

Hindustan Unilever Limited

CMP	:235
Sector Outlook	:Neutral
Relative to Sector	:Outperformer
Rating	: Buy at Fair value Rs.200

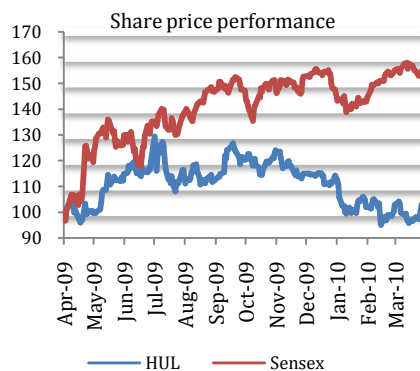


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Investment Rationale

Bloomberg Code	HUVR IN
NSE Volumes	344,573
Equity (Rs. In crs.)	221.19
Face Value (in Rs.)	1.0
BV/share (in Rs.)	9.33
Market Cap	53,420
52 Week H/L	306/218
Sensex Beta	
SHARE HOLDING PATTERN	
	%
Foreign	14.8
Institutions	14.1
Govt Holding	0.0
Corporate Holding	3.5
Promoters	52.0
Public & Others	15.6
CMP	
	240
PE x TTM	26.0
PE x FY11e	21.6
PE x FY12e	19.3
Dividend Yield	3.6%

- ⊞ **HUL is the largest FMCG company in India with a dominant market share in most segments and a strong brand equity. The Indian consumption story is well known and is expected to provide stable demand growth going forward.**
- ⊞ **Since HUL has had a pretty stable record of earnings, ROE and income growth with high dividend payouts, the dividend discount model is well applicable for valuing the company.**
- ⊞ **We have also observed that over the past decade the company's one year forward PE range has been 19x-34x with an average of 24.5. The current one year forward PE is 22x and the difference from the mean is not statistically significant and HUL appears fairly valued.**
- ⊞ **The company's PE multiple has contracted due to the recent increased competitive intensity. We consider this normal a part and parcel of normal competition and not a cause for a structural change in industry or company dynamics.**
- ⊞ **HUL has a long operating history and has managed to maintain high profitability over business cycles and varied levels of competitive intensities. As a result of this HUL offers great value vis a vis its competitors which appear relatively expensive.**
- ⊞ **We expect the current PE to contract in the coming quarters as the current price war gets reflected in quarterly numbers. Once the stock comes close to Rs.200 one can buy it at its intrinsic fair value and expect a sizeable appreciation as the market has a tendency to assign HUL a higher PE on an average. Additionally buying at the lower end of its PE band also minimizes risk as that is the lowest level at which the company is has been valued.**



Rs. In crs.	CY07	FY09*	FY10e	FY11e	FY12e
Revenue	13640.87	20192.4	17395.8	19544.2	21957.9
EBIDTA	1806.98	2430.1	2490.9	2638.5	2964.3
Net Income	1925.47	2496.5	2213.7	2406.3	2703.5
EPS	8.8	11.4	10.1	11.0	12.4

FY09 results for 15 months



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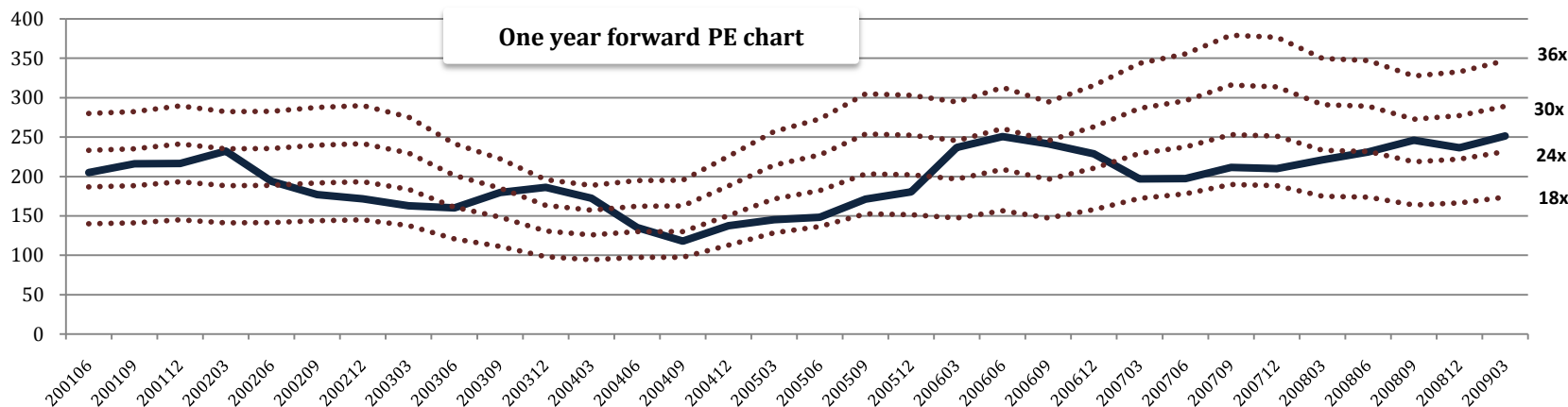
PE based valuation

