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Buy

Target price
Rs337.00

Price
Rs332.80

Hindustan Unilever

HUVR annual report analysis

HUVR's free cash generation dropped 37% in FY11, but it converted 74% of its EBITDA earned into free cash which remains impressive. Despite 2% rise in PAT, it increased shareholder payouts by 28%. Revival in foods business growth at 13.4% is significant, as it has been a drag on overall growth over last 10 years.

FY2011 volume growth at 13% impressive, but segments show mixed trend

- Management stressed that the 5 consecutive quarters of double digit volume growth was a feat which has not been achieved in the last 10 years.
- A closer look at volume growth trends reveals that the volume growth has been mixed: soaps at 8.5%, detergents at 19.6%, personal products at 15.1%, processed foods at 29.4% were the key drivers. However, tea business recorded a volume growth of just 0.8%, ice-creams at just 4.5%, and branded staple foods recorded a decline of -5.8%.
- In FY11, the company expanded its direct retail coverage of outlets by 600,000 outlets all in rural India. This resulted in tripling its direct coverage in rural India, and the management indicated that this expansion in outlets coverage contributed around 50% of its rural growth.

Food business has been drag in past, but will it change in future ?

- HUVR has achieved revenue CAGR of 6% over the last 10 years, and 12% in the last 5 years. It got 40% of revenues from soaps & detergents in 2001 as compared to 46% in FY11. The share of personal products business has increased from 21% in 2001 to 32% in FY11, while the share of the foods business has declined from 33% of revenues in 2001 to 20% in FY11.
- The best performing category has been the personal products business which grew at 11% in last years, and a acceleration in growth to 15% in last 5 years. Soaps and detergents business grew at 8% CAGR over 10 years, and 11% CAGR in the last 5 years. The foods business over a 10 year period grew just a 0.48% CAGR, but in the last 5 years, grew at 9%.
- The sluggish growth in foods business is largely due to its tea business (63% of overall foods revenues) which is a mature business in terms of penetration, and HUVR has been focusing

(Continued on page 2)

HUVR's cash generation and deployment analysis (Rsm)

Analysis of Cash deployment for last 5 years	5 year					Cumulative	% of Total
	2006	2007	2009	2010	2011		
Free cashflow / share	6.5	8.1	8.3	14.7	9.3		
Free cash generation to EBITDA	79%	85%	59%	116%	74%		
Sources of Cash							
Cash from operations before working capital changes (net of taxes)	16,079	15,579	23,576	20,034	20,440	95,708	75%
Net reduction in investments	(2,418)	9,981	11,872	(8,126)	1,190	12,498	10%
Decrease in Working Capital	(131)	1,222	(3,289)	14,289	(1,534)	10,557	8%
Issue of Equity Shares (ESOPS)	339	124	381	313	65	1,222	1%
Others (income from investments etc.)	1,507	1,732	1,483	1,312	1,548	7,582	6%
TOTAL	15,377	28,638	34,023	27,822	21,709	127,568	100%
Application of Fund							
Capex (Net of assets sold)	1,069	1,476	4,573	4,560	1,388	13,065	10%
Dividend and Corporate Dividend Tax	13,809	22,919	16,766	17,827	16,556	87,877	69%
Repayment of Debt	(157)	(153)	(3,334)	4,220	-	576	0%
Buy back of Equity Shares	-	6,315	-	-	6,284	12,599	10%
Others	134	255	253	70	2	715	1%
TOTAL	14,855	30,813	18,258	26,676	24,230	114,832	90%
Net Increase/(decrease) in cash & cash equivalents	521	(2,175)	15,765	1,146	(2,522)	12,736	10%

Source: Company annual report

Important disclosures can be found in the Disclosures Appendix.

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Flashnote

Analyst

Mohan Swamy
+91 22 6715 5304
mohan.swamy@rbs.com

83/84 Sakhar Bhawan, Nariman Point, Mumbai 400 021, India

<http://research.rbsm.com>

on the premium end of the market. Besides, the ice-creams business growth has been constrained by infrastructure issues.

- HUVR in 2010 has forayed in 3 big categories under the "Kissan" brand. These include fruit juices, soya milk, and Indian (non-sweet) spreads market. Under the "Knorr" umbrella brand, it has sustained its value leadership position in the soups segment, the innovative "soupy noodles" segment.
- A combination of the above efforts has helped to revive the growth in FY11 in foods business to 13.4%. A sustained pickup in the foods business growth is critical for HUVR to sustain a healthy (14-15%) revenue growth.

Cash generation continues to be impressive, but we see limited stock upside

- HUVR's free cash generation dropped by 37% over the high base of FY10. Its working capital management continues to be impressive, which is reflected in high conversion of EBITDA to free cash. In FY11, it has converted 74% of its EBITDA earned into free cash.
- Company has Rs28.4bn of liquid assets in the balance-sheet which is Rs13/share.
- Over the last 5 years, it has used 79% of the free cash generation from business to pay its shareholders (dividends + buy backs), and just 10% of the cash generation has gone towards fixed asset investments.
- HUVR stock price has risen by 17% since the Q4FY11 results, outperforming the market by 15%, and it trades close to our fair value of Rs337. We see limited scope for stock upside in the near term, given its valuations at 28.5x FY12F earnings. The impact of falling commodity prices on improving margins beyond our expectations will take time to play out.

