

Hindustan Unilever

REDUCE

Slowdown in volume growth; concerns ahead

CMP: Rs481

Target Price: Rs448

HUL's results were below our estimates with – (1) revenue up 11.7% yoy to Rs66.5bn (2) operating profit up 12.2% yoy to Rs10.9bn and (3) APAT up 14.7% yoy to Rs8.8 bn. The growth of merely 5% yoy in domestic consumer volume was a disappointment. Also, HUL's plan to increase royalty will exert pressure on profitability ahead. Hence, we are lowering our EPS estimates for FY13 and FY14 from Rs15.3 and Rs17.1 to Rs15.1 and Rs16.0. Maintain Reduce with revised TP of Rs448.

Domestic business volume growth under pressure: Domestic consumer business revenue grew 14.9% yoy, driven by increase of 5% yoy in volume – lower than our estimate. This marked the lowest growth recorded by HUL in last 12 quarters, which can be attributed to increased competitive intensity in domestic market.

APAT below our estimate: Revenue grew 11.7% yoy to Rs66.5bn, while operating profit was up 12.2% yoy to Rs10.9bn. Operating margin remained flat at 16.4%, as a yoy decline of 100bps and 30bps in other expenses and RM costs was fully offset by a yoy increase of 80bps and 50bps in A&P spend and employee expenses. APAT jumped up by 14.7% yoy to Rs8.8 bn – below our estimate of Rs9.0 bn.

Margins decline in Soap and Detergent business: HUL's recent price hikes helped its soap and detergent business record a revenue growth of 19.8% yoy. However, increased investments in branding and cost pressures impacted its EBIT performance, with its EBIT margin down 100 bps yoy to 12.4%.

Margin improvement in Personal Products a surprise: After recording a revenue growth of merely 8.2% yoy in Q2, PP bounced back with a revenue growth of 13.0% yoy in Q3. Also, the segment's EBIT margin expanded by 140bps yoy to 28.3%, marking its first margin expansion in Q3 in the last four years, which came as a surprise.

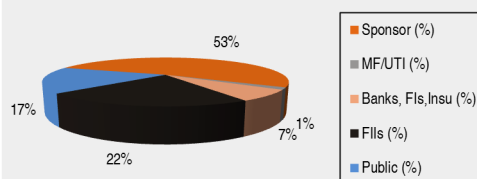
- Corporate development
- Earnings estimate change
- Target price change
- Rating change

KEY DATA

Bloomberg	HUVR IN
Reuters	HLL.BO
52-wk H/L (Rs)	572.0/368.9
6-m avg trd value	US\$23.0mn
Market cap	Rs1039.7bn/US\$19.4bn
Shares o/s	2,162.0mn
Face value	Re1

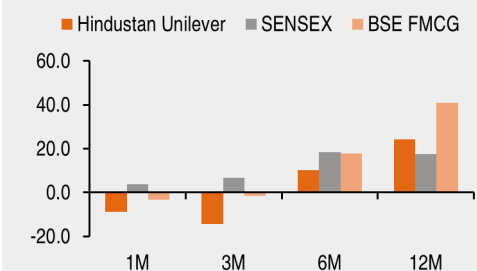
Source: Bloomberg

SHAREHOLDING (%)



Source: Ace equity

PRICE PERFORMANCE



Source: Bloomberg

KEY FINANCIALS	(Rs mn)			
Y/E 31 March	2011	2012	2013E	2014E
Revenue	196,945	221,164	257,097	291,204
EBITDA	26,693	33,264	39,629	42,496
EBITDA margin (%)	13.6	15.0	15.4	14.6
PAT	23,060	26,914	38,559	34,565
FDEPS (Rs)	10.0	12.0	15.1	16.0
% growth	3.4	19.9	25.6	6.3
P/E (x)	48.1	40.1	31.9	30.0
RoCE avg (%)	93.0	96.3	77.9	69.7

Source: Company, BRICS Research

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Mixed performance in other businesses; disappointment in packaged foods continues: Beverages delivered a strong performance, with sales up 18.2% yoy to Rs7.9bn and EBIT up 33.5% yoy to Rs1.4bn. However, packaged foods continued to disappoint, with a growth of merely 7.7% yoy to Rs3.3bn and an EBIT loss of Rs26 mn in the quarter.

Exhibit 1: Q3FY13 segmental performance

Segment Revenues	Q3FY13	Q3FY12	YoY Growth	Q2FY13	QoQ Growth
Soaps and Detergents	31,712	26,481	19.8%	31,762	-0.2%
Personal Products	20,489	18,134	13.0%	17,445	17.4%
Beverages	7,929	6,709	18.2%	7,196	10.2%
Packaged Foods	3,301	3,067	7.7%	3,663	-9.9%
Others	2,902	5,104	-43.1%	2,884	0.6%
Total	66,334	59,495	11.5%	62,949	5.4%
Segment PBIT	Q3FY13	Q3FY12	YoY Growth	Q2FY13	QoQ Growth
Soaps and Detergents	3,937	3,559	10.6%	4,536	-13.2%
Personal Products	5,789	4,865	19.0%	4,226	37.0%
Beverages	1,404	1,052	33.5%	1,031	36.2%
Packaged Foods	-26	-60	-55.9%	9	-392.2%
Others	-186	359	-151.9%	21	-1009.3%
Total	10,917	9,776	11.7%	9,822	11.2%
PBIT Margin	Q3FY13	Q3FY12	YoY Growth	Q2FY13	QoQ Growth
Soaps and Detergents	12.4%	13.4%	-100 bps	14.3%	-190 bps
Personal Products	28.3%	26.8%	140 bps	24.2%	400 bps
Beverages	17.7%	15.7%	200 bps	14.3%	340 bps
Packaged Foods	-0.8%	-1.9%	120 bps	0.2%	-100 bps
Others	-6.4%	7.0%	-1350 bps	0.7%	-710 bps
Total	16.5%	16.4%	0 bps	15.6%	90 bps

Source: BRICS Research, Company

Increase in royalty to hit profitability: According to the current Technical Collaboration Agreement (TCA), HUL pays 1% royalