

February 1, 2010

Rating	Sell
Price	Rs244
Target Price	Rs253
Implied Upside	3.6%
Sensex	16,358

(Prices as on January 29, 2010)

#### Trading Data

Market Cap. (Rs bn)	532.1
Shares o/s (m)	2,180.0
Free Float	48.0%
3M Avg. Daily Vol ('000)	3,290.6
3M Avg. Daily Value (Rs m)	878.6

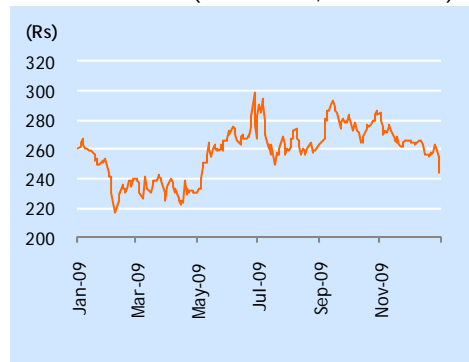
#### Major Shareholders

Promoters	52.0%
Foreign	15.0%
Domestic Inst.	13.9%
Public & Others	19.1%

#### Stock Performance

(%)	1M	6M	12M
Absolute	(10.2)	(18.3)	(9.0)
Relative	(3.5)	(22.3)	(81.9)

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



Source: Bloomberg

Hindustan Unilever's (HUVR's) new found aggression, reflected in initiating a pricing battle in the laundry category, may stretch longer and spread to other categories as well, as we expect competition to react. In the short term, it has margin implications for HUVR and other players. News-flow surrounding the pricing actions will keep the stock under pressure in our view. This is perfectly in sync with our long-held view that market share and volume recovery will be expensive and gradual.

- **Return of price war??** Apart from the price cuts in laundry, which we flagged off on Thursday, we also learn from our channel checks that next on the radar for price cuts/ grammage increase is Soaps category.
- **We revisit numbers of CY03 and CY04 for HUVR:** In the price war year (CY2004), EBITDA margins had compressed by 430bps and profits declined by more than 30%, indicating the extent of damage (discussed on next page).
- **Longevity and spread of price war will determine earnings impact:** Though current pricing war is in its infancy yet, we believe it has enough disruptive potential for margins and earnings performance of HUVR, P&G, GCPL etc. However, the magnitude of margins and consequently, the earnings impact will depend on a) Longevity of the "price war" and b) Spreading of pricing actions to other categories e.g. Shampoo, Skin Care etc.
- **Expect pricing actions to stretch** as competitors react. When the sector leader itself has to initiate the game of pricing, it's a reflection of deteriorating growth profile of the segments viz. Laundry and Soaps, which forms ~40% of HUVR's top-line. This has been one of the pillars of our structural bearish stance on HUVR from a long time i.e. dependence of top-line on heavily penetrated categories like Soaps and Detergents is significant and hence, will restrict the overall volume growth to sub-optimal levels.
- **Expect consensus earnings downgrades:** Though we haven't revised our earnings estimates, we expect consensus earnings estimates to come down. FY10E and FY11E consensus estimates have been revised 2-3% downwards in previous one month (we are still 2% and 4% below consensus for FY11E and FY12E, respectively). Having corrected more than 10% in 4 trading sessions, absolute downside may remain limited. Maintain Sell.

Key financials (Y/e March)	FY09	FY10E	FY11E	FY12E
Revenues (Rs m)	205,011	180,275	200,881	222,742
Growth (%)	47.8	(12.1)	11.4	10.9
EBITDA (Rs m)	27,029	25,479	28,339	31,222
PAT (Rs m)	24,900	22,765	25,350	28,176
EPS (Rs)	11.4	10.4	11.6	12.9
Growth (%)	43.1	(8.6)	11.4	11.1
Net DPS (Rs)	7.5	8.4	9.3	10.3

Source: Company Data; PL Research

Profitability & valuation	FY09	FY10E	FY11E	FY12E
EBITDA margin (%)	13.3	14.2	14.2	14.1
RoE (%)	136.6	103.0	107.3	111.2
RoCE (%)	133.6	100.6	106.3	111.7
EV / sales (x)	2.5	2.8	2.5	2.3
EV / EBITDA (x)	18.9	20.1	18.0	16.4
PE (x)	21.4	23.4	21.0	18.9
P / BV (x)	24.9	23.3	21.8	20.3
Net dividend yield (%)	3.1	3.4	3.8	4.2

Source: Company Data; PL Research

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## What next after laundry?

After Laundry, Soaps can be the next category to witness pricing actions. Specifically, we deduce that following actions have been/can be taken

- Grammage increase in Lux from 100 to 110 gm at the same price point, an effective price cut of 9%.
- Lifebuoy price cut from Rs12 to Rs10 and grammage revised from 90gm to 80gm, effective price cut of 6%.
- Lux and Lifebuoy are the two largest selling toilet soaps brands for HUVR (Soaps category contribute ~22% of revenues).

As per channel checks, some of the aforementioned pricing actions have already reached some markets.

- **Comparison with 2004 price war:** Though smaller in magnitude, it reminds us of the 2004 price war, when P&G initiated the game with 20-50% price drop in laundry and then it spread to shampoos.