Income statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	206235	177253	200282	226736	253788
Cost of sales	-118380	-97416	-116852	-134174	-151205
Operating costs	-57453	-52337	-56385	-59831	-64478
EBITDA	30402	27500	27045	32730	38105
DDA & Impairment (ex gw)	-1953	-1840	-2208	-2430	-2610
EBITA	28449	25659	24836	30301	35495
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	28449	25659	24836	30301	35495
Net interest	-253.2	-69.8	-2.40	-219.5	-880.2
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	2056	1481	2519	3151	3401
Reported PTP	30251	27071	27353	33232	38016
Taxation	-5244	-6044	-6310	-7809	-8934
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	-42.6	993.5	2068	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	24964	22020	23111	25422	29082
Normalised Items Excl. GW	-42.6	993.5	2068	0.00	0.00
Normalised net profit	25007	21027	21043	25422	29082

Source: Company data, RBS forecasts

year to Mar

Balance sheet

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	17773	18922	16400	16400	16400
Other current assets	38236	34756	44552	51568	55077
Tangible fixed assets	20789	24361	24682	25253	25643
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	5875	15129	14703	19703	19703
Total assets	82673	93167	100338	112924	116823
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	57838	67332	73999	73843	56682
Long term debt (3)	4219	0.00	0.00	6755	20329
Oth non-current liab	0.00	0.00	0.00	0.00	0.00
Total liabilities	62057	67332	73999	80598	77010
Total equity (incl min)	20615	25835	26339	32326	39813
Total liab & sh equity	82673	93167	100338	112924	116823
Net debt	-13554	-18922	-16400	-9645	3928

Source: Company data, RBS forecasts

year ended Mar

Cash flow statement

Rsm	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	30402	27500	27045	32730	38105
Change in working capital	-3289	14289	-3130	-7171	-20670
Net interest (pd) / rec	-253.2	-69.8	-2.40	-219.5	-880.2
Taxes paid	-6337	-6617	-6310	-7809	-8934
Other oper cash items	-489.5	-848.0	200.0	0.00	0.00
Cash flow from ops (1)	20033	34254	17802	17530	7621
Capex (2)	-6361	-5701	-2530	-3000	-3000
Disposals/(acquisitions)	66.4	132.7	0.00	0.00	0.00
Other investing cash flow	15077	-5807	2553	-1849	3401
Cash flow from invest (3)	8782	-11375	23.4	-4849	400.7
Incr / (decr) in equity	381.2	312.7	-5331	0.00	0.00
Incr / (decr) in debt	3334	-4220	0.00	6755	13574
Ordinary dividend paid	-16766	-17827	-17276	-19436	-21595
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	0.00	0.00	0.00	0.00	0.00
Cash flow from fin (5)	-13050	-21733	-22607	-12681	-8021
Forex & disc ops (6)	0.00	2.71	0.00	0.00	0.00
Incr/(decr) cash (1+3+5+6)	15765	1149	-4782	0.00	0.00
Equity FCF (1+2+4)	13672	28553	15272	14530	4621

Lines in bold can be derived from the immediately preceding lines.
Source: Company data, RBS forecasts

year to Mar

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

Long term recommendations (as at 06 Jul 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	818 (11)	531 (3)
Hold	418 (6)	230 (3)
Sell	85 (2)	52 (0)
Total (IB%)	1321 (9)	813 (3)

Source: RBS

Trading recommendations (as at 06 Jul 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (0)	1 (0)
Trading Sell	1 (0)	1 (0)
Total (IB%)	2 (0)	2 (0)

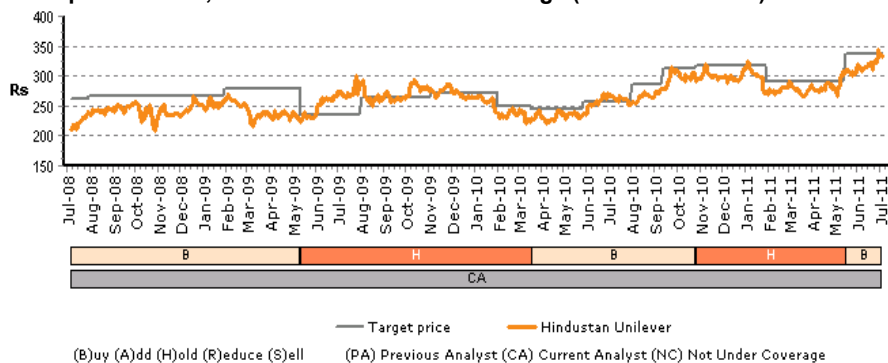
Source: RBS

Valuation and risks to target price

Hindustan Unilever (RIC: HLL.BO, Rec: Buy, CP: Rs332.80, TP: Rs337.00): The key downside risks to our DCF-based price target would be: 1) a price war in one of HUVR's highly profitable categories - for example, we believe P&G and ITC are eying the skin care market; and 2) the emergence of price competition in the detergents business could also reduce margins and forecasts. The key upside risks would be if HUVR's advertising costs were to moderate sharply, resulting in higher-than-expected EBITDA margins, or if raw material costs fall sharply.

Hindustan Unilever coverage data (HLL.BO, HUVR IN)

Stock performance, recommendations and coverage (as at 06 Jul 2011)



Mohan Swamy started covering this stock on 25 Aug 00. Moved to new recommendation structure between 1 November 2005 and 31 January 2006. Source: RBS

Trading recommendation history

Date	Rec	Analyst
n/a	n/a	n/a

Source: RBS

Price perf (at Close 05 Jul 2011)

	(1M)	(3M)	(12M)
Price (Rs)	318.5	275.4	266.1
Absolute (%)	4.5	20.9	25.0
Rel market (%)	2.4	26.9	16.3
Rel sector (%)	1.9	10.5	12.1

Source: Bloomberg
Market: Sensex
Sector: Personal Products

Regulatory disclosures

None

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