q2FY12.
- Growth in foods business was driven by strong performance by both Beverages & Packaged Foods segments, which grew by 14.6% & 20.9% respectively. Exports revenue grew by 9.9% Y-o-Y. However, others category (which includes Chemicals, Water, etc) de-grew by 24% Y-o-Y.
- Operating profit grew by 31.1% (higher than in line with sales growth), while the OPM improved by 134 bps Y-o-Y to 13.4%, despite the higher input cost (up 25.9% Y-o-Y), aided by marginal growth in A&P spends and other expenditure (up 0.8% & 0.1% Y-o-Y respectively). A&P cost as a % of Net Sales stood at 11.8%, a decline of 206 bps Y-o-Y. Employee Cost grew almost in line with the sales growth by 17.3% Y-o-Y.
- The HPC business PBIT rose by 26.8%, while its PBIT margins improved by 87 bps to 17% on the back of improved margins reported by both soaps & detergents and personal products segment. Foods segment PBIT grew marginally by 1.1%, while the PBIT margins fell by 163 bps Y-o-Y to 10.6%. The muted growth in the segment profits was mainly due to poor performance reported by beverages, which reported flat growth in its PBIT. While others segment did not perform well on the revenue front, it managed to reduce its losses substantially during the quarter.
- While depreciation cost rose 3.1% Y-o-Y, lower growth in other income (grew marginally by 3.3% Y-o-Y) & higher effective tax rate on PBT (up 254 bps Y-o-Y) suppressed the PAT growth (pre-exceptional & extr. ord items), which stood at 22.6% Y-o-Y at Rs. 6.45 bn. Reported PAT grew by 21.7% Y-o-Y to Rs. 6.89 bn. The EPS (Adj.) for Q2FY12 stood at Rs. 3 vs. Rs. 2.4 in Q2FY11.

Q-o-Q

- Sequentially the results were good. Net sales grew marginally by 0.3%, which was better than the Q-o-Q performance displayed by the company in Q2 of last two years. Growth was witnessed in Soaps & Detergents, Beverages & Others segments (up 1.5%, 7.3% & 8.9% Q-o-Q respectively). Personal Products, Packaged Foods & Exports de-grew by 1.1%, 5% & 10.8% Q-o-Q respectively.
- Operating Profit grew by 8.8%, while the OPM rose 104 bps Q-o-Q. Segment-wise, HPC business PBIT grew by 10.2%, led by strong PBIT growth of 36.1% Q-o-Q reported by Soaps & Detergents segment. However, Personal Products PBIT de-grew by 4.7%. Foods PBIT grew by 12.3% Q-o-Q, led by Beverages, whose PBIT grew by 7.3%. However Packaged Foods PBIT de-grew by 10.8% Q-o-Q.
- Adjusted PAT grew by 13.4%, supported by lower depreciation expense (up 1.6% Q-o-Q) and decline in the effective tax rate (down 19 bps Q-o-Q). However, reported PAT grew at a slower pace by 9.8% Q-o-Q on the back of lower one off gains (down 24.4% Q-o-Q) in Q2FY12.

Quarterly Financials:

(Rs. in Million)

