

Hindustan Unilever Ltd (HUL)

April 10, 2008

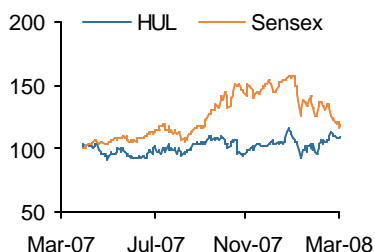
Stock data

Sensex:	15,791
CMP (Rs):	244
Target price (Rs):	238
Downside (%):	2.5
52 Week h/l (Rs):	256/169
Market cap (Rs cr)	53,229
6m Avg vol BSE ('000 nos):	3,016
No of o/s shares (mn):	2,178
FV (Re):	1
Bloomberg code:	HUVR IN
Reuters code:	HLL.BO
BSE code:	500696
NSE code:	HINDUNILVR

Shareholding pattern

December 2007	(%)
Promoters	52.1
FII & institutions	30.0
Non promoter corp hold	1.1
Public & others	16.8

Share price trend



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HUL recorded a robust performance during F12/07 driven by strong 14% yoy growth in the domestic FMCG business. The core HPC segment recorded sharp 12.3% yoy growth led by 9% and 14% increase in personal care and soaps & detergents revenues respectively. The company has started focusing on new growth categories like high-end personal care (skin, hair care), foods and water. It has invested heavily in the water purifier business and expects to complete national rollout by F12/08. Heavy onslaught of competition in the core categories from emerging players like ITC, will result in higher adspend. Firm raw material prices will further add pressure on margins going forward.

While we remain positive on the business model of the company, we recommend a SELL based on expensive valuations with a price target of Rs238 – downside of 2.5%.

Key highlights from CY07 annual report

- HUL has bought back 30,235,772 equity shares of Re1 each (from October 03, 2007 to January 31, 2008) at an average price of Rs207.13 (upper price limit was decided at Rs230 per share). HUL has bought back these shares through open market route with an investment of ~Rs6.26bn.
- During F12/07, HUL recorded healthy 13.3% yoy revenue growth (highest in the last few years). Detergents segment recorded strong 17.8% yoy growth - highest in the past nine years.
- The underlying volume growth declined to 5% in F12/07 from 7-8% recorded in F12/05-06. Personal care and coffee segment recorded drop in volumes.
- HUL has made substantial investments in the skin care, processed foods and water (Pureit) business.
- Many of HUL's brands continued to grow strongly with Wheel, Brooke Bond and Surf, exceeding turnover of Rs10bn each in 2007.
- HUL has formed a Beauty and Wellness division by merging Ayush Therapy Centre and Lakme Beauty Salon (recorded strong 30%+ growth in 2007).

Valuations

We expect HUL to witness a revenue and profit CAGR of ~15% respectively over the next two years. At the current market price of Rs244, the stock is trading at 22.6x F12/09E EPS of Rs10.8. We recommend a Sell rating on the stock with a price target of Rs238.

Key financials and ratios

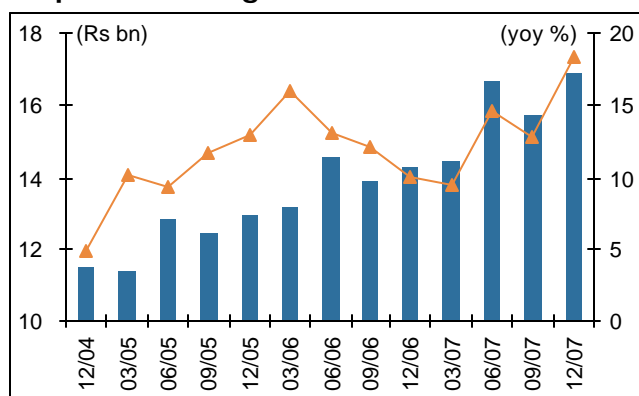
y/e December, Rs mn	F12/05	F12/06	F12/07	F12/08E	F12/09E
Revenues	110,605	121,034	137,178	157,417	181,248
yoy growth (%)	11.4	9.4	13.3	14.8	15.1
EBITDA	14,433	16,481	18,857	21,976	25,538
EBITDA margin (%)	13.0	13.6	13.7	14.0	14.1
PAT	14,081	18,554	19,255	20,474	23,584
Pre-exceptional PAT	13,545	15,397	17,691	20,474	23,584
yoy growth (%)	17.6	31.8	3.8	6.3	15.2
EPS (Rs)	6.4	8.4	8.8	9.4	10.8
P/E (x)	38.2	29.1	27.6	26.0	22.6
P/BV (x)	23.3	19.8	37.0	35.6	33.1
EV/EBITDA (x)	37.1	32.5	28.2	24.1	20.7
ROE (%)	61.1	68.1	133.8	136.9	146.9
ROCE (%)	68.7	67.0	144.7	163.4	175.6