HUL has historically traded at a forward PE multiple of 24x on an average. Currently the company is witnessing increased levels of competitive intensity which has led to price reductions of final products and increased grammage at the same price points. As a result EBIDTA margins are expected to suffer in the short term. However the long term outlook continues to be stable and positive.

The entire FMCG sector is to be discounted 19-20x of its FY12e currently. HUL requires just 11% growth to reach its forecast and hence the risk of not meeting expected earnings is quite low.

We expect HUL prices to correct in the near future as earnings for the next couple of quarter show the effects of increased competition on EBIDTA margins. Any price level below 220-200 is a great buying opportunity. Fall in price due to market corrections can also provide great entry points.

Additionally the dividend yield for HUL is the highest at 3.6%. Based on current pricing as well as future potential due to its market leadership HUL appears to be the most attractive bet amongst the FMCG pack.



Dividend Discount model Valuation.

The H model values the company under the assumption that the company will enjoy a higher growth rate for a period of time which will linearly decline over a forecast time horizon to its long term terminal growth rate.

The first part of the equation provides the value to the company under the terminal growth assumption. HUL's value would be close to Rs.129 if the company was expected to grow for perpetuity at 5%.

The second part provides the value for the higher growth expected in the interim, which we estimate at 12.5%. This provides an additional value of Rs.69.1 per share.

The total value for HUL under the H model is Rs.198/share.

The H Model:

$$P_0 = \frac{D_0 \times (1+G_n)}{(r - G_n)} + \frac{D_0 \times H(G_h - G_n)}{(r - G_n)}$$

$D_0 = \text{Current Dividend (FY10e)} - \text{Rs.8.6}$	$= \frac{8.6 \times 1.05}{(.12-.05)} + \frac{8.6 \times (15/2) (.125-.05)}{(.12-.05)}$
$G_n = \text{Long Term/Terminal Growth} - 5\%$	$= 129 + 69.1$
$G_h = \text{High Growth rate} - 12.5\%$	$= 198.1$
$H = n/2 \text{ where } n = \text{No of higher growth years} - 15 \text{ years}$	
$r = \text{required return (Cost of Equity)} - 12\%$	

Peer Review

Co_Name	Consensus EPS estimates			Earnings Growth	CMP	PE			Dividend Yield - %
	FY10	FY11E	FY12E	FY10-12 CAGR		FY10	FY11E	FY12E	
Hind. Unilever	10.1	11.1	12.5	11.0	240	23.8	21.6	19.3	3.6
Colgate-Palm.	29.3	31.7	37.3	13.0	760	26.0	23.9	20.4	3.0
Godrej Consumer	11.3	12.9	15.0	15.2	295	26.0	22.9	19.6	2.3
Dabur India	5.7	6.9	8.2	19.4	177	30.9	25.6	21.7	1.7
Marico	4.0	4.8	5.9	20.7	112	27.9	23.4	19.1	1.0
ITC Ltd	10.7	12.4	14.3	15.6	270	25.3	21.8	18.9	2.0

⚠ On a relative basis HUL appears to be fairly value as well as the entire FMCG pack's FY12e earnings are currently discounted 19-21x.

