

Dec Q highlights slow and costly road to recovery

Bank of America
Merrill Lynch

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Dec Q profit of Rs5.7bn, down 5% yoy; Maintain U/P

HUL continued to perform poorly, with earnings missing our below-consensus estimates. Sales growth, at 12% yoy, supported by volume growth of 14%, was marginally ahead of expectations. However, the 310bp margin decline was more than we estimated, as gross margins fell sharply, while HUL accelerated its A&P spends to support volume growth. We maintain our Underperform rating, as the marginal surprise in top-line growth was more than offset by the cost pressures.

No breakout visible from volume vs profitability conundrum

For us, the key would be the sustenance of current volume growth, which is benefiting from the low base of last year. We believe HUL will have to take more price hikes in order to offset cost push, which will impact the recovery in its volume growth. We believe that HUL has yet to break out of a situation in which it can either chase volume growth at the cost of margins or push for profitability by taking up price, but sacrificing volume growth.

Soaps & Detergents undo good work of Personal Products

S&D sales growth recovered to 6% yoy, but EBIT fell 39% yoy on a margin decline of 570bp yoy, led by a raw material (palm oil and LAB) cost spike and A&P support. PP performed well, with 20% yoy sales growth and a modest 310bp margin fall from an exceptionally high base. Going forward, we expect S&D to worsen, as input costs continue to rise and sales growth will moderate on a high base and a price cut in Wheel in select geographies. We believe that this will undermine the strong growth in PP, which is benefiting from a range of new launches by HUL in skin, hair and oral care.

Valuation expensive on weaker than sector growth

HUL, at 25x FY12E, is trading at 10% premium to sector. This appears unjustified, given our expectations of ex-HUL sector growth of ~20% in FY11E vs. 8% for HUL. Hence, we expect HUL to de-rate, with the weak earnings results and the negative news flow around rising competition acting as downward triggers.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	20,905	21,027	20,976	24,545	28,624
EPS	9.60	9.64	9.61	11.25	13.12
EPS Change (YoY)	19.7%	0.4%	-0.2%	17.0%	16.6%
Dividend / Share	7.58	6.50	7.69	9.00	10.49
Free Cash Flow / Share	7.67	14.40	10.67	12.23	14.33

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	29.37x	29.25x	29.32x	25.06x	21.49x
Dividend Yield	2.69%	2.31%	2.73%	3.19%	3.72%
EV / EBITDA*	21.31x	20.31x	19.93x	17.21x	14.89x
Free Cash Flow Yield*	2.72%	5.11%	3.79%	4.34%	5.08%

* For full definitions of *iQmethod*SM measures, see page 7.

Stock Data

Price	Rs281.90
Price Objective	Rs240.00
Date Established	25-Oct-2010
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs218.00-Rs329.90
Mrkt Val / Shares Out (mn)	US\$13,461 / 2,182.0
Average Daily Volume	2,178,790
BofAML Ticker / Exchange	HINLF / BSE
Bloomberg / Reuters	HUVR IN / HLL.BO
ROE (2011E)	78.9%
Net Dbt to Eqty (Mar-2010A)	-73.2%
Est. 5-Yr EPS / DPS Growth	15.0% / 15.0%
Free Float	49.0%

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27 January 2011

iQprofileSM Hindustan Unilever

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	166,985	177,659	193,121	214,814	239,152
Gross Profit	28,130	29,521	30,085	34,834	40,275
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	26,826	28,052	28,104	32,704	37,979
Net Interest & Other Income	(1,452)	(982)	(503)	(407)	(316)
Associates	NA	NA	NA	NA	NA
Pretax Income	25,374	27,071	27,601	32,296	37,663
Tax (expense) / Benefit	(4,469)	(6,044)	(6,624)	(7,751)	(9,039)
Net Income (Adjusted)	20,905	21,027	20,976	24,545	28,624
Average Fully Diluted Shares Outstanding	2,178	2,182	2,182	2,182	2,182

Key Cash Flow Statement Data

Net Income	20,905	21,027	20,976	24,545	28,624
Depreciation & Amortization	1,303	1,469	1,981	2,131	2,296
Change in Working Capital	(742)	12,975	4,310	4,143	4,649
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	250	993	0	0	0
Cash Flow from Operations	21,716	36,463	27,267	30,819	35,568
Capital Expenditure	(5,011)	(5,041)	(3,981)	(4,131)	(4,296)
(Acquisition) / Disposal of Investments	11,082	(9,315)	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	6,071	(14,355)	(3,981)	(4,131)	(4,296)
Shares Issue / (Repurchase)	2	2	0	0	0
Cost of Dividends Paid	(18,628)	(16,736)	(19,466)	(22,778)	(26,563)
Cash Flow from Financing	(15,292)	(20,954)	(19,466)	(22,778)	(26,563)
Free Cash Flow	16,706	31,423	23,286	26,688	31,272
Net Debt	(13,556)	(18,922)	(22,742)	(26,653)	(31,362)
Change in Net Debt	(9,161)	(5,374)	(3,820)	(3,910)	(4,709)

Key Balance Sheet Data

Property, Plant & Equipment	20,789	24,361	26,361	28,361	30,361
Other Non-Current Assets	5,875	15,129	15,129	15,129	15,129
Trade Receivables	5,369	6,784	6,566	7,518	8,370
Cash & Equivalents	17,775	18,922	22,742	26,653	31,362
Other Current Assets	32,867	27,971	26,071	28,785	32,046
Total Assets	82,674	93,167	96,869	106,446	117,268
Long-Term Debt	4,219	0	0	0	0
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	57,838	67,332	69,524	77,333	86,095
Total Liabilities	62,058	67,332	69,524	77,333	86,095
Total Equity	20,616	25,835	27,346	29,113	31,174
Total Equity & Liabilities	82,674	93,167	96,870	106,446	117,269

iQmethodSM - Bus Performance*

Return On Capital Employed	110.2%	90.5%	84.6%	92.0%	99.5%
Return On Equity	119.4%	90.5%	78.9%	86.9%	95.0%
Operating Margin	16.1%	15.8%	14.6%	15.2%	15.9%
EBITDA Margin	16.8%	16.6%	15.6%	16.2%	16.8%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.0x	1.7x	1.3x	1.3x	1.2x
Asset Replacement Ratio	3.8x	3.4x	2.0x	1.9x	1.9x
Tax Rate (Reported)	17.6%	22.3%	24.0%	24.0%	24.0%
Net Debt-to-Equity Ratio	-65.8%	-73.2%	-83.2%	-91.5%	-100.6%
Interest Cover	NM	NM	NM	NM	NM

Key Metrics

* For full definitions of iQmethodSM measures, see page 7.

Company Description

HLL, 51% owned by Unilever, is India's largest consumer products company. It offers more than 9 types of everyday household products - soaps, detergents, shampoos, skin care, oral care, beverages, and foods. Key strengths: extensive distribution network (its products are available in 6mn outlets), powerful brand equity (most of its brands are market leaders and straddle price segments), strong balance sheet, and high-quality management.

Investment Thesis

We have an Underperform on HUL due to a weaker earnings growth scenario. HUL is facing pressure on its top-line growth due to lower volume growth. Also, it appears to be losing market share across most categories. Competition appears to be catching up by offering lower-priced products. Any corrective strategy is likely to include price cuts and higher ad spend, which would impact margin gains from lower raw material costs. Valuation looks expensive in the current weaker earnings growth scenario.

