

# Hindustan Lever

Rs209  
NEUTRAL

## RESULT NOTE

Mkt Cap: Rs438.9bn; US \$10.2bn

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**Result:** Q1CY07

**Comment:** Unimpressed!

**Last Report:** 20 February 2007 (Price Rs200; Recommendation: Neutral)

## Key valuation metrics

Year to March 31	Net revenues	yoy chg (%)	Net Profit	EPS	yoy chg (%)	PER (x)	EV/EBITDA (x)
CY05	110,605	11.4	13,545	6.2	13.1	32.3	29.9
CY06	121,033	9.4	15,397	7.0	13.5	28.5	26.3
CY07E	135,298	11.8	18,420	8.4	19.6	23.8	22.3
CY08E	150,139	11.0	21,267	9.6	15.5	20.6	19.2

Hindustan Lever has reported revenue growth of 13.8% in Q1CY07 at Rs31.8bn and PAT growth at 13.6% at Rs3.3bn. While soaps and detergents grew at 9.6%, foods at 23% and exports at 28%, high margin personal care portfolio continues to disappoint with 10.5% yoy growth (continuing business). Shrinkage in EBITDA margins continue (down by 44bp) on account of slow growth in personal product business, higher ASP spends and initial losses in water business (we estimate around Rs200m).

While HLL is growing at robust pace, our concern pertaining to HLL continues – abysmal growth in personal product portfolio (which ideally ought to be the growth driver), market share sustenance happening at high cost (ASP spends ahead of growth) and limited growth edifices (lack of innovation). Continued ASP spends growth ahead of growth in domestic operations (1.6x of sales growth) and slow growth in HPC is evident signals of increasing competitive intensity and dilution of brand equity. This, coupled with unfavorable revenue mix, defeats the thesis of profitable growth going ahead. Unless HLL looks beyond, to develop scalable growth edifices it will at best track (and not lead) the industry growth, a perfect recipe for a sustained de-rating of the stock. Maintain Neutral.

## HIGHLIGHTS OF Q1CY07 RESULTS

### □ Robust growth, but personal product continues to disappoint

Hindustan Lever has reported sales growth at 13.8% in Q1CY07 at Rs31.8bn (14.7% in continuing operations). Soaps and detergents business has grown at 9.6%, beverages business has grown sharply at 16.6%, processed foods at 48.7% and ice-cream at 22%. Exports operations have grown at 27.7%. However, what continues to disappoint is the 10.5% growth in the high margin personal product business, which ought to be the growth driver for HLL. This not only raises concern over the high growth traction going forward, but also incremental profitability in the business.

## Segmental Growth

	Sales		growth %
	Q1CY07	Q1CY06	
Soaps & Detergents	14453	13186	9.6
Personal Products	8221	7441	10.5
Beverages	3705	3177	16.6
Ice Cream	1311	882	48.7
Processed Foods	322	265	21.6
Exports	3519	2755	27.7
Others	631	340	85.7

### ❑ Margins under pressure – changing product mix

EBITDA margins for the quarter have dipped by 44bp from 11.81% in Q1CY06 to 11.37% in Q1CY07. While the margins in most of the individual SBUs (barring beverages) have improved marginally, overall margins in the business are affected by low margin businesses outpacing high margin personal product business. Material cost as percentage of sales has moved up by 100bp at 55.5%. Increasing competitive pressure in the business is evident; as ASP spends continue to grow ahead of domestic revenue growth (1.6x domestic sales growths). We believe that margin expansion going forward will be restricted as HLL needs to spend heavily to sustain market share as also growth in personal product portfolio remains a concern.