Particulars	Q2FY12	Q2FY11	VAR [%]	Q1FY12	VAR [%]	Remarks
Net Sales	55221.6	46808.7	18.0	55038.9	0.3	Y-o-Y growth was both volume & price led. The volume growth was strong at 9.8%, despite the price hikes undertaken in the soaps & detergents segment in June & July 2011. Though Q-o-Q growth in revenues was flat, it was better than the Q-o-Q performance displayed by the company in Q2 of last two years. The growth was witnessed across the categories and was ahead of the market.
Total Expenditure	47838.0	41177.8	16.2	48250.9	-0.9	
(Inc) / Dec. in Stock in Trade	-526.3	-1034.4	-	1902.6	-	
Cons. of Raw / Packaging Material	22905.4	17995.1	27.3	21141	8.3	Material Cost [incl. (Inc) / Dec. in Stock in Trade, Cons. of Raw / Packaging Material & Purchase of Goods] as a % to net sales rose 344 bps Y-o-Y to 54.4%. Palm oil prices increased by 20% Y-o-Y, crude prices rose 45% Y-o-Y, while coffee prices were up 52% Y-o-Y in Q2FY12. Though palm oil & other inputs have witnessed some cooling off recently, this has partly been offset by ~10% rupee depreciation, which would start reflecting in performance from Q3FY12 onwards.
Purchase of Goods	7631.1	6869.2	11.1	7697.9	-0.9	
Advertising & Promotions	6513.7	6464.8	0.8	6329.5	2.9	The company managed its Advertising & Promotion expenses effectively as the A&P / Net Sales stood at 11.8% in Q2FY12, down 202 bps Y-o-Y (up marginally by 30 bps Q-o-Q). The moderation in the A&P cost on Y-o-Y basis supported OPM expansion. The management indicated that the A&P spends was cut in the soaps & detergents segment, but were in line with the prevailing industry trends. However, ad spends in the rest of the segments moved up.
Employees Cost	2873.1	2450.1	17.3	2862.3	0.4	
Other Expenditure	8441	8433.0	0.1	8317.6	1.5	The lower Y-o-Y growth in other expenditure was on a high base of Q2FY11, which included innovation led cost on packaging moulds. This benefit would be available in Q3FY12 as well.
Operating Profit	7383.6	5630.9	31.1	6788	8.8	
Other Income	1659.9	1606.2	3.3	1260.7	31.7	Other Income includes other operational income, which rose 5.4% Y-o-Y and other financial income, which rose 20.2% Y-o-Y. Other financial income includes interest income, dividend income and net gain on sale of other non-trade investments.
EBIDTA	9043.5	7237.1	25.0	8048.7	12.4	
Interest	5.4	0.7	671.4	0.2	2600.0	
PBDT	9038.1	7236.4	24.9	8048.5	12.3	
Depreciation	571	553.7	3.1	562	1.6	
PBT	8467.1	6682.7	26.7	7486.5	13.1	
Tax (incl. DT & FBT)	2022.1	1425.9	41.8	1802.4	12.2	Effective tax rate on PBT rose 254 bps Y-o-Y, but declined by 19 bps Q-o-Q to 23.9%. We expect the tax rate in FY12 to be in the range of 23%-24%. Taxation for the quarter includes taxation adjustments of previous years amounting to a credit of Rs. 34.4 mn (Q2FY11: Rs. Nil).
PAT (pre-except & extra-ord items)	6445.0	5256.8	22.6	5684.1	13.4	Lower growth in other income & higher effective tax rate suppressed the Y-o-Y PAT growth.
Extr. Ord. Items [gain /(loss)]	444.2	404.4	9.8	587.5	-24.4	Exceptional items in Q2FY12 include profit on sale of properties Rs. 472.8 mn (Q2FY11: Rs. 255.6 mn) and restructuring costs of Rs. 28.6 mn (Q2FY11: Rs. 27.1 mn).
Reported PAT	6889.2	5661.2	21.7	6271.6	9.8	

EPS	3.0	2.4	22.6	2.6	12.3	
Equity	2182.1	2182.1	0.0	2160.7	1.0	
Face Value	1.0	1.0	0.0	1	0.0	
OPM (%)	13.4	12.0	11.1	12.3	8.4	Gross margin contracted sharply by 344 bps Y-o-Y to 45.7% in Q2FY12, as the extent of price hikes undertaken were insufficient to fully compensate for input cost inflation. However, despite the input cost pressure, the OPM expanded 134 bps Y-o-Y on the back of rationalization of A&P cost in soaps & detergents segment and marginal growth in the other expenses.
PBIT (%)	15.3	14.3	7.5	13.6	12.8	
PATM (%)	11.7	11.2	3.9	10.3	13.0	

(Source: Company, HDFC Sec)

Segmental Results:

Quarterly:

(Rs. in Million)

