Company

27 July 2010 | 11 pages

Hindustan Unilever (HLL.BO)

Equity ☑
Target price change ☑
Estimate change ☑

Growth: Competitive Maybe, Profitable Not Yet

- **1QFY11 Recurring PAT at ~Rs5.12bn** — HLL's recurring PAT (8% Y/Y decline) disappointed slightly (our est. was Rs5.68bn). While volume growth was 11% (slightly above our expectations of c8-10%), EBITDA margins at 14% were a tad (80 bps) below estimates. Mgmt will need to continue investing behind brands - ad/sales promotion spends continue to accelerate, even sequentially – up ~115bps Q/Q to 15.7% of revenues. However, gross margins positively surprised – up 80bps Y/Y, driven (we believe) by mix shift in the PP segment.
- **Volume growth has been competitive** — Volume growth of 11% has been aided by a low base (1QFY10: +2% Y/Y) but is healthy, in the context of peers – Godrej Consumer (GOCP.BO; Rs358.95; Analyzed Not Rated) soap volumes declined ~9%Y/Y, Dabur (DABU.BO; Rs203.00; 2L) shampoo sales dipped 17% Y/Y. Detergent volumes have risen in double digits, while soaps volumes have grown in high single digits. We estimate PP volume growth of 11% – healthy in the light of competition's volumes. We await value market share data from mgmt conf call.
- **Segmental Focus: PP Margins surprise positively, revenue growth disappoints** — Mgmt noted that PP EBIT margins (~25%, up 280bps Y/Y) have benefited from mix shift (up trading in skin), and improved better operating leverage. Revenue growth at 11.4% Y/Y disappointed – against our expectations of 14-15% revenue growth. We believe HLL was impacted by the slowdown in hair care.
- **Revise TP to Rs246, Maintain Sell** — We revise our target price as we roll forward to Dec11 from Mar11. Our EPS estimates have been cut by 3-6% over FY11-12. We have raised our target multiple to 22x from 20x, as we think directionally, earnings are bottoming out (EBIT margins in the soaps & detergents category are the lowest in the last 4 years, A&P spends are elevated and could trend lower). HLL's buyback aggregating Rs6.3bn at a price not exceeding Rs280 has resulted in the recent stock price movement. We note downside is limited, but see few catalysts at this juncture to get more constructive.

Sell/Low Risk	3L
Price (27 Jul 10)	Rs260.30
Target price	Rs246.00
from Rs219.00	
Expected share price return	-5.5%
Expected dividend yield	2.6%
Expected total return	**-2.9%**
Market Cap	Rs567,995M
	US$12,071M

Price Performance (RIC: HLL.BO, BB: HUVR IN)

Figure 1. Hindustan Unilever: Statistical Abstract

Year to	Net Profit (Rs mills)	EPS (Rs)	EPS Growth (%)	P/E (x)	ROE (%)	ROCE (%)	Div. Yield (%)
CY2007	17,691	8.1	16.4%	32.0	85.0%	113.7%	3.5%
FY2009	25,007	11.5	41.2%	22.7	114.3%	137.7%	2.9%
FY2010	21,027	9.6	nm	27.0	90.5%	119.0%	2.5%
FY2011E	22,319	10.2	6.1%	25.4	78.3%	111.8%	2.6%
FY2012E	25,038	11.5	12.2%	22.7	73.3%	103.0%	2.9%
FY2013E	27,762	12.7	10.9%	20.5	68.5%	95.2%	3.2%

Source: Company Reports and CIRA Estimates; FY09 is 15 months (Jan-08 to Mar-09)