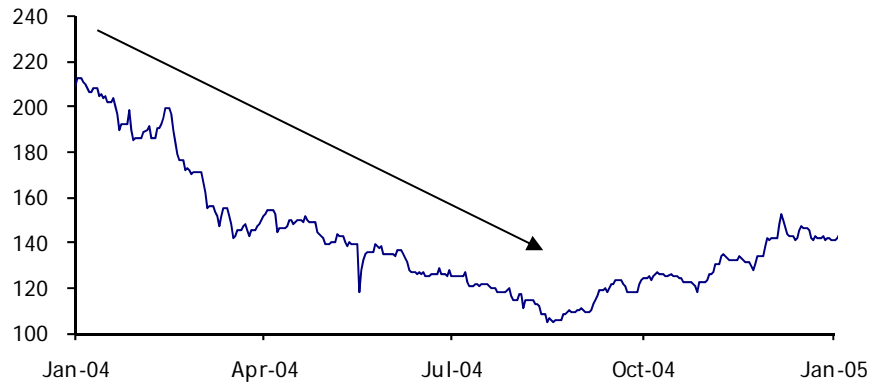
Fig 1: We revisit CY03 and CY04 numbers

	CY2003	CY2004
Net sales	108,369	105,982
<i>Growth</i>		-2.2%
Raw materials	57,533	56,691
Gross profit	50,836	49,291
<i>Gross margins</i>	46.9%	46.5%
EBITDA	19,962	14,902
<i>EBITDA margins</i>	18.4%	14.1%
Net profits	17,118	11,476
<i>Growth</i>		-33.0%
<b>Soaps and Detergents</b>		
Revenues	43,794	44,707
EBIT	10,883	7,751
<i>Growth</i>		-28.8%
<i>EBIT margins</i>	24.8%	17.3%

Source: Company Data, PL Research

EBITDA margins had compressed by 430bps and profits declined by more than 30%, indicating the extent of damage of price war. Naturally, the stock price and P/E multiple also underwent significant correction. Stock has corrected almost 50% in the 8 month period beginning 1<sup>st</sup> Jan-04.

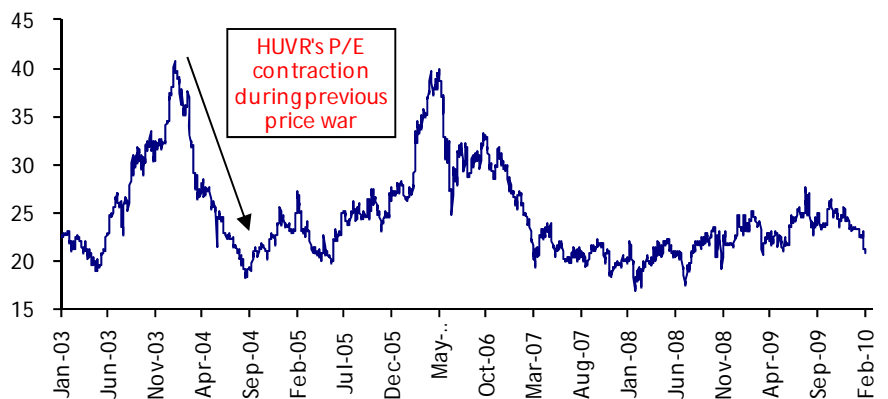
**Fig 2: HUVR's stock price performance during earlier price war**



Source: Bloomberg, PL Research

HUVR's aggressive strategy of going all out to gain back volumes/market share, though expected, is going to impact margins in the short term. Not only will it impact margins, it can also lead to further compression in P/E multiples like in CY2004 (Fig 3). Though it may benefit HUVR in the longer term, it highlights, in our view a) the risk of competitive intensity in the category (as discussed in detail in our thematic note "The Rising Tide" dated 10-12-2009) and b) the price of 'excessive price hikes' taken in CY08.

**Fig 3: HUVR's P/E contracted significantly during previous price war**



Source: Bloomberg, PL Research

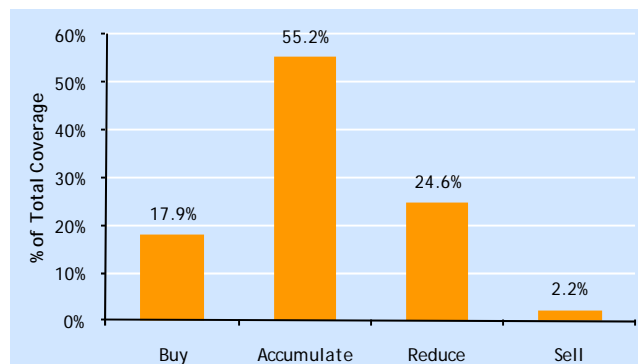
We expect pricing actions to stretch as competitors react. Difference in the game is that HUVR has initiated rather than being reactive and it seems a planned strategy in our view. When the sector leader itself has to initiate the game of pricing, it's a reflection of deteriorating growth profile of the segments viz. Laundry and Soaps, which forms ~40% of HUVR's top-line. This has been one of the pillars of our structural bearish stance on HUVR from a long time i.e. dependence of top-line on heavily penetrated categories like Soaps and Detergents is significant and hence, will restrict the overall volume growth to sub-optimal levels. The other pillar of our bearish stance i.e. HUVR will remain in catch-22 situation of volumes vs profitability which will necessitate higher brand spends is also amply born out by the 42% YoY jump in ad expenses for 9MFY10 as against 5% topline growth.

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#### PL's Recommendation Nomenclature

<b>BUY</b>	: Over 15% Outperformance to Sensex over 12-months	<b>Accumulate</b>	: Outperformance to Sensex over 12-months
<b>Reduce</b>	: Underperformance to Sensex over 12-months	<b>Sell</b>	: Over 15% underperformance to Sensex over 12-months
<b>Trading Buy</b>	: Over 10% absolute upside in 1-month	<b>Trading Sell</b>	: Over 10% absolute decline in 1-month
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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