Source: Company, India Infoline Research

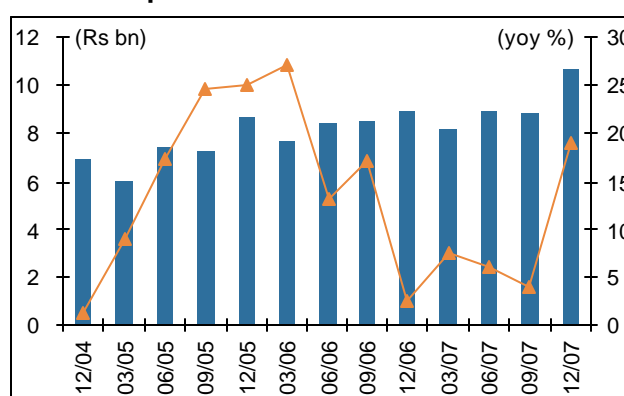
Growth in HPC segment back on track

During F12/07, HUL recorded 13.3% yoy revenue growth - highest in the last few years at Rs137.2bn led by strong 13.7% yoy growth in domestic FMCG sales. Soaps & detergents and personal products (contributing ~46% and ~26% to revenues and ~45% and ~46% to EBIT respectively) – the key segments in the HPC category recorded strong growth during the year. The detergents segment recorded highest growth in the past nine years at 17.8% yoy. The personal products segment, which has under-performed over the last two years has returned to the double-digit growth trajectory during Q4 F12/07; aided by strong and extended winter. To cater to the fast growing (~50%) premium-end skin care market, HUL has introduced products under the Ponds (skin care and anti-aging solutions) and Dove (shampoos and conditioners) brands. However, going forward, a key challenge for HUL would be to maintain margins in the personal products and soaps & detergents segments, which account for ~91% of profits.

Soaps and detergents revenues



Personal products revenues



Source: Company, India Infoline Research

Segment-wise revenue trend

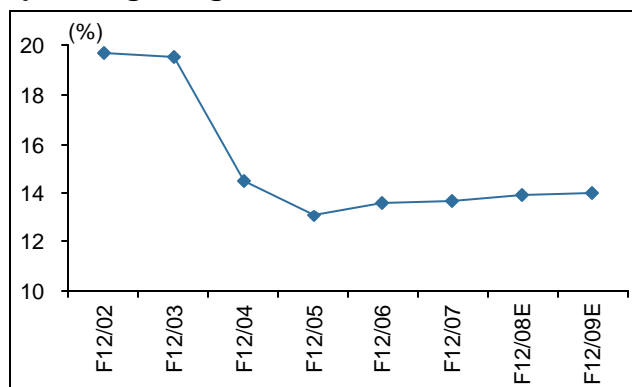
Segments	Q1 F12/06	Q2 F12/06	Q3 F12/06	Q4 F12/06	F12/06	Q1 F12/07	Q2 F12/07	Q3 F12/07	Q4 F12/07	F12/07
Soaps & det.	13,186	14,559	13,933	14,281	55,959	14,445	16,687	15,722	16,892	63,745
Personal prod.	7,659	8,467	8,538	8,934	33,598	8,221	8,978	8,876	10,643	36,718
Beverages	3,177	3,006	3,455	3,670	13,307	3,705	3,633	3,905	4,085	15,328
Processed foods	882	973	973	1,022	3,849	1,311	1,334	1,289	1,443	5,377
Ice cream	265	505	338	263	1,371	322	622	371	292	1,606
Exports	2,755	3,287	3,274	3,473	12,789	3,519	3,331	3,136	3,437	13,423
Others	340	379	480	603	1,802	631	639	642	941	2,853
Total	28,263	31,175	30,991	32,246	122,675	32,156	35,223	33,940	37,731	139,050

Source: Company, India Infoline Research

Higher adspend and firm raw material prices to put pressure on margins

Over the last two years, HUL has maintained its operating margins through judicious price hikes across products and reduction in pack sizes. For the year 2007, the average price hike across the board has been ~7%. In the wake of firm raw material price outlook, HUL had implemented a price hike in the soap segment during March 2008. However, the company has reversed the hike by slashing prices of key mid-segment soaps (three soap brands particularly Lux) to protect volume growth. Heavy onslaught of competition in the core categories from emerging players like ITC may necessitate even higher adspends in the future. We expect, the rising raw material cost and higher adspend to restrict margin expansion going forward.

Operating margins to remain flat



Source: Company, India Infoline Research

Other highlights

- During the year, HUL has completed a buyback of shares out of free reserves and share premium account. The paid-up capital post buyback stood at Rs2.18bn comprising 2,177,463,355 equity shares of Re1 each.
- Revenues from the Surf franchise crossed Rs10bn mark for the first time. Wheel - the largest detergent brand in India recorded sales of over 800,000 tons during the year.
- Growth in the toothpaste segment was impacted by shortage of stocks for about three months in the year on account of lockout in Doom Dooma factory in Assam.
- Staff cost for the year increased sharply by 19.4% yoy (due to one-off item in Q4 F12/07), which is highest in the past eight years.
- HUL has launched Ponds top-end range of creams (anti-aging, moisturizer, fairness) in the Rs400+ range and extended its Dove range, by launching hair care products like shampoo and conditioner.
- In the processed foods segment, HUL introduced a new variant in Ketchup – Kissan Chatakdar, a new range of Chinese meal-maker products and added Bertolli Olive Oil (imported) to the portfolio.
- HUL has entered the niche child health foods segment with 'Amaze brain foods' under the umbrella of the Kissan brands. This product is available under two formats – wafers and milk additives.
- HUL has launched new concept tea – Taj Mahal Dessert Teas and re-launched Brooke Bond '3 roses' and 'Red Label'. All brands under the Brooke Bond franchise recorded an improvement in market share except Brooke Bond Taaza resulting in marginal erosion of overall value share at 22.7% during Q4 F12/07.
- Coffee bean prices increased sharply during the year. HUL has introduced ice cappuccino coffee under the coffee portfolio.
- In the ice-creams segment, HUL introduced Moo, a milk-based ice-cream in stick and brick formats positioned on nutrition and vitality platform.
- HUL is a key supplier to Unilever global sourcing network for original tea. HUL plans to supply instant tea to Europe and US from its instant tea plant at Etah. HUL also plans to increase instant coffee sales to newer geographies by F12/08.
- HUL has consolidated its position as a major sourcing hub for Unilever. It has commissioned a plant at Kandla for producing top-end skin care products and is investing heavily for increasing capacities for skin and oral care categories.
- HUL has extended the water business to 210 towns in 10 states.
- HUL has exited from value added Shrimps and Castor exports during 2007 and continued with more value added Surimi and Crabsticks exports. HUL plans to exit this business too.
- Modern Foods was merged with HUL during the year. Manufacturing operations are being carried out in six large towns with brand franchisee arrangements in many other parts of the country.

- Exports division recorded 5% yoy growth during F12/07, despite rupee appreciation. In dollar terms revenues have increased by over 15%.
- Kimberly Clark Lever Pvt. Ltd (KCLL), a JV between HUL and Kimberly Clark Corporation, USA continues to record strong growth led by good underlying volume growth in both infant and feminine care products.
- HUL's Lakme Beauty Salon business has 105 salons (including franchisee owned) spread across 30 cities while Ayush has 45 therapy centers in 7 cities.
- During F12/07, HUL's distribution network increased to over 45,000 Shakti entrepreneurs covering 100,000+ villages across 15 states. In the next 3 years, HUL aims to cover 500,000 villages with 100,000 Shakti entrepreneurs.
- HUL has declared a final dividend of Rs3 per share over and above Rs6 (interim dividend of Rs3 and the platinum jubilee dividend of Rs3) paid earlier, taking the total dividend for F12/07 to Rs9 per share.

Valuations

We expect HUL to witness revenue and profit CAGR of ~15% respectively over the next two years. The stock is trading at 22.6x F12/09E EPS of Rs10.8. We recommend a sell rating on the stock with a price target of Rs238 – downside of 2.5%.

Income statement

Period to	F12/06	F12/07	F12/08E	F12/09E
(Rs mn)	(12)	(12)	(12)	(12)
Net sales	121,034	137,178	157,417	181,248
Operating expenses	(104,553)	(118,321)	(135,441)	(155,710)
Operating profit	16,481	18,857	21,976	25,538
Other income	3,545	4,627	5,132	5,427
PBIDT	20,026	23,484	27,107	30,965
Interest	(107)	(255)	(183)	(144)
Depreciation	(1,302)	(1,384)	(1,331)	(1,341)
Profit before tax (PBT)	18,617	21,845	25,593	29,480
Tax	(3,220)	(4,155)	(5,119)	(5,896)
Profit after tax (PAT)	15,397	17,691	20,474	23,584
Extraordinary items	3,157	1,564	-	-
Adjusted profit after tax	18,554	19,255	20,474	23,584

Balance sheet

Period to	F12/06	F12/07	F12/08E	F12/09E
(Rs mn)	(12)	(12)	(12)	(12)
Sources				
Share capital	2,207	2,177	2,177	2,177
Reserves	25,028	12,215	12,778	13,882
Net worth	27,235	14,392	14,956	16,059
Loan funds	726	885	823	814
Def tax liability	1,609	1,913	1,913	1,913
Total	29,570	17,191	17,692	18,787
Uses				
Gross block	24,627	26,691	29,191	31,691
Accd depreciation	(10,619)	(11,466)	(12,797)	(14,137)
Net block	14,007	15,225	16,394	17,553
Capital WIP	1,103	1,856	1,975	2,143
Total fixed assets	15,110	17,081	18,369	19,696
Investments	24,139	14,408	15,908	18,908
Total current assets	31,697	32,774	37,736	41,732
Total current liabilities	(45,231)	(51,110)	(58,358)	(65,587)
Net working capital	(13,534)	(18,336)	(20,622)	(23,855)
Def tax assets	3,854	4,037	4,037	4,037
Total	29,570	17,191	17,692	18,787

Key ratios

Period	F12/06	F12/07	F12/08E	F12/09E
	(12)	(12)	(12)	(12)
Per share ratios (Rs)				
EPS	8.4	8.8	9.4	10.8
Cash EPS	9.0	9.5	10.0	11.4
Div per share	6.0	9.1	7.8	8.8
Book value per share	12.3	6.6	6.9	7.4
Valuation ratios (x)				
P/E	29.1	27.6	26.0	22.6
P/BV	19.8	37.0	35.6	33.1
Mcap / sales	4.5	3.9	3.4	2.9
EV/EBIDTA	32.5	28.2	24.1	20.9
EV/sales	4.4	3.9	3.4	2.9
Profitability ratios (%)				
OPM	13.6	13.7	14.0	14.1
PAT	15.3	14.0	13.0	13.0
ROCE	67.0	144.7	163.4	175.6
RONW	68.1	133.8	136.9	146.9
Liquidity ratios				
Current ratio	0.7	0.6	0.7	0.6
Debtors days	13.3	11.8	11.8	11.8
Inventory days	46.7	52.0	52.0	52.0
Creditors days	94.9	100.0	100.0	100.0
Leverage ratios (x)				
Debt / Total equity	-	0.1	0.1	0.1
Payout ratios (%)				
Dividend payout	81.5	121.1	97.2	95.3
Tax payout	17.3	19.0	20.0	20.0

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