Particulars	Q2FY12	Q2FY11	VAR [%]	Q1FY12	VAR [%]	Remarks
Segment Revenue						
Soaps & Detergents	25925.5	21293.8	21.8	25550.4	1.5	▪ Y-o-Y Growth was both price & volume driven (largely price led). Price hikes were mainly to compensate for the input cost inflation. The management stated that prices hikes undertaken do not indicate heightened competitive intensity. However, what was impressive was that despite aggressive price hikes in this segment, the value growth was impressive. ▪ Y-o-Y Growth in Laundry was ahead of market, underpinned by double-digit growth in Rin, Surf and Wheel. Vim was relaunched during the quarter with “100 Nimbuon Ki Shakti”. Skin Cleansing had one of its strongest quarters with all segments of the portfolio performing well. Lux and Lifebuoy grew in double digits while the premium portfolio registered its 10th consecutive quarter of double digit growth. Lux was relaunched during the quarter with superior product and salient advertising.
Personal Products	16126.3	13648.5	18.2	16307	-1.1	▪ Y-o-Y growth was led by both price & volumes. Strong growth is a result of the new innovations led by Lux, coupled with Pond's, Fair & Lovely, Vaseline, Dove, market development initiatives and continued emphasis on enhancing distribution. ▪ Growth in Skin Care accelerated with Fair & Lovely, Vaseline and Pond’s growing in strong double digits. Fair & Lovely has been modernized and is yielding good results. Vaseline and Pond’s continue to build segments of future with differentiated benefits and aspirational offerings - Vaseline Total Moisture was relaunched with 3 variants and Pond’s White Beauty was extended with Naturals range during the quarter. The face wash range was expanded with introduction of Dove Face Wash. Hair and Oral delivered double digit growth amidst heightened competitive intensity. Nourishing Oil care range and Re. 1 sachets were introduced under Dove during the quarter to expand the consumer franchise.
Beverages	6532.6	5700.0	14.6	6085.6	7.3	All brands delivered double digit growth. New range of flavored and green tea bags was launched under Taj Mahal.
Export	2909.3	2647.0	9.9	3063.4	-5.0	
Packaged Foods	3318.4	2744.0	20.9	3720.8	-10.8	Packaged Foods growth at 20.9% was broad based. Kissan range was relaunched with a new brand visual and “100% Real” proposition. Knorr Soupy Noodles range was extended with an accessible Rs. 5 pack. Kwality Walls continued its strong growth momentum led by innovations

						and distribution expansion.
Others (incl. Chemicals. Water etc)	1160.7	1527.1	-24.0	1066.0	8.9	Pureit continues to expand its portfolio with the latest entry into fast growing “RO water purifier” segment with “Marvella RO”. Distribution across modern electronic retail chains is being scaled up and “Go to Market” integration is expected to be completed by the year-end.
Total	55972.8	47560.4	17.7	55793.2	0.3	
Less: Inter Segment Revenue	0	0.0		0		
Net sales/inc. from Operations	**55972.8**	**47560.4**	**17.7**	**55793.2**	**0.3**	
Segment Results						
Soaps & Detergents	3212.3	2501.00	28.4	2360.6	36.1	
Personal Products	3940.3	3139.80	25.5	4132.6	-4.7	
Beverages	877.3	875.70	0.2	754	16.4	
Export	240.2	189.20	27.0	236.8	1.4	
Packaged Foods	164.7	155.10	6.2	173.8	-5.2	
Others (incl. Chemicals. Water etc)	-78	-183.30	-	-25.6	-	The segment witnessed reduction in its losses on Y-o-Y basis.
Total	**8356.80**	**6677.50**	**25.1**	**7632.20**	**9.5**	
EBIT Margin (%)						
Soaps & Detergents	12.4	11.7	65 bps	9.2	315 bps	The segment witnessed an improvement in PBIT margins both on Y-o-Y & Q-o-Q basis, led by rationalization of ad spends & price hikes undertaken during the quarter in soaps & detergents.
Personal Products	24.4	23.0	143 bps	25.3	-91 bps	The margin improvement was impressive given the weight reductions in shampoos. The margin expansion was on a low base.
Beverages	13.4	15.4	-193 bps	12.4	104 bps	The segment has been facing input cost inflation (firm tea & coffee prices) as a result of which its PBIT margins declined during the quarter on Y-o-Y basis. There was also a step up in the brand investments under this category.
Export	8.3	7.1	111 bps	7.7	53 bps	
Packaged Foods	5.0	5.7	-69 bps	4.7	29 bps	The segment PBIT margins (Y-o-Y) were impacted due to higher ad spends
Others (incl. Chemicals. Water etc)	-6.7	-12.0	528 bps	-2.4	-432 bps	
Total	**14.93**	**14.04**	**89 bps**	**13.68**	**125 bps**	
Capital Employed						
Soaps & Detergents	-3757.4	-5671.2	-	-2634.6	-	
Personal Products	642.6	-1707.7	-	168.8	280.7	
Beverages	1248	350.4	256.2	2566.6	-51.4	.
Export	1544.9	2194.9	-29.6	1884.7	-18.0	
Packaged Foods	1470.4	245.2	499.7	1116.8	31.7	Significant increase in the Capital Employed witnessed on Y-o-Y & Q-o-Q basis

