

**Q3FY10 Result Update**

February 06, 2010

Hindustan Unilever Limited (HUL) is India's largest fast moving consumer goods company, with leadership in Home & Personal Care Products. It is the market leader across diverse FMCG categories and has powerful brands like Rin, Surf Excel, Lux, Lifebuoy, and Ponds in its portfolio.

We present an update on the stock after the Q3FY10 results:

Q3FY10 Results Review

HUL's topline grew by 4.6% (Y-o-Y) to Rs. 45 bn [Q3FY09: Rs. 43.1 bn] with the underlying volume growth standing at 5%. Domestic FMCG net sales grew by 4.8% with decent revenue growth of 4% reported by HPC (Home & Personal Care) business, which accounts for 75% of the total revenue. Growth in HPC was mainly led by Personal Products segment, which rose 15.5% (Y-o-Y) driven by strong volume growth in the hair care & skin care categories. Soaps & Detergents however disappointed, as the segment de-grew 2.4% impacted by aggressive price cuts / grammage increases done by the company since January 2009 to bring the volumes back on track, which led to decline in the value sales. Foods business grew 8.2% Y-o-Y driven by all the three processed foods, beverages & ice creams. However, exports revenue declined marginally by 0.6% owing to a planned reduction in non-core exports and commodity segments.

The operating profit margins declined by 14 bps Y-o-Y to 16% despite the decrease in the raw material consumed by 10.9%. Higher advertising & promotion expenses (up 66.4%) to support the new product launches & bring in the volume growth, increase in the purchase of goods & other expenditure (up 17.3% & 5.2% respectively) led to decline in the margins during the quarter. The A&P cost as a % to net sales increased significantly by 522 bps Y-o-Y to 14.1%. However, the employee cost declined by 4% during the quarter. The core operating profit grew by 3.7% (Y-o-Y) to Rs. 7.2 bn. The total expenditure as a % to sales rose marginally by 10 bps to 84%. PBIT grew 3.2% (Y-o-Y) to Rs. 7.8 bn.

The other income (consisting of non-operating & other operating income) stood at Rs. 1078.5 mn in Q3FY10 vs Rs. 1045 mn in Q3FY09, an increase 3.2%. The other operating income declined by 2.8% on account of forex loss of Rs. 152 mn vs forex gain of Rs. 52 mn in Q3FY09 due to MTM valuation of open forward contracts. The non-operating income grew by 15.9%. However, the effective tax rate on PBT rose sharply from 11.9% in Q3FY09 to 22.6%. This was due to tax adjustments of the previous years amounting to a credit of Rs. 233.4 mn vs Rs. 524 mn in Q3FY09. This resulted in decline in the PAT (pre-exceptional & extraordinary items), which de-grew by 8.8% (Y-o-Y) to Rs. 6 bn. However, HUL reported an exceptional gain of Rs. 444.8 mn during the quarter (which included profit on sale of properties Rs. 495.2 mn, profit on transfer of assets to subsidiaries Rs. 22 mn & restructuring cost of Rs. 72.4 mn) as compared to exceptional & extra-ordinary loss of Rs. 473 mn (which included restructuring cost of Rs. 406.4 mn, provision for write down of advances in subsidiary Rs. 67 mn, provision for diminution in value of investments in subsidiaries Rs. 98 mn and profit on sale of properties & disposal of brand Rs. 98.4 mn). This led to a rise of 5.4% in the reported PAT to Rs. 6.5 bn [Q3FY09: Rs. 6.2 bn]. The EPS (Adjusted) for the quarter stood at Rs. 2.8 vs Rs. 3 in Q3FY09.

Soaps & Detergents

Soaps & Detergents segment de-grew 2.4% (Y-o-Y) to Rs. 20.7 bn (the first time in 6 years) despite increase in trade pipeline due to increase in trade incentives and promotions. Segment PBIT margins declined by 305 bps (Y-o-Y) to 13.4%. PBIT decreased by 20.5% to Rs. 2.8 bn. Aggressive price cuts (particularly in Laundry)/ grammage increases done by the company since January 2009 to bring the volumes back on track resulted in decline in the value sales & margins. Also there was significant downtrading witnessed in detergents. However, the segment volumes picked up due to higher ad-spends, a pause in market share decline and benefits of major re-launches/ brand activities, which the company had undertaken in the previous quarters. Volume growth in Soaps stood at 3.5%, while detergents volumes grew by 7%. In Q2FY10 the volumes of soaps and detergents had declined by 3%. Soaps market share has stabilized post the launch of Dove, re-launch of Breeze and Rexona, increase in consumer offers in Lux. Wheel delivered strong volume growth in Laundry. In Personal wash, relaunched Lux led volume growth and the premium soaps segment (Dove, Pears and Liril) continued to grow strongly.