Jamshed Dadabhoy
+91-22-6631-9883
jamshed.dadabhoy@citi.com

Aditya Mathur
+91-22-6631-9841
aditya.mathur@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	Jan08-Mar09	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	28.3	27.0	25.4	22.7	20.5
EV/EBITDA adjusted (x)	26.3	21.5	20.4	18.1	16.2
P/BV (x)	27.5	22.0	18.2	15.3	13.0
Dividend yield (%)	2.9	2.5	2.6	2.9	3.2
Per Share Data (Rs)					
EPS adjusted	11.48	9.64	10.23	11.48	12.72
EPS reported	11.48	10.09	10.23	11.48	12.72
BVPS	9.47	11.84	14.29	17.04	20.09
DPS	7.51	6.50	6.65	7.46	8.27
Profit & Loss (RsM)					
Net sales	202,393	175,238	198,854	219,588	242,613
Operating expenses	-177,567	-151,594	-174,052	-191,805	-211,986
EBIT	**24,827**	**23,644**	**24,802**	**27,783**	**30,627**
Net interest expense	-253	-70	-100	-120	-140
Non-operating/exceptionals	5,678	3,496	4,284	4,855	5,568
Pre-tax profit	**30,251**	**27,071**	**28,986**	**32,517**	**36,054**
Tax	-5,244	-6,044	-6,667	-7,479	-8,293
Extraord./Min.Int./Pref.div.	-43	993	0	0	0
Reported net income	**24,965**	**22,020**	**22,319**	**25,038**	**27,762**
Adjusted earnings	25,007	21,027	22,319	25,038	27,762
Adjusted EBITDA	26,780	25,484	26,929	30,081	33,096
Growth Rates (%)					
Sales	18.0	8.2	13.5	10.4	10.5
EBIT adjusted	13.7	19.0	4.9	12.0	10.2
EBITDA adjusted	13.6	19.0	5.7	11.7	10.0
EPS adjusted	13.1	4.9	6.1	12.2	10.9
Cash Flow (RsM)					
Operating cash flow	**25,793**	**35,902**	**21,303**	**30,500**	**33,910**
Depreciation/amortization	1,953	1,840	2,127	2,298	2,469
Net working capital	-742	12,975	-3,143	3,163	3,679
Investing cash flow	**5,422**	**-14,727**	**-3,773**	**-3,850**	**-3,935**
Capital expenditure	-5,660	-5,412	-3,000	-3,000	-3,000
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**-15,408**	**-21,020**	**-16,973**	**-19,042**	**-21,113**
Borrowings	3,334	-4,219	0	0	0
Dividends paid	-19,123	-16,560	-16,973	-19,042	-21,113
Change in cash	**15,765**	**1,149**	**557**	**7,608**	**8,862**
Balance Sheet (RsM)					
Total assets	**82,673**	**93,167**	**99,741**	**112,653**	**127,094**
Cash & cash equivalent	17,773	18,922	19,479	27,087	35,949
Accounts receivable	5,369	6,784	7,627	8,423	9,306
Net fixed assets	20,789	24,361	25,233	25,935	26,466
Total liabilities	**62,057**	**67,332**	**68,560**	**75,476**	**83,268**
Accounts payable	33,050	43,737	42,392	46,728	51,662
Total Debt	4,219	0	0	0	0
Shareholders' funds	**20,615**	**25,835**	**31,181**	**37,177**	**43,826**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	13.2	14.5	13.5	13.7	13.6
ROE adjusted	114.3	81.4	78.3	73.3	68.5
ROIC adjusted	120.8	nm	nm	184.4	nm
Net debt to equity	-65.7	-73.2	-62.5	-72.9	-82.0
Total debt to capital	17.0	0.0	0.0	0.0	0.0

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1QFY11 Results – Strong Volumes, Weak Margins

Net revenue growth of 7% Y/Y was on the back of 11% Y/Y domestic FMCG volume growth during the Q, slightly ahead of our expectations.

While soaps and detergent portfolio revenues rose ~2%Y/Y, personal care revenue growth disappointed (~11%). Growth in foods (+21%) exceeded expectations, while beverages category (+~8%) disappointed.

Investments behind the food/ice-creams category led to 21% Y/Y revenue growth and a small EBIT profit of Rs106m during the Q. Sequentially, margins in foods rose to 3.3% (from 2.5% in 4Q10)

Despite growth in volumes during the quarter on last year's low base, the operating leverage was low as EBITDA declined 5% Y/Y.

EBITDA margins contracted ~192bps Y/Y to 14% – despite good gross margins, these were impacted by high advertising spends (34% Y/Y growth, higher by 313bps Y/Y and ~120bps QoQ). Excluding other operating income, margins still contracted by 290bps Y/Y.

Excluding exceptional items and MTM fluctuations, recurring PAT at Rs5.1bn declined by 8% Y/Y (below expectations).

