

July 30, 2009

ACCUMULATE

Price **Rs268** Target Price **Rs290**

Sensex **15,173**

Price Performance

(%)	1M	3M	6M	12M
Absolute	1	19	3	13
Rel. to Sensex	(2)	(14)	(37)	3

Source: Capitaline

Stock Details

Sector	FMCG
Reuters	HLL.BO
Bloomberg	HUVR@IN
Equity Capital (Rs mn)	2181
Face Value(Rs)	1
No of shares o/s (mn)	2181
52 Week H/L	306/185
Market Cap (Rs bn/USD mn)	584/12,075
Daily Avg Volume (No of sh)	4858772
Daily Avg Turnover (US\$m)	25.3

Shareholding Pattern (%)

	J'09	M'09	D'08
Promoters	52.0	52.1	52.1
FII/NRI	14.7	14.7	15.2
Institutions	14.9	15.1	15.1
Private Corp	2.8	2.6	2.0
Public	15.6	15.6	15.7

Pritesh Chheda, CFA
pritesh.chheda@emkayshare.com

+91 22 6612 1273

Sachin Bobade
sachin.bobade@emkayshare.com

+91 22 6624 2492

Hindustan Unilever

Result Update

Better Quality

In Q1FY10, Hindustan Unilever (HUL) reported (1) 7.7% yoy growth in its revenues to Rs45.3 bn, in line with our estimates (2) operating profit growth at 22.3% YoY to Rs7.5 bn – ahead of our estimate and (3) adjusted net profit declined 0.6% YoY to Rs5.4 bn – marginally below our estimate. The core consumer business reported 13% YoY growth with underlying volume growth of 2.0% YoY and price led growth of 11.0% YoY. Lower material costs and gains from operating leverage resulted in 200 bps YoY expansion in operating margins from 14.5% to 16.5% YoY – positive surprise. However, despite better operating performance, adjusted net profit decline by 0.6% YoY due to lower other income and higher tax outgo.

Our argument of margin expansion owing to fall in cost index is evident since Q5FY09 with sharp improvement in gross margins. But, gain from operating leverage in the quarter is a positive surprise with SG&A expenditure reducing from 16.5% of revenues in Q2CY08 to 14.5% in Q1FY10. We believe that, HUL is more likely to adopt competitive growth against profitable growth in ensuing quarters- restricting incremental gains to margins. A 180 bps jump in A&P spends to 12.4% of revenues, highest in last 16 quarters- indicates HUL strategy to attract consumer attention and arrest downside in value share and volume share. Consequently, we maintain our FY10E and FY11E earning estimates at Rs10.9/Share and Rs12.1/Share respectively. At CMP of Rs268/Share- HUL is trading at PER of 24.7X FY10E earnings and PER of 22.1X FY11E earnings. We maintain our positive bias on HUL, but due to short-term outperformance we downgrade rating from 'BUY' to 'ACCUMULATE with revised price target of Rs290/Share (Rs276/Share earlier) – valuing at 24X FY11E earnings –which is 5-year average multiple.

Adjusted net profit down 0.6% to Rs5.4 bn, marginally below estimates

HUL reported 7.7% YoY growth in revenues to Rs45.3 bn – in line with our estimates. Growth in revenues is attributed to 13.0% growth in domestic consumer business with underlying volume growth of 2.0% and price-led growth of 11.0%. The robust growth in consumer business was partially offset by planned decline in the exports business. At operational level, HUL has reported 110 bps improvement in gross margins from 47.7% to 48.8% - ahead of our expectation of 48.3%. Company has certainly benefited from fall in material costs in the current quarter. But, gain from operating leverage in the quarter is a positive surprise. HUL has reduced the combined costs of SG&A expenditure from 16.5% of revenues in Q2CY08 to 14.5% in Q1FY10. Consequently, the margins have improved from 14.5% to 16.5% - ahead of our estimates. However, sharp fall in other income (Rs17 mn in Q1FY10 versus Rs1.0 bn in Q2CY08) coupled with higher tax outgo at 23.4% of profit before taxes resulted in 0.6% yoy decline in adjusted net profit to Rs5.4 bn- below our estimates.