Others (incl. Chemicals. Water etc)	-504.5	-611.7	-	-617.1	-
Total	**644.0**	**-5200.1**	**-**	**2485.2**	**-74.1**
Other Unallocable Items	39124.0	42084.1	-7.0	30346.4	28.9
Total	**39768.0**	**36884.0**	**7.8**	**32831.6**	**21.1**

(Source: Company, HDFC Sec)

Note: i) Domestic Consumer business includes Soaps & Detergents, Personal Products, Beverages, Packaged Foods (including Ice Creams); ii) HPC category includes Soaps & detergents & Personal Products; iii) Foods business includes Beverages & Packaged Foods

Other Highlights

- In order to fully exploit the opportunity in exports market and to provide necessary focus, flexibility and speed to the business, the Board of Directors and Shareholders have approved a proposal for demerger of FMCG exports business including specific exports related manufacturing units of HUL into its wholly owned subsidiary Unilever India Exports Ltd. (UIEL) with effect from April 01, 2011. Pending approval by the Hon'ble Mumbai High Court, the financial results of the FMCG exports business continue to be reported as part of the company's results for the quarter.
- The Board of Directors has declared an Interim Dividend of Rs 3.5 per share of Re.1/- for the financial year.

Conclusion & Recommendation:

HUL displayed good performance in Q2FY12 both on the revenue & profit front. The quarter witnessed innovations across the categories. Though in single digits, volume growth of 9.8% appeared robust, considering the price hikes undertaken by the company during the quarter. Activation of Modern trade (in mid-August) & early Diwali seems to have boosted the volume growth. The company has also benefited from the expansion of rural distribution (increase of 0.5m rural outlets in FY11). Despite a sharp contraction in the gross margins (down 344 Y-o-Y), the overall OPM improved by 134 bps Y-o-Y on the back of rationalization of A&P cost in soaps & detergents segment and marginal growth in the other expenses. The company's two main categories viz; Soaps & Detergents and Personal Products, which contribute nearly 75% to the total revenues (with Soaps & Detergents accounting for 46.3%) performed well during the quarter.

Soaps & Detergents posted impressive revenue growth, which was largely price driven. Price hikes, coupled with rationalization of ad spends aided the segment margin expansion both on Y-o-Y & Q-o-Q basis. The segment has started to gather pace as it reported robust double-digit growth for the third straight quarter, despite continuing high competitive intensity & price hikes taken during the quarter. The company has stated that the price hikes undertaken was to compensate for the input cost inflation & the cut in the segment ad spends was in line with the industry trends. The company stated that this strategy would continue going forward. Any incremental price hikes in the coming quarters could lead to moderation in the segmental volume growth and could result in some downtrading in the next fiscal. Further, ad spends could step up in this segment, based on innovations & the level of competitive intensity. However, price hikes could provide cushion to margins going forward.

Personal Product segment has reported strong growth both on revenue & profit front. The segment witnessed margin expansion despite high competition, weight reduction in shampoos & step up in ad spends. With new launches and re-launches and distribution expansion, we expect the segment to continue to report strong revenue growth in the medium term. However, with increasing competition & relatively higher ad spends (as compared to that in the soaps segment), we don't expect the margin expansion to be significant in this segment. We expect the segment margins to stabilize in the coming quarters.

Some of the key things, which we will need to monitor over the next few quarters include i) Volume Sustainability (especially in the Soaps & Detergents), ii) New launches, variants across the categories, iii) Pricing actions taken by the competitors and iv) Price behavior of key inputs like palm oil, raw tea, HDPE & LAB. While price war may be fading in the laundry segment, competition action is to be closely watched in hair care & oral care segments. We feel that the company could manage its business dynamically, through judicious pricing actions and increased focus on cost effectiveness, while ensuring at the same time that it remains competitive in the market place.

Considering the challenging environment, we feel that HUL has delivered one of its strongest quarters with the topline growth well ahead of the market & improved operating margin. The management has stated that the competitive scenario still remains high in FMCG & rising inflation and rupee depreciation is cause of concern. However, it has indicated that it has not seen any significant downtrading in any of its category. Also the rural market was good, slightly ahead of urban growth. Monsoons have been positive and recent increase in MSP of wheat and other crops could boost the rural demand. We feel that while high food inflation, rising competitive activity and slowdown in the economy would prevent any major acceleration in volume growth, improved product mix, selective price increases & cost rationalization could keep the overall revenue growth robust & could provide cushion to HUL's margins going forward. However, we expect the effective tax rate to be higher in FY13.

We feel that the company could surpass our sales & profit projections for FY12. Hence we are enhancing our FY12 sales & PAT estimates by 2.3% each. We have incorporated FY13 projections, wherein we expect HUL's net sales & PAT to increase by 12.5% & 13% respectively. FY13 EPS is likely to be Rs. 12.8.

At CMP of Rs. 396.2, HUL trades at 30.8xFY13E. In our Q1FY12 result review dated August 05, 2011, we recommended investors to buy this scrip at lower levels in the price band of Rs. 292-303 for a price target of Rs. 326 over the next quarter. Thereafter, the stock touched a low of Rs. 310 on August 16, 2011 & subsequently touched a new high of Rs. 397.8 on November 11, 2011.

HUL has been one stock, which has gained quite significantly in Q2FY12 in a market that has been very listless. Post two consecutive quarters of strong performance, investors have started to believe in HUL. In majority of the cases in the last ten years, HUL's premium over the benchmark index has increased during periods of uncertainty and consequent flight to safety. This has been supported by HUL's stable free cash flow generation during these years. The company has seen its worst times and now it has started showing resilience in a high inflationary scenario. After reporting almost flat growth in annual profits for the last two years, HUL can once again return to Pre-2006 times and report robust bottomline CAGR over the next two years. A return to growth has triggered PE re-rating. Historically, stock performance has reacted positively to volume growth with PE re-rating.

Valuing the stock at 32xFY13E EPS, we arrive at a price target of Rs. 411 over the next quarter. This indicates that the stock has limited upsides from the current levels. The stock has outperformed over the last 3-4 months and moved up into a higher band. Hence for better returns & margins of safety we recommend investors to buy this scrip at lower levels in the price band of Rs. 347-360 (27-28xFY13E EPS) for the mentioned target over the next quarter.

Financial Estimations: (Quick Estimates)

(Rs. in Million)

Particulars	FY09 (12 mn)	FY10	FY11	FY12OE	FY12RE	FY13E
Net Sales	164767.5	175238.0	194011.1	215506.2	220521.0	248086.1
Core Operating Profit	22482.1	25484.4	23652.2	26938.3	28505.5	32499.3
Adjusted PAT	21431.4	20907.0	20991.4	24244.4	24809.1	28033.7
Equity	2179.9	2181.4	2159.5	2159.5	2182.1	2182.1
EPS	9.8	9.6	9.7	11.2	11.4	12.8
OPM (%)	13.6	14.5	12.2	12.5	12.9	13.1
PATM (%)	13.0	11.9	10.8	11.3	11.3	11.3
PE	40.3	41.3	40.8	35.3	34.8	30.8

(Source: Company, HDFC Sec Estimates)

* OE - Original Estimates; RE - Revised Estimates

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