⚠ HUL however seems to offer a higher value as the company would have to register a lower growth of 11% to meet market expectations and the stock also offers the highest dividend yield amongst the front line FMCG companies.

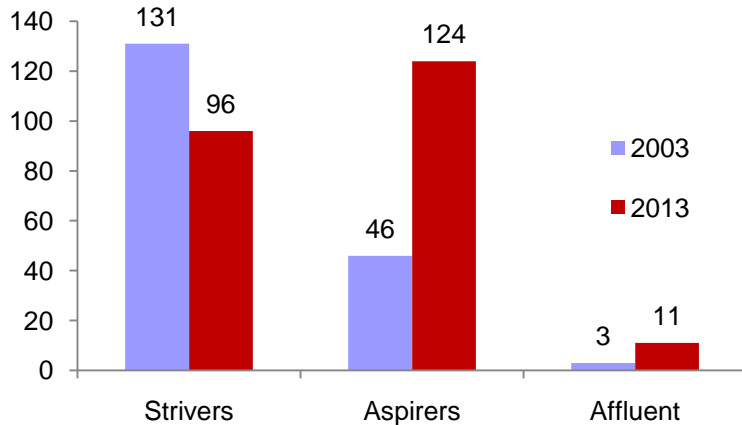
Well entrenched in the Indian Economy to reap growth benefits

HUL is the largest FMCG company in India. The large Indian population provides a stable demand outlook and the change in its demography present an opportunity of a higher growth trajectory.

HUL has a long operational history and commands a strong brand equity, with many brands which are household names. Brand perception is a very important factor in the FMCG industry that drives market share and revenue. FMCG companies spend anywhere between 7-10% of their revenue on advertisements and promotions. HUL's strength on this front will enable it to garner a large chunk of new users as penetration increases. HUL has a diversified portfolio of products covering the three main categories of Indian consumers (Affluent, Aspirers, Strivers), segmented along income.

HUL is a very profitable enterprise with an average ROE of 80% over the past 5-7 years. The company has an excellent capital allocation record and the company has returned excess earnings to investors when opportunities to earn higher returns on capital weren't present. The company's payout ratio has averaged 80% over the past 5-7 years. At CMP the dividend yield of the company works out to 3.6%.

CMP of Rs.240 discounts FY11e EPS of Rs.11, 22 times. We believe the increased competitive intensity is a temporary phase as most companies have enjoyed gross margins and this has enabled them to slash prices heavily. As this situation corrects we expect the PE to revert to its historical level of 24x and closer to its peers.



Our expectation of HUL maintaining a steady growth rate and shifting the growth rate trend higher stems from the expected structural change in Indian demographics.

According to NCAER estimates, of the 181mn households in 2003, 72% or 131mn households were classified as Strivers.

It is estimated that by 2013 the number of households will increase to 231mn and Aspirers will account for 54% of the total.

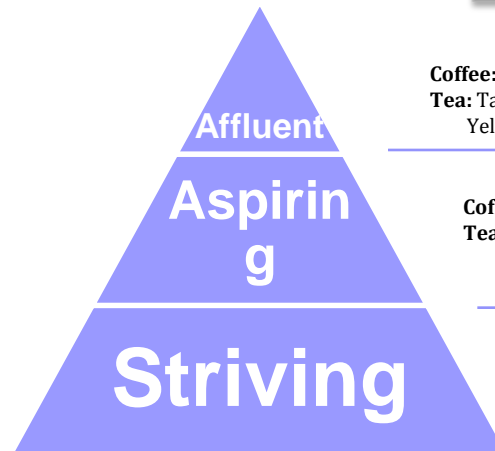
FMCG companies are targeting the strivers through low price point reduced content packages like sachets to increase penetration.

The shift in demographics will result in significantly higher penetration and also higher sales of standard products.

With HUL being the dominant player in the organized FMCG market, it enjoys tremendous brand recognition. With most of their products household names, their current dominant position will enable to grab a large share of new users shifting to branded FMCG products.

HUL has a large diversified portfolio of products covering most facets of the FMCG sector.

Their product line are well segmented and each line targets the 3 main segments of the Indian demography at various content and price points.

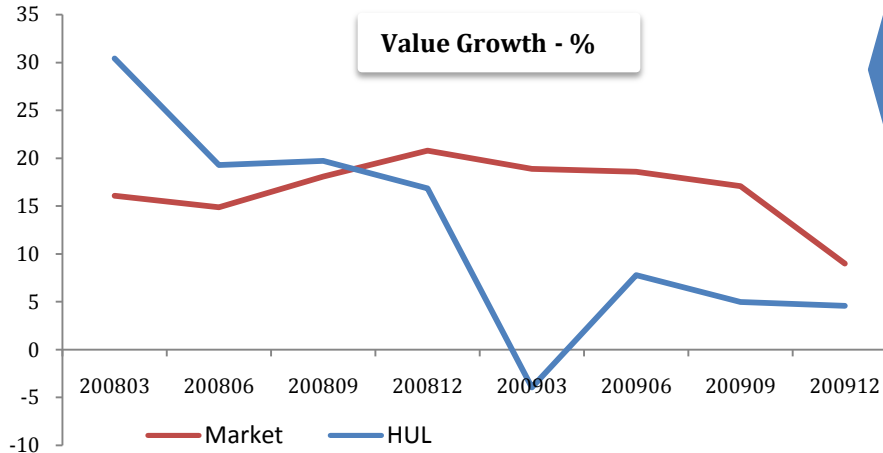


Coffee: Bru Tea: Taj Mahal, Yellow Lable	Hair Care: Dove, Clinic All Clear Oral Care: Close Up	Detergents: Surf Excel Skin Care: Lakme, Ponds. Soaps : Liril 2000, Dove, Pears
Coffee: Bru Tea: Red Label	Hair Care: Sunsilk Oral Care: Pepsodent	Detergents: Rin Soaps: Hamam, Lux Skin Care: Vaseline, Fair and Lovely
Coffee: Bru Tea: Taaza	Hair Care: Clinic, Sunsilk Sachets Oral Care: Peosodent, Close UP	Detergents: Wheel Soaps: Lifebuoy, Breeze Skin Care: Vaseline, Fair and Lovely



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Value Growth - %

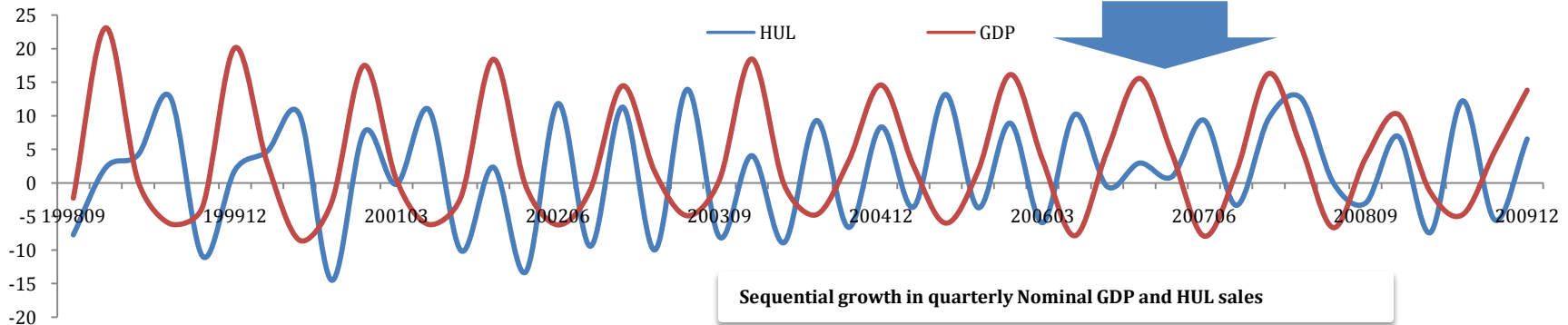


HUL's sales growth in value terms has been lower than the market since December 2008. However we believe this is a temporary slowdown the company is experiencing due to increased competitive intensity rather than a structural shift in growth trend for the company.

This belief is largely based upon the historical observation that HUL's sales growth is highly co-related to nominal GDP growth.

Observed co-relation between YoY growth in nominal GDP and HUL sales is positive and fairly strong at 0,6. Co-relation in the recent past few years is stronger at 0,75.