Financials

	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	AEPS (Rs)	EV/ EBITDA	Div Yld (%)	RoE (%)	P/E (x)
FY2008	139,134	19,033	13.7	19189	8.0	25.0	38.7	3.9	84.1
FY2009	208,330	30,065	14.4	24929	11.6	17.6	27.8	3.3	139.6
FY2010E	180,738	27,910	15.4	23665	10.9	18.8	24.9	3.6	106.4
FY2011E	198,196	30,715	15.5	26446	12.1	16.9	22.5	4.0	108.4

Segment level – mixed performance

HUL reported mixed performance at the segment level – (1) Personal product segment reported robust growth at 14.7% YoY to Rs12.3 bn (largely volume-led), but EBIT decline by 9.2% YoY due to higher A&P spends (2) Soap & Detergent reeled under impact of transition, thereby reporting abysmal volume growth, but value-wise growth was 9.5% YoY to Rs22.1 bn and EBIT grew by 28.4% YoY to Rs3.8 bn gaining from lower material costs (3) Beverages reported 18.6% YoY growth in revenues to Rs5.0 bn, largely led by price hikes and consequently 14.4% YoY growth in EBIT to Rs703 mn and (4) Ice creams grew at 23.0% YoY to Rs886 mn and EBIT growth at 12.9% to Rs137 mn. HUL reported strong volume growth in personal products, ice creams and beverages, but volume growth in soaps & detergents was abysmal.

Gains from cost reduction and operating leverage- is a positive surprise

At operational level, HUL has reported 110 bps improvement in gross margins from 47.7% to 48.8% - ahead of our expectation of 48.3%. Company has benefited from fall in material costs in the current quarter- argument mentioned in our report 'Drawing Parallel'. But, gain from operating leverage in the quarter is a positive surprise. HUL has reduced the combined costs of SG&A expenditure from 16.5% of revenues in Q2CY08 to 14.5% in Q1FY10. Consequently, the margins have improved from 14.5% to 16.5%- ahead of our estimates. Management believes that gains from cost reduction and leverage are sustainable.

A&P spends increased 25.7% YoY and stood at 12.4% of revenues-highest in last 16 quarters

The 110 bps gain from lower material costs and 200 bps gains from lower SG&A expenditure were offset by 180 bps increase in the A&P expenditure. HUL stepped-up A&P spends in Q1FY10 recording growth of 25.7% YoY to Rs5.6 bn. A&P spends at 12.4% of revenues are highest in last 16 quarters- despite the media deflation. Higher A&P spends are in sync with HUL's strategy to attract consumer attraction and arrest the fall in both value share and volume share. So far, success is achieved in consumer categories of Soap, Detergents and Skin Care – to protect the volume share. Whereas, true impact of the higher A&P spends on the value share - will be evinced in ensuing quarters. We believe that, strategy to enhance A&P spends and attract consumers - shall work favorably in combating competition and turbo-charging the subdued volume growth in select consumer categories.

6.0% volume growth in Q1FY10 on qoq basis – atleast hints at growth actions at play

HUL reported swing in volume growth – from decline of 4.2% YoY in Q5FY09 to 2.0% YoY in Q1FY10. Sharp uptick of volumes in consumer categories like Skin Care, Beverages and Ice Creams – contributed to change in volume growth. Further, strong volume growth in Q1FY10 – 6.0% improvement over Q5FY09 indicates an uptick in Soaps & Detergents – earlier facing competition due to relative pricing and positioning. We believe that, higher A&P spends at 12.4% of revenues, adjustments in relative pricing and positioning and re-launch of select brands like 'Liril', and 'Lifebuoy' – could revive the volume growth momentum.

Rating revised from 'BUY' to 'ACCUMULATE'

Our argument of margin expansion owing to fall in cost index is evident since Q5FY09 with sharp improvement in gross margins. But, gain from operating leverage in the quarter is a positive surprise with SG&A expenditure reducing from 16.5% of revenues in Q2CY08 to 14.5% in Q1FY10. We believe that, HUL is more likely to adopt competitive growth against profitable growth in ensuing quarters- restricting incremental gains to margins. A 180 bps jump in A&P spends to 12.4% of revenues, highest in last 16 quarters- indicates HUL strategy to attract consumer attention and arrest downside in value share and volume share. Consequently, we maintain our FY10E and FY11E earning estimates at Rs10.9/Share and Rs12.1/Share respectively. At CMP of Rs268/Share- HUL is trading at PER of 24.7X FY10E

earnings and PER of 22.1X FY11E earnings. We maintain our positive bias on HUL, but due to short-term outperformance we downgrade rating from 'BUY' to 'ACCUMULATE with revised price target of Rs290/Share (Rs276/Share earlier) – valuing at 24X FY11E earnings –which is 5-year average multiple.