Stock Data

Price to Book Value 22.5x

Results highlights

Table 1: Summarized results highlights

	Dec-09	Dec-10	% chg	9M10	9M11	%chg
Net Sales	45043	50270	11.6%	132081	145018	9.8%
Other Ops In	690	1007	46.0%	1370	2668	94.7%
Total Income	45,732	51,277	12.1%	133451	147686	10.7%
Materials	22046	25692	16.5%	66604	73988	11.1%
As % of sales	48.9%	51.1%	2.2%	50.4%	51.0%	0.6%
Staff costs	2120	2310	9.0%	6982	7269	4.1%
Advertising	6329	7433	17.4%	17649	21410	21.3%
As % of sales	14.1%	14.8%	0.7%	13.4%	14.8%	
Others	7363	8593	16.7%	20671	24494	18.5%
Total Exp	37857	44027	16.3%	111906	127160	13.6%
EBITDA	7,875	7,250	-7.9%	21545	20526	-4.7%
EBITDA margin	17.5%	14.4%	-3.1%	16.3%	14.2%	-2.2%
Depreciation	450.1	563	25.1%	1337	1652	23.5%
EBIT	7,425	6,687	-9.9%	20208	18874	-6.6%
Interest income	386.9	769.6	98.9%	1143	1958	71.3%
Pretax profit	7,812	7,456	-4.6%	21351	20832	-2.4%
Total Tax	1766	1724	-2.4%	4923	4698	-4.6%
Tax rate	22.6%	23.1%		23.1%	22.5%	
Net profit	6,046	5,732	-5.2%	16428	16135	-1.8%
Exceptional inc (exp)	444.8	643		-220	1232	
PAT after XO	6,491	6,375	-1.8%	16208	17367	7.1%
Segment Details						
Turnover						
Total HPC	34489	38476	11.6%	100799	109718	8.8%
- Soaps & Detergents	20719	21929	5.8%	62872	65868	4.8%
- Personal Products	13770	16547	20.2%	37927	43850	15.6%
Beverages	5511	6022	9.3%	15723	17101	8.8%
Foods	1872	2219	18.6%	5332	6525	22.4%
Ice Creams	368	481	30.9%	1757	2076	18.2%
Exports	2653	2909	9.7%	7497	8204	9.4%
Others	958	1111	15.9%	2823	3763	33.3%
Net Turnover	45851	51218	11.7%	133892	147388	10.1%
EBIT						
HPC EBIT	7184	6462	-10.0%	19557	17978	-8.1%
Total HPC	20.8%	16.8%	-4.0%	19.4%	16.4%	-3.0%
Soaps & Detergents	2785	1693	-39.2%	9325	6682	-28.3%
% Margin	13.4%	7.7%	-5.7%	14.8%	10.1%	-4.7%
Personal Products	4399	4769	8.4%	10232	11296	10.4%
% Margin	31.9%	28.8%	-3.1%	27.0%	25.8%	-1.2%
Beverages	817	1014	24.0%	2408	2585	7.3%
% Margin	14.8%	16.8%	2.0%	15.3%	15.1%	-0.2%
Foods	-13	-161	1184.8%	-35	45	-230.6%
% Margin	-0.7%	-7.2%	-6.6%	-0.6%	0.7%	1.3%
Ice Creams	-37	-6	-84.5%	143	202	41.8%
% Margin	-10.2%	-1.2%	9.0%	8.1%	9.7%	1.6%
Exports	75	227	201.2%	452	643	42.1%
% Margin	2.8%	7.8%	5.0%	6.0%	7.8%	1.8%
Others	-149.5	-184.7	-23.5%	-527	-634	-20.3%
% Margin	-15.6%	-16.6%	-1.0%	-18.7%	-16.8%	1.8%
Total EBIT	7877	7351	-6.7%	21998	20819	-5.4%
Total EBIT margin	17.2%	14.4%	-2.8%	16.4%	14.1%	-2.3%
EBIT after unallocables	8259	8100	-1.9%	20525	22068	7.5%
Less: Intt Exp	-1.9	-0.6		-68	-2	
Add:Unallocable Income / (Exp)	381.6	748.3		-1473	1249	
Total PBT	8257	8099	-2%	20457	22066	8%

Source: Company, BofA Merrill Lynch Global Research Estimates

What surprised us:

- Volume growth of 13% was above est
- S&D sales were up 6% vs our expectation of a 3% rise on stronger vol growth
- S&D EBIT decline of 39% on 570bp margin decline
- PP sales growth of 20% and muted margin fall of 310bp
- EBITDA margin decline of 310bp on lower gross margin and higher A&P spends

Sales: Rs51bn up 12% yoy, beat our est by 3%

S&D: Sales up 6%, ahead of our est by 2%, on higher-than-expected volume growth in laundry and some price hikes.

PP: Sales up 20% yoy, beat our est by 7%, supported by new product launches.

Volume growth was in double digits.

Beverages: Sales up 9% yoy, marginally below our est, on weak volume growth.

Foods: Sales up 21% yoy, mainly due to a strong performance by ice creams

Exports: Sales up by 10%, as basket rationalization appears to be completed

Others: Sales up only 16% yoy, missing our est by 17%, as 1H momentum slows down.

EBIT: Rs6.7bn down 10% yoy, missed est by 5%

S&D: Margins fell a massive 570bp, on surging input costs and A&P spend.