Figure 2. Hindustan Unilever Results (Rupees in Million, Percent)

	1QFY10	1QFY11	% Change
Net Sales	**44,757**	**47,939**	**7.1**
Domestic FMCG	41,487	44,252	6.7
Exports	2,556	2,630	2.9
Other sales	714	1,057	47.9
Other Operating Income	270	823	205.5
Total Income	**45,026**	**48,762**	**8.3**
Total Expenses	-37,876	-41,953	10.8
EBITDA	**7,150**	**6,809**	**-4.8**
EBITDA margin (%)	*15.9*	*14.0*	*-192 bps*
EBITDA without other operating income	**6,881**	**5,986**	**-13.0**
EBITDA margin (%)	*15.4*	*12.5*	*-289 bps*
Interest	-52	-1	-98.5
Depreciation	-425	-535	25.9
Other Income	335	421	25.6
PBT	**7,009**	**6,695**	**-4.5**
Tax	-1,643	-1,548	-5.8
Tax rate (%)	*23.4*	*23.1*	*-31 bps*
Recurring PAT	**5,586**	**5,124**	**-8.3**
Reported PAT	**5,651**	**5,332**	**-5.6**
Key Costs			
Raw/Packing Material	17,967	17,943	-0.1
As % of Sales	*40.1*	*37.4*	*-271 bps*
Purchase of Goods	5,232	6,523	24.7
As % of Sales	*11.7*	*13.6*	*192 bps*
Employee Costs	2,504	2,506	0.1
As % of Sales	*5.6*	*5.2*	*-37 bps*
Advertising and Sales Promotion	5,611	7,512	33.9
As % of Sales	*12.5*	*15.7*	*313 bps*
Other Expenses	6,563	7,469	13.8
As % of Sales	*14.7*	*15.6*	*92 bps*

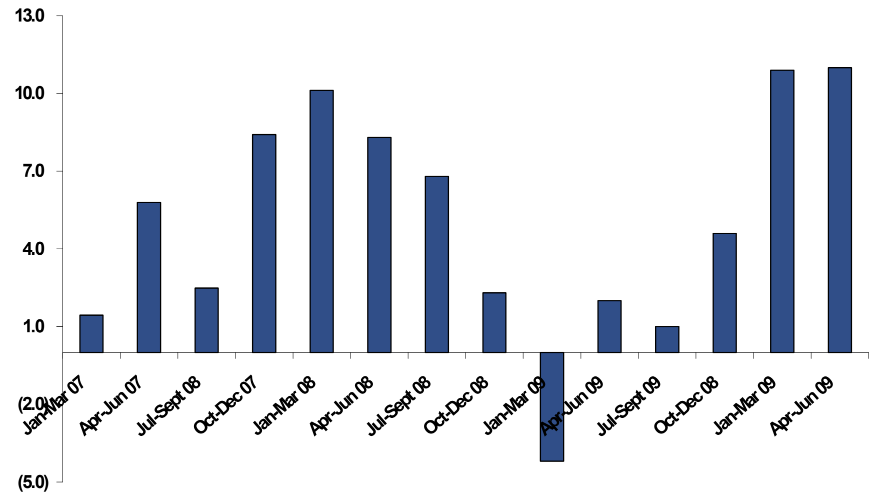
Source: Company Reports

Figure 3. Hindustan Unilever: Segmental Results (Rupees in Million, Percent)

Revenues	1QFY10	1QFY11	% Change
Soaps and detergents	22,115	22,645	2.4
Personal care products	12,255	13,655	11.4
Foods	2,607	3,158	21.1
Beverages	4,996	5,378	7.7
Exports	2,575	2,648	2.8
Others	794	1,126	41.8
Overall segmental sales	**45,342**	**48,609**	**7.2**
EBIT			
Soaps and detergents	3,815	2,488	-34.8
Margin (%)	*17.2*	*11.0*	*-626 bps*
Personal care products	2,699	3,388	25.5
Margin (%)	*22.0*	*24.8*	*279 bps*
Foods	142	106	-25.7
Margin (%)	*5.4*	*3.3*	*-211 bps*
Beverages	703	695	-1.1
Margin (%)	*14.1*	*12.9*	*-115 bps*
Exports	205	227	10.5
Margin (%)	*8.0*	*8.6*	*59 bps*
Others	-279	-266	-4.8
Margin (%)	*-35.2*	*-23.6*	*1155 bps*

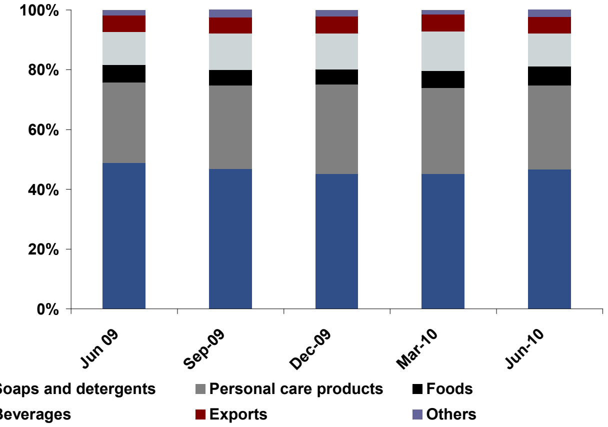
Source: Company Reports

Figure 4. Hindustan Unilever: FMCG Volumes Growth Trend (%)



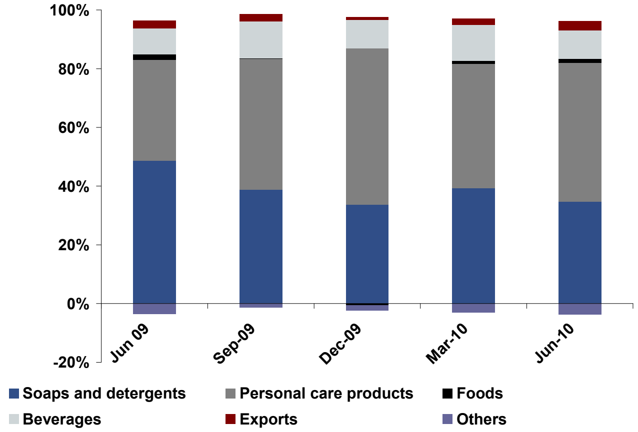
Source: Company Reports

Figure 5. Hindustan Unilever: Revenue Mix (%)



Source: Company Reports

Figure 6. Hindustan Unilever: EBIT Mix (%)



Source: Company Reports

Figure 7. Hindustan Unilever- Market Share Trends

%	Jan-Mar 08	Apr-Jun 08	Jul-Sept 08	Oct-Dec 08	Jan-Mar 09	Apr-Jun 09	July-Sept 09	Oct-Dec 09
Laundry	39.1	38.3	37.9	38.7	37.4	36.2	35.0	34.6
Personal Wash	52.1	52.7	50.3	49.6	48.2	46.3	44.5	44.6
Hair	46.5	46.5	46.1	45.0	44.9	45.4	45.2	44.8
Skin Care	54.6	53.4	52.7	53.1	51.4	50.2	50.1	46.7
Oral	29.6	30.0	29.6	28.7	27.8	28.0	27.1	26.1
Tea	23.3	23.2	23.3	23.7	23.4	21.8	22.3	21.1
Coffee	46.9	46.9	47.1	41.8	39.9	44.0	44.6	39.9

Source: Company Reports

Figure 8. Earnings Revision Summary

Year to	Sales (Rs Mils.)			Net Profit (Rs Mils.)			Diluted EPS (Rs)			Dividend Per Share (Rs)		
31-Mar	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
2011E	197,623	198,854	0.6%	23,808	22,319	-6.3%	10.93	10.23	-6.4%	7.7	6.6	-13.1%
2012E	218,838	219,588	0.3%	25,688	25,038	-2.5%	11.80	11.48	-2.7%	8.3	7.5	-9.7%

Source: Citi Investment Research and Analysis

Hindustan Unilever

Company description

Hindustan Unilever (HLL) is the largest consumer non-durables company in Asia. 51%-owned by the Unilever Group, HLL has one of the best-managed businesses in India, in our view, and has a record of steady growth spanning decades. It has a diversified product portfolio, including fabric wash, personal care, tea, coffee and staple foods. Some of the strongest brands in India such as Lifebuoy, Lux, Surf, Wheel, Lakme, Ponds and Lipton are from the Hindustan Unilever stable.

Investment strategy

We have a Sell/Low Risk (3L) rating on HLL shares. We think the stock is likely to de-rate as profitability over the near to medium term is likely to be impacted given the heightened competitive intensity in its key soaps and detergents portfolio, coupled with the need to spend aggressively to support initiatives in new ventures and maintain market shares in the core PP categories (hair, skin). Limited operating leverage will result in EBITDA margins compressing 85bps over FY10-12E. FMCG market revenue growth has moderated as high food inflation is adversely impacting the FMCG share of the consumer wallet.

Valuation

HLL's fairly steady earnings stream renders P/E a good methodology to value the stock. Our target price of Rs246 is based on 22x Dec 11E P/E, near the lower end of the stock's historical trading band of 18-28x over the past 5 years. We use a lower multiple as the earnings growth is likely to be relatively muted (at ~9% CAGR over FY10-12E). At 22x 1 year forward P/E, HLL will trade at a relative P/E of ~1.45-1.5x, i.e. around the levels it found support during the last price war with P&G. We don't believe HLL should trade at a premium to its past relative P/E multiples (1.7x average since 2004), given that competitive intensity in most of its key segments has heightened over the past few years -

and which has reflected in the company ceding market share in key categories like hair care and soaps. The company has historically enjoyed more than a 100% premium to the Sensex owing to its high capital-efficiency ratios and consistent earnings growth. However, we do not expect the stock to re-trace to its historical high premium (almost 3-3.1x witnessed in the late 90s, given that HLL's growth prospects are far more sedate today than they were around 10 years ago).