The graph below shows that for over a decade the sequential sales growth has moved very closely to sequential nominal GDP growth even as the company has witnessed various rounds of increasing competitive intensity from incumbents and new entrants.

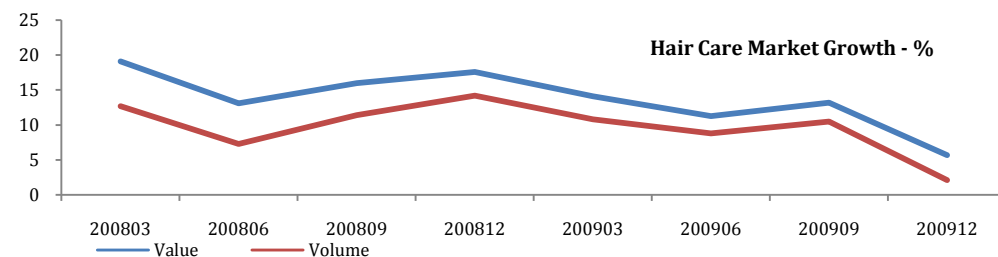
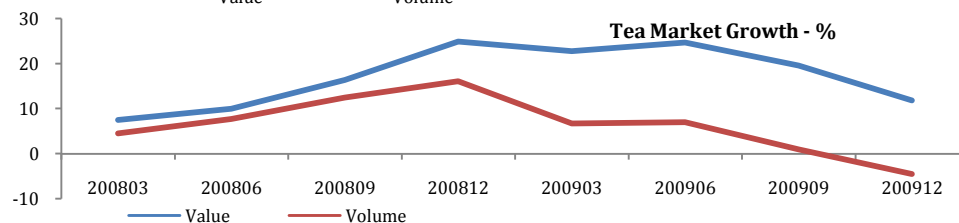
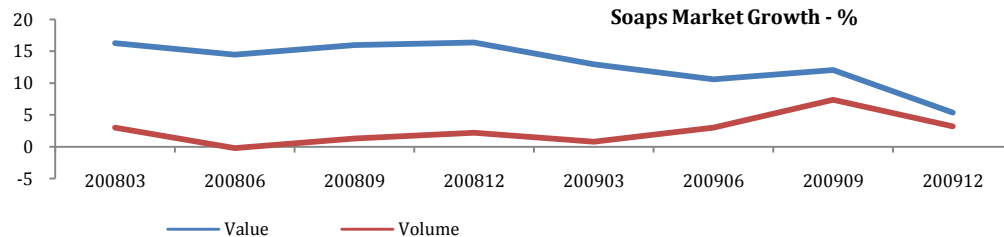
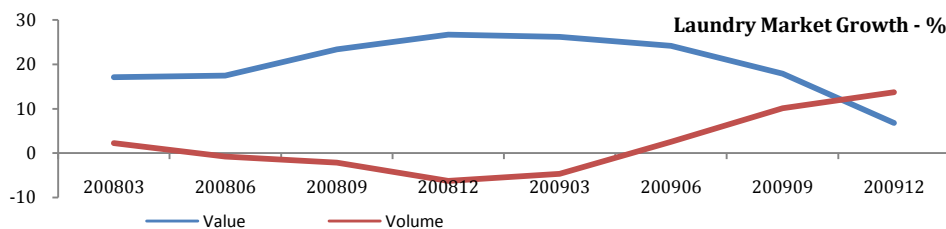


Sequential growth in quarterly Nominal GDP and HUL sales



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Movements in Key Market Segments.



The Indian market is extremely price sensitive. This aspect is quite visible in the charts.

Increasing inflation and input cost had forced manufacturers to increase laundry detergent prices. This led to growth in sales in terms of value, but volume growth has declined significantly. As prices started cooling off, as is visible by lower sales revenue growth, volume growth picked up sharply.

A similar trend is visible in the soaps market chart as well as the tea markets. Sharply rising tea prices have increased sales but volume growth has fallen off sharply. While tea consumption may not have fallen off to the extent indicated, and most likely indicates a shift toward unbranded tea from the unorganized sector.

The hair care market seems to have stable pricing with sales growth following volume growth closely.

Company Background

Hindustan Unilever Limited, a fast moving consumer goods company, provides nutrition, hygiene, and personal care products in India and internationally.

It offers soaps and detergents, including soaps, detergent bars, detergent powders, detergent liquids, and scourers; personal products, such as oral, skin, and hair care products, as well as toothpaste and brush, deodorants, talcum powder, color cosmetics, and beauty and wellness services; and beverages, including tea and coffee.

HUL's brands includes Lifebuoy, Lux, Surf Excel, Rin, Wheel, Fair & Lovely, Pond's, Sunsilk, Clinic, Pepsodent, Close-up, Lakme, Brooke Bond, Kissan, Knorr-Annapurna, Kwality Wall's - are household names across the country and span many categories - soaps, detergents, personal products, tea, coffee, branded staples, ice cream and culinary products. They are manufactured in over 40 factories across India.

The company also provides food products, such as branded staples, including flour and salt; culinary products comprising tomato based products, fruit based products, and soups; wheat based products consisting of bread and supplementary nutritional products; bakery products; recipe mixes; and ice creams and frozen desserts.

In addition, it exports marine products, rice, and leather products. Further, the company involves in chemicals, agri seeds, property development, and water businesses.

The company is headquartered in Mumbai with a national sales network with offices in 4 metros. HUL has more than 35 manufacturing locations across India, with major hubs being Assam, Uttaranchal, Himachal Pradesh, Pondicherry and Dadra & Nagar Haveli. Its estimated 700 million people in the country use HUL products. The company covers over 6.3 million retail outlets including direct reach to over 1 million.

In the spirit of interdependence, HUL enjoys unrestricted access to the repertoire of Unilever's brands, technologies, business processes and international best practices. HUL is also able to take advantage of Unilever's global scale, particularly in the areas of brand marketing and advertising, international supply chain, procurement of material and leadership development.



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Income Statement

Rs. In Crs.	CY07	FY09*	FY10e	FY11e	FY12e
Net Sales	13640.9	20192.4	17395.8	19544.2	21957.9
Total Expenditure	11833.9	17762.2	14904.9	16905.7	18993.6
EBIDTA	1807.0	2430.1	2490.9	2638.5	2964.3
Depreciation	138.4	195.3	178.7	195.4	219.6
EBIT	1668.6	2234.8	2312.1	2443.0	2744.7
Interest	25.5	25.3	9.3	21.5	24.2
Other Income	684.7	791.0	464.3	586.3	658.7
PBT	2327.8	3000.5	2767.1	3007.8	3379.3
Tax	402.3	504.1	553.4	601.6	675.9
Net Profit	1925.5	2496.5	2213.7	2406.3	2703.5
Dividend	1976.1	1634.5	1881.6	2045.3	2297.9
EPS	8.8	11.4	10.1	11.0	12.4



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Balance Sheet

Rs. In Crs.	CY07	FY09	FY10e	FY11e	FY12e
Share Capital	217.8	218.0	218.0	218.0	218.0
Reserves	1221.5	1843.5	2175.6	2536.5	2942.0
Share Holders Funds	1439.2	2061.5	2393.6	2754.5	3160.0
Debt	88.5	422.0	93.4	215.0	241.5
Total Liabilities	1527.8	2483.5	2487.0	2969.5	3401.6
Net Block	1920.5	2333.7	2399.4	2695.7	3028.7
Investments	1440.8	332.6	609.4	860.1	1031.6
Current Assets	3277.4	5601.0	5392.7	6058.7	6806.9
Current Liabilities	5111.0	5783.8	5914.6	6645.0	7465.7
Net Current Assets	-1833.6	-182.8	-521.9	-586.3	-658.7
Total Assets	1527.8	2483.5	2486.9	2969.5	3401.5

Thank You

Amit Nalin Securities Pvt. Ltd.

142/A, Mittal Tower, Nariman Point, Mumbai 400021

Phone no.: +91 22 4002 1601

Institutional Equity Desk - 91 22 4002 1605

Research Desk - +91 22 4002 1604

Email : amitdalal@anseclimited.com

Research Team:

- Rujuta Dalal
- Vinod Malviya
- Moiz Tambawala
- Jitendra kumar
- Amruta Vaidya
- Manoj Jethwa



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