PP: Margins down 310bps on exceptionally high base, as A&P spend remains high to support new product launches

Beverages: 200bp margin gain, as raw material prices offset by price hikes

Foods: EBIT loss of Rs167mn

Exports: EBIT of Rs227, with 7.8% margin, indicates stabilization of profitability post basket rationalization.

Others: EBIT loss of 185mn was in line with expectations

Earnings: Net profit Rs5.7bn, down 5% yoy and 1% below BofAMLe

Including exceptional income, reported profit was Rs6.4bn, down 2% yoy. This includes profits from the sale of property and long-term investments, and provisions for restructuring costs.

Summarized financial estimates

Table 2: Summarized earnings estimates

	FY09-Portf	FY10A	FY11E	FY12E	FY13E
Turnover					
- Soaps & Detergents	81424	82656	85963	93699	102132
- Personal Products	43486	50479	57546	66178	76105
- Beverages	18635	21424	23567	25923	28516
- Foods	6587	7308	8623	9917	11404
- Ice creams	1982	2310	2772	3326	3992
- Exports	11768	10053	10857	11400	11970
- Other operations	3168	3467	3987	4585	5273
Total Revenue	166985	177659	193121	214814	239152
% chg	20.1%	6.4%	8.7%	11.2%	11.3%
Total EBITDA	28130	29521	30085	34834	40275
% chg	19.2%	4.9%	1.9%	15.8%	15.6%
Total EBITDA Margin	16.8%	16.6%	15.6%	16.2%	16.8%
Depreciation	1303	1469	1981	2131	2296
EBIT					
- Soaps & Detergents	12492	11853	10374	12265	14412
- Personal Products	11832	12965	14128	16282	18762
- Beverages	2547	3198	3382	3722	4097
- Foods	-20	44	126	188	266
- Ice creams	111	127	125	181	251
- Exports	904	586	600	658	720
- Other operations	-1039	-720	-631	-592	-528
Total EBIT	26826	28052	28104	32704	37979
% chg	20.2%	4.6%	0.2%	16.4%	16.1%
Profit bef Tax	25374	27071	27601	32296	37663
% chg	16.2%	7%	2%	17%	17%
Tax	4469	6044	6624	7751	9039
Tax rate	17.6%	22.3%	24.0%	24.0%	24.0%
PAT bef Exceptionals	20905	21027	20976	24545	28624
EPS	9.6	9.6	9.6	11.2	13.1
% chg	19.7%	0.4%	-0.2%	17.0%	16.6%

Source: Company, BofA Merrill Lynch Global Research Estimates

Table 3: Summarized balance sheet estimates

BALANCE SHEET AS AT	FY10A	FY11E	FY12E	FY13E
ASSETS				
Net Fixed Assets	24361	26361	28361	30361
Investments	12641	12641	12641	12641
Cash and Bank Balances	18,922	22,742	26,653	31,362
Total Current Assets	53678	55380	62957	71779
Total Current Liabilities	67,332	69,524	77,333	86,095
Net Current Assets excl Cash	-32577	-36886	-41029	-45678
Total Assets	23347	24857	26625	28686
LIABILITIES				
General Reserve	22997	24507	26275	28336
Net Worth	25835	27346	29113	31174
Accumulated Def Tax Asset	-2488	-2488	-2488	-2488
Debt	0	0	0	0
Total Liabilities	23347	24858	26625	28686

Source: Company, BofA Merrill Lynch Global Research Estimates

Table 4: Summarized cash flow estimates

Year to 31 December	FY10A	FY11E	FY12E	FY12E
Profit after tax and XO	22,020	20,976	24,545	28,624
Depreciation	1,469	1,981	2,131	2,296
Op profit bef W.Cap chg	23,489	22,957	26,676	30,919
Changes in working cap	12975	4310	4143	4649
Cash from operations	36,463	27,267	30,819	35,568
Capex	-5041	-3981	-4131	-4296
Cash from investing	-14355	-3981	-4131	-4296
Free cash flow	22,108	23,286	26,688	31,272
Chg in debt	-4219	0	0	0
Dividend paid	-16736	-19466	-22778	-26563
Cash from financing	-20954	-19466	-22778	-26563
Total cash flow	1,155	3,820	3,910	4,709
Opening cash	19,815	20,962	24,782	28,693
Closing cash	20,969	24,782	28,692	33,402