Risks

We rate HLL shares as Low Risk as the company operates in branded consumer products and has a diversified product portfolio. The Low Risk rating is consistent with our quantitative risk rating system which tracks the 260-day share price volatility of the shares. The most significant risk to our target price is the possibility of a prolonged battle for market share with other MNC peers as well as Indian companies. HLL is equally leveraged to the rural and the urban economies and, as such, any dislocation would affect the company's performance. Although the company's brands have strong pricing power, in a challenging external environment price increases are limited. P&G is aggressively seeking to increase its market share in detergents, shampoos and some other categories. Other downside risks to our target price include higher-than-expected raw-material costs and the company's inability to deliver on top-line growth. Upside risks to our target price include: a) benefits on distribution side (SKU and distributor rationalisation exercises) would aid growth, b) favourable shift towards PP should result in a more stable profit profile, especially as 25% of HLL's revenues (low end soaps / detergents) is largely commoditized.

Dabur India

Valuation

We utilize a P/E methodology to value Dabur because it is a steady growth company and is unlikely to face extreme cyclicality or volatility in its earnings. Our target price of Rs210 is based on 25x Dec11E P/E. Over the past two years, the stock has traded between 15-29x one-year forward earnings, while its five-year historical average is ~23x. Our target multiple is slightly higher than the average, given superior earnings growth currently driven by strong international and domestic volume growth in a benign input cost environment. We forecast a 23% EPS growth CAGR for FY10-12E for Dabur (better than peers), which we believe should offer some downside support for the stock price. Current valuations of ~27x one-year forward P/E leave limited upside potential.

Risks

We believe Dabur is a steady growth company. As such, our Low Risk rating is consistent with our quantitative risk-rating system, which tracks 260-day historical share price volatility. The key downside risks to our target price include: (1) lower-than-expected volume growth in the event of rural demand not picking up; (2) emerging competition in Dabur's product segments, which could exert pricing pressure; and (3) changes in excise/tax norms, which would negate the savings from new facilities in excise-exempt locations. Upside risks to our target price include: (1) better-than-expected sales growth due to better monsoons; and (2) beneficial currency movements may aid profitability in international business division and consolidated raw materials expenses.

Appendix A-1

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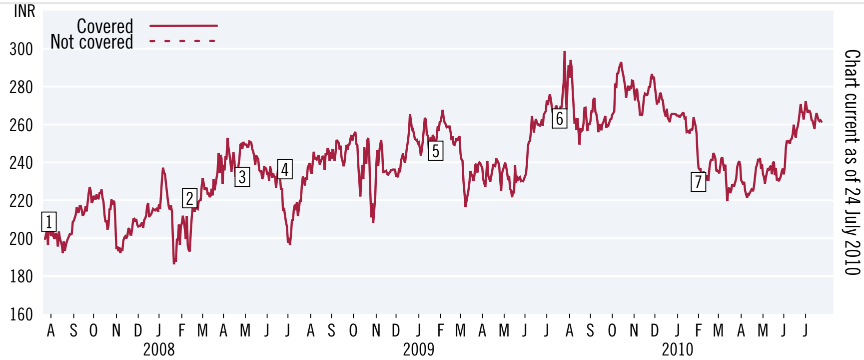
Hindustan Unilever (HLL.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008



	Date	Rating	Target Price	Closing Price
1	29-Jul-07	1L	*254.00	196.45
2	13-Feb-08	1L	*258.00	193.05
3	28-Apr-08	1L	*280.00	247.20
4	26-Jun-08	1L	*267.00	212.15
5	26-Jan-09	1L	*276.00	246.90
6	19-Jul-09	*2L	*273.00	267.30
7	31-Jan-10	*3L	*219.00	244.10

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Dabur India (DABU.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008

	Date	Rating	Target Price	Closing Price
1	26-Jun-08	*2L	*97.00	87.50
2	29-Jul-09	2L	*142.00	135.45
3	27-Oct-09	2L	*163.00	151.85
4	6-Apr-10	2L	*173.00	167.70
5	27-Jul-10	2L	*210.00	203.00

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Data current as of 30 Jun 2010	**Buy**	**Hold**	**Sell**
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% of companies in each rating category that are investment banking clients	47%	45%	40%

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