	EBITDA Margins		Expansion bp	Portfolio mix	
	Q1CY07	Q1CY06		Q1CY07	Q1CY06
Soaps & Detergents	12.1	11.6	0.52	45.0	46.7
Personal Products	24.7	24.4	0.31	25.6	27.1
Beverages	15.0	19.5	-4.51	11.5	11.2
Ice Cream	5.6	0.4	5.28	4.1	3.1
Processed Foods	4.1	3.2	0.89	1.0	0.9
Exports	3.8	2.9	0.87	10.9	9.8
Others	(24.9)	(14.70)	-10.20	2.0	1.2

### ❑ Our concerns – profitable growth and new growth drivers

Two key concerns that we have had pertaining to HLL are high cost market share sustenance and lack of new growth edifices. While competitive pressure in the existing categories is pushing HLL hard to sustain its market share, innovations and new business entry still takes a back seat. Continuing ASP spends ahead of growth (ASP spends to sales ratio up from 8.3% in Q1CY07 to 11.2% in Q1CY07) as also in absence of any major product launches indicates increasing competitive pressure and dilution of the brand equity of HLL. Every incremental gain in the existing categories will come at a very high price, thus defeating the hypothesis of profitable growth going forward.

Market Share (%)	CY03	CY04	CY05	CY06	Q1CY06	Q1CY07
Laundry	36.9	36.5	37.1	35.5	35.6	36.4
Personal Wash	58.3	56.8	54.9	55.0	55.8	55.3
Toothpaste	33.0	32.5	32.1	30.4	30.4	30.0
Shampoo	54.8	49.2	47.1	48.3	47.7	46.9
Skin Cream	56.2	58.4	55.7	54.7	53.0	53.8

Besides, the key issues of dearth of innovation and new category entry continues to devoid HLL from building new growth edifices. We believe that only renovation and no innovation will not take HLL anywhere, as renovation and product extension as a strategy may work for relatively smaller consumer companies like Emami, Marico or Dabur. But it is too insignificant for a behemoth like HLL. Besides, in its focus on smaller niches, HLL is losing out on larger market pie. We believe that HLL has to aggressively look beyond its existing businesses to keep up with high growth

pace. More importantly we believe that HLL should be more focused on leveraging its core competency of mass distribution.

### □ Maintain Neutral

What worries us is the fact that the largest play in the consumer space is not leading the industry growth and just tracking the industry growth. While we expect HLL to grow at double digit in the next couple of years, it has more to do with buoyancy in the business than HLL getting things right. Probably this is also the reason that even when the markets are trading at all time high, HLL is looked upon at best as a 3% dividend yield story and not as value creating potential. Maintain Neutral

#### Quarterly results

Quarterly results (Rs Mn)	Q1CY06	Q2CY06	Q3CY06	Q4CY06	CY06E	Q1CY07	CY07E	CY08E
<b>Net Sales</b>	<b>27,981</b>	<b>30,833</b>	<b>30,660</b>	<b>31,561</b>	<b>121033</b>	<b>31,843</b>	<b>135,298</b>	<b>150,139</b>
% yoy	11.6	8.7	12.2	6.1	9.4	13.8	11.8	11.0
<b>EBITDA</b>	<b>3,306</b>	<b>4,146</b>	<b>4,029</b>	<b>5,000</b>	<b>16,481</b>	<b>3,620</b>	<b>19,292</b>	<b>22,424</b>
EBITDA (%)	11.8	13.4	13.1	15.8	13.6	11.4	14.3	14.9
Net interest	21	34	34	18	-2,116	51	-2,829	-3,210
Depreciation	339	301	320	342	1,302	329	1,365	1,405
Other Income	694	814	968	1,070	1,321	908	1,571	1,707
Profit before Tax	3,640	4,625	4,642	5,709	18,616	4,147	22,328	25,936
Tax	700	833	812	875	3,219	809	3,907	4,668
<b>Profit After Tax</b>	<b>2,940</b>	<b>3,793</b>	<b>3,830</b>	<b>4,834</b>	<b>15,397</b>	<b>3,339</b>	<b>18,420</b>	<b>21,267</b>
% yoy	32.4	26.2	17.7	10.2	13.7	13.6	19.6	15.5

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