Personal Care

Personal Care segment reported robust growth of 15.5% at Rs. 13.8 bn in Q3FY10 driven by a strong volume growth in the hair care and skin care categories. The segment reported double-digit volume growth for third consecutive quarter. In the Hair category, Dove grew rapidly across shampoo and conditioners, becoming the No.1 Hair Care brand in Modern Trade. In Skin Care, recently launched Pond's White Beauty, received very good consumer response and FAL 'winter fairness' variant performed well; Pond's Talc and Vaseline grew strongly in the Hand & Body segment. In Oral, both Close Up and Pepsodent delivered volume growth aided by launch of Close Up "Peppermint Splash" and a new "Germicheck" advertising campaign on Pepsodent. However, the segment PBIT margins declined by 88 bps (Y-o-Y) to 32% on account of higher ad spends. The segment PBIT increased by 12.4% (Y-o-Y) to Rs. 4.4 bn.

Foods Business

Foods business reported decent growth of 8.2% in revenue (Y-o-Y) to Rs. 7.8 bn, driven by all the three processed foods, beverages & ice creams. The foods segment PBIT increased by 31.4%, while the margins improved from 8.2% in Q3FY09 to 9.9% in Q3FY10. Beverages revenue grew by 7.9% (Y-o-Y) with all brands growing well. Tea prices rose, while the tea volumes declined during the quarter. Coffee growth was largely driven by small packs. The segment PBIT rose 25.5%, while the margins improved by 208 bps to 14.8% as company was able to fully pass on increased costs to the consumers. Processed foods segment rose 9.2% with all brands - Kissan, Knorr and Annapurna performing well. However, the segment reported PBIT loss of Rs. 12.5 mn on account of continued investments in advertising & sale promotions. However, the losses were lower as compared to Rs. 39 mn loss reported in Q3FY09. Ice-cream segment rose 7.2% (Y-o-Y), thus continuing its volume led growth. 10 new Swirls parlours were started during the quarter. However, the segment reported loss of Rs. 37.4 mn vs Rs. 28.4 mn loss in Q3FY09.

Others (Water Chemicals etc.)

Others category including businesses like water & chemicals rose 29.7% (Y-o-Y). Even the losses under this category reduced from Rs. 254.6 mn in Q3FY09 to Rs. 149.5 mn in Q3FY10. In the water business, 'Pure-It' is making good progress and expanding its national franchise through innovation and channel expansion. A value added offering, 'Pure-It Autofill' was launched during the quarter.

Conclusion & Recommendation:

After dull Q2FY10 results, HUL continued to disappoint in Q3FY10 as well. The Net sales & operating profit increased by 4.6% (entire growth was volume based) & 3.7% respectively, while the Adjusted PAT declined by 8.8%. Higher tax expense (up 97.1%) resulted in decline in PAT. On a sequential basis, the performance was relatively better as the net sales & operating profit grew by 4.6% & 17.6% respectively, while the Adjusted PAT grew by 7.3%. Soaps and Detergents segment reported poor performance as the net sales & PBIT both declined during the quarter. Though the personal products did well on the revenue front, the margins were impacted (Y-o-Y) due to higher ad spends. Exports continue to decline on both revenue & PBIT front, while the Processed Foods & Other Businesses (water, chemicals) are still taking time to breakeven on PBIT levels (though the losses have contracted on Y-o-Y basis, they have increased sequentially). However, it is to be noted that the corrective actions implemented by the company in the previous quarters have started yielding benefits in terms of volume growth. Soaps & Detergents returned to volume growth during the quarter (3.5% & 7% volume growth respectively), while the personal care category continued to report double-digit growth for third consecutive quarter.

Since the last few quarters, HUL has been facing the problems of constant market share loss across its categories, subdued volume growth, mainly in Soaps & Detergents & price cuts. However, in Q3FY10, signs of stabilization were witnessed in soaps category, though it was at the expense huge A&P spends, which has impacted the margins. Going forward we feel that HUL might be able to stabilise its market share losses, but would find it difficult to gain market share earlier lost to its competitors like P&G, GCPL & Wipro etc, since like HUL, these players have also been aggressively launching new products and expanding their distribution network. The company should rationalize & ensure more productivity out of A&P spends. To remain in competition & report good volume growth, HUL will have to consistently widen its portfolio with new benefits, variants & formats to cater to affluent people who have the propensity to spend. Also deficient monsoon (in June & July 2009) could have a lag effect & could distort HUL's performance in the coming quarters since its rural sales accounts for around 50% of its revenues.

For 9MFY10, HUL's net sales & PAT (Adjusted) grew by 5.8% & 3.9% respectively, while EPS stood at Rs. 7.8. We feel HUL could find it difficult to meet our FY10E projections. Hence we are revising our sales & PAT projections downwards by 5.4% & 4.9% respectively. FY10E EPS has been revised downwards to Rs. 10.9 vs Rs. 10.3 earlier estimated. In FY11, we expect HUL's net sales & PAT to grow by 11% & 12.7% respectively. EPS is expected to be Rs. 11.6.

At CMP of Rs. 229.7, HUL trades at 22.2x FY10E & 19.7x FY11E EPS. It has been observed that over the last few quarters, HUL's market premium to Sensex has contracted significantly. Infact now, the company trades at a discount to some of its peers like Dabur & Nestle, who have reported much better quarterly numbers as compared to HUL. Until we see signs of significant revival in the volumes or / and market share across its product categories in the coming quarters, HUL could continue to trade at a discount to its peers. In our Q2FY10 result review, we recommended investors to buy this scrip in the price band of Rs. 254-260 for a price target of Rs. 289 over the next two quarters. The stock very nearly entered our price band, touching Rs. 262.5 on November 10 & subsequently achieved our price target on November 27. Thereafter, the stock has corrected significantly, citing the above mentioned concerns. At current levels of Rs. 229.7, we feel that stock has factored in most of the negatives. The stock could trade at 21-22x FY11E EPS. Hence we recommend investors to buy it in the price band of Rs. 220-232 for a price target of Rs. 249 (21.5x FY11E EPS) over the next quarter.

Quarterly Financials:

(Rs. in Million)

Particulars	Dec-09	Dec-08	VAR [%]	Sep-09	VAR [%] (Q-o-Q)	Sep-08	VAR [%] (Y-o-Y)	Jun-09	Mar-09
Net Sales	45042.6	43077.1	4.6	42281.1	6.5	40278.7	5.0	44756.8	39883.3
Other Income	1078.5	1045.0	3.2	884.0	22.0	1304.3	-32.2	604.9	673.0
Total Income	46121.1	44122.1	4.5	43165.1	6.8	41583.0	3.8	45361.7	40556.3
Total Expenditure	37857.3	36146.5	4.7	36172.7	4.7	35515.5	1.9	37876.0	34390.5
PBIDT	8263.8	7975.6	3.6	6992.4	18.2	6067.5	15.2	7485.7	6165.8
Interest	1.9	43.9	-95.7	14.8	-87.2	65.0	-77.2	51.7	22.1
PBDT	8261.9	7931.7	4.2	6977.6	18.4	6002.5	16.2	7434.0	6143.7
Depreciation	450.1	405.7	10.9	462.4	-2.7	392.7	17.7	424.9	412.5
PBT	7811.8	7526.0	3.8	6515.2	19.9	5609.8	16.1	7009.1	5731.2
Tax (incl. DT & FBT)	1765.5	895.6	97.1	878.1	101.1	1231.0	-28.7	1642.5	710.4
PAT (pre-exceptional & extra-ord items)	6046.3	6630.4	-8.8	5637.1	7.3	4378.8	28.7	5366.6	5020.8
Extr. Ord. Items [gain /(loss)]	444.8	-473.0	-	-1351.8	-	1087.3	-	65.3	-1070.9
Reported PAT	6491.1	6157.4	5.4	4285.3	51.5	5466.1	-21.6	5431.9	3949.9
EPS (Rs.)	2.8	3.0	-8.9	2.6	7.2	2.0	28.6	2.5	2.3
Equity	2181.4	2179.5	0.1	2180.9	0.0	2179.2	0.1	2180.5	2179.9
Face Value	1.0	1.0	0.0	1.0	0.0	1.0	0.0	1.0	1.0
PBIDTM (%) (excl. other inc.)	16.0	16.1	-0.8	14.4	10.4	11.8	22.2	15.4	13.8
PBIDTM (%) (incl. other inc.)	18.3	18.5	-0.9	16.5	10.9	15.1	9.8	16.7	15.5
PBIT (%)	17.3	17.6	-1.3	15.4	12.3	14.1	9.6	15.8	14.4
PATM (%)	13.4	15.4	-12.8	13.3	0.7	10.9	22.6	12.0	12.6

(Source: Company, HDFC Sec)

Segmental Results:

(Rs. in Million)

Particulars	Q3FY10	Q3FY09	VAR [%]	Q2FY10	VAR [%] (Q-o-Q)
Segment Revenue					
Soaps & Detergents	20719.4	21234.2	-2.4	20036.9	3.4
Personal Products	13770.0	11923.4	15.5	11901.8	15.7
Beverages	5511.1	5106.3	7.9	5215.8	5.7
Export	2652.7	2667.7	-0.6	2270	16.9
Processed Foods	1871.9	1714.5	9.2	1739.2	7.6
Others (includes Chemicals. Water etc)	958.3	738.7	29.7	1070.5	-10.5
Ice Creams	367.5	342.7	7.2	503.6	-27.0
Total	45850.9	43727.5	4.9	42737.8	7.3
Segment Results					
Soaps & Detergents	2784.5	3501.00	-20.5	2726.2	2.1
Personal Products	4399.2	3914.10	12.4	3133.7	40.4
Beverages	817.3	651.20	25.5	887.3	-7.9
Export	75.3	155.50	-51.6	171.7	-56.1
Processed Foods	-12.5	-39.00	-	-9.3	-
Others (includes Chemicals. Water etc)	-149.5	-254.60	-	-98.4	-
Ice Creams	-37.4	-28.40	-	25.1	-249.0
Total	7876.9	7899.8	-0.3	6836.3	15.2
EBIT Margin (%)					
Soaps & Detergents	13.4	16.5	-305 bps	13.6	-17 bps
Personal Products	32.0	32.8	-88 bps	26.3	562 bps
Beverages	14.8	12.8	-208 bps	17.0	-218 bps
Export	2.8	5.8	-299 bps	7.6	-472 bps
Processed Foods	-0.7	-2.3	-	-0.5	-
Others (includes Chemicals. Water etc)	-15.6	-34.5	-	-9.2	-
Ice Creams	-10.2	-8.3	-	5.0	-
Total	17.2	18.1	-89 bps	16.00	118 bps

Capital Employed				
Soaps & Detergents	-2614.4	4889.7		-955.6
Personal Products	-911	799.8		-1530
Beverages	440.3	1209.2		-88.2
Export	1620.6	2893.1		2028.3
Processed Foods	-153.4	370.3		-74
Others (includes Chemicals. Water etc)	-991.6	-814.8		-1300.3
Ice Creams	457.8	509.4		374.6
Total	-2151.7	9856.7		-1545.2
Other Unallocable Items	31590	16942		24380.7
Total	29438.3	26798.7		22835.5

(Source: Company, HDFC Sec)

Financial Estimations:

Particulars	(Rs. in Million)			
	FY09#	FY10 (OE)*	FY10 (RE)*	FY11E
Net Sales	202393	186070	176081	195449
Core Operating Profit	26780	27231	26335	29708
Adjusted PAT	25216	23724	22550	25408
Equity	2180	2181	2181	2181
EPS	11.6	10.9	10.3	11.6
OPM (%)	13.2	14.6	15.0	15.2
PATM (%)	12.5	12.8	12.8	13.0

(Source: Company, HDFC Sec Estimates)

The company has changed its accounting year from December to March. Hence FY09 numbers are for 15- months period. Thus, year on year comparison becomes meaningless. Projections for FY10 & FY11 have been made for 12 months from April-March.

* OR - Original Estimates; RE - Revised Estimates

Analyst: Mehernosh Panthaki (mehernosh.panthaki@hdfcsec.com)

RETAIL RESEARCH Tel: (022) 3075 3400 Fax: (022) 2496 5066 Corporate Office

HDFC Securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066 Website: www.hdfcsec.com
Email: hdfcsecretailresearch@hdfcsec.com

Disclaimer: This document has been prepared by HDFC Securities Limited and is meant for sole use by the recipient and not for circulation. This document is not to be reported or copied or made available to others. It should not be considered to be taken as an offer to sell or a solicitation to buy any security. The information contained herein is from sources believed reliable. We do not represent that it is accurate or complete and it should not be relied upon as such. We may have from time to time positions or options on, and buy and sell securities referred to herein. We may from time to time solicit from, or perform investment banking, or other services for, any company mentioned in this document. **This report is intended for Retail Clients only and not for any other category of clients, including, but not limited to, Institutional Clients**