Source: Company, BofA Merrill Lynch Global Research Estimates

Table 5: Key Ratios

Year to 31 December	FY10A	FY11E	FY12E	FY12E
Avg ROE after extra-ord items	95%	79%	87%	95%
Avg ROE bef extra-ord items	91%	79%	87%	95%
Avg ROCE	90%	85%	92%	100%
Gearing	0%	0%	0%	0%
Net gearing	-81%	-91%	-99%	-107%
Book value / share	11.8	12.5	13.3	14.3

Source: Company, BofA Merrill Lynch Global Research Estimates

Price objective basis & risk Hindustan Unilever (HINLF)

Our preferred valuation methodology is a target P/E multiple on one-year-forward EPS. Our target multiple for HUVR is 21x, which, on FY12E EPS of Rs11.2, gives us our price objective of Rs240. Our target multiple is at a 15pc discount to its last-five-year average trading multiple. We believe this discount is justified given the weaker earnings growth outlook, due to declining market shares and volume declines across key categories. Upside risks to our estimates are higher-than-expected volume growth and a sharper-than-expected fall in input costs. Downside risks are slower-than-expected demand and stiffer competition.

Link to Definitions Consumer & Retail

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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India - Consumer Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Asian Paints	XAPNF	APNT IN	Anuj Bansal
	Colgate India	CPIYF	CLGT IN	Anuj Bansal
	Dabur India	DBUIF	DABUR IN	Anuj Bansal
	Godrej Consumer Products Ltd.	XGOCF	GCPL IN	Anuj Bansal
	ITC Limited	ITCTF	ITC IN	Anuj Bansal
	K S Oils Limited	XKSOF	KSO IN	Prasad Deshmukh
	Mcleod Russel India Ltd.	XCVFF	MCLR IN	Prasad Deshmukh
	Pantaloon	PFI AF	PF IN	Anuj Bansal
	Radico Khaitan	RKHAF	RDCK IN	Anuj Bansal
	Titan Industries Ltd	TTNIF	TTAN IN	Anuj Bansal
	United Spirits	UDSRF	UNSP IN	Anuj Bansal
UNDERPERFORM				
	Hindustan Unilever	HINLF	HUVR IN	Anuj Bansal
	Nestle India	XNTEF	NEST IN	Anuj Bansal
	Shoppers' Stop	XPQUF	SHOP IN	Anuj Bansal

*iQmethod*SM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

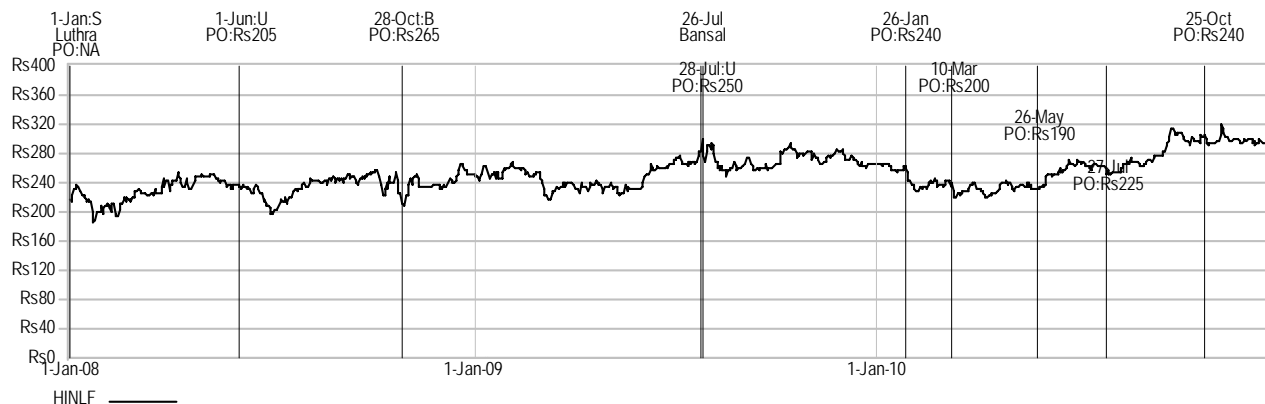
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HINLF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of December 31, 2010 or such later date as indicated.

Investment Rating Distribution: Consumer Products Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	36	54.55%	Buy	20	60.61%
Neutral	17	25.76%	Neutral	8	53.33%
Sell	13	19.70%	Sell	5	38.46%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

* Companies in respect of which BofA Merrill Lynch or one of its affiliates has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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