Standalone Quarterly Results

(Rs Million)	Q1F109	Q1FY09	YoY Gr (%)	Q4FY09	QoQ Gr (%)
Net Sales	45,344.4	42,119.4	7.7%	40,353.7	12.4%
Expenditure	37,876.0	36,013.5	5.2%	34,390.5	10.1%
Material Cost	23,198.3	22,043.9	5.2%	20,856.4	11.2%
% of Sales	51.2%	52.3%	-120 bps	51.7%	-50 bps
Employee Expenses	2504.0	2539.1	-1.4%	2343.5	6.8%
% of Sales	5.5%	6.0%	-50 bps	5.8%	-30 bps
Other Expenses	6562.6	6968.5	-5.8%	6685.1	-1.8%
% of Sales	14.5%	16.5%	-210 bps	16.6%	-210 bps
Operating Profit	7468.4	6105.9	22.3%	5963.2	25.2%
EBIDTA (%)	16.5%	14.5%	200 bps	14.8%	170 bps
Other Income	17.3	1055.7	-98.4%	202.6	-91.5%
Interest	51.7	87.2	-40.7%	22.1	133.9%
Depreciation	424.9	379.2	12.1%	412.5	3.0%
PBT	7009.1	6695.2	4.7%	5731.2	22.3%
Tax	1642.5	1293.8	27.0%	710.4	131.2%
APAT	5366.6	5401.4	-0.6%	5020.8	6.9%
APAT (%)	11.8%	12.8%	-100 bps	12.4%	-60 bps
EPS	2.5	2.5	-0.7%	2.3	6.9%

Segmental Results (Revenues)

(Rs Mn)	Q1F109	Q1FY09	YoY Gr (%)	Q4FY09	QoQ Gr (%)
Segment Revenue					
Soaps and Detergents	22,115	20,205	9.5%	20,122	9.9%
Personal Products	12,255	10,680	14.7%	10,386	18.0%
Beverages	4,996	4,214	18.6%	4,893	2.1%
Processed Foods	1,721	1,500	14.7%	1,634	5.3%
Ice Creams	886	720	23.0%	453	95.6%
Exports	2,575	3,934	-34.6%	2,205	16.8%
Others	794	847	-6.2%	675	17.6%
Total	45,342	42,100	7.7%	40,367	12.3%

Segmental Results (EBIT)

(Rs Mn)	Q1F109	Q1FY09	YoY Gr (%)	Q4FY09	QoQ Gr (%)
Segment PBIT					
Soaps and Detergents	3,815	2,971	28.4%	3,335	14.4%
Personal Products	2,699	2,973	-9.2%	2,389	12.9%
Beverages	703	615	14.4%	655	7.4%
Processed Foods	-13	38	-133.9%	-45	-71.4%
Ice Creams	155	137	12.9%	-19	-932.3%
Exports	205	288	-28.7%	144	43.0%
Others	-279	-254	10.0%	-242	15.4%
Total	7,285	6,768	7.6%	6,218	17.2%

Segmental Results (EBIT Margins)

(Rs Mn)	Q5FY09	Q1CY08	YoY Gr (%)	Q4FY09	QoQ Gr (%)
Segment PBIT Margin					
Soaps and Detergents	17.2%	14.7%	250 bps	16.6%	70 bps
Personal Products	22.0%	27.8%	-580 bps	23.0%	-100 bps
Beverages	14.1%	14.6%	-50 bps	13.4%	70 bps
Processed Foods	-0.7%	2.5%	-330 bps	-2.7%	200 bps
Ice Creams	17.5%	19.0%	-160 bps	-4.1%	2160 bps
Exports	8.0%	7.3%	70 bps	6.5%	150 bps
Others	-35.2%	-30.0%	-520 bps	-35.9%	70 bps
Total	16.1%	16.1%	0 bps	15.4%	70 bps

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Emkay Global Financial Services Ltd.,

Paragon Center, H -13 -16, 1st Floor, Pandurang Budhkar Marg, Worli, Mumbai – 400 013.

Tel: +91-22-66121212, Fax: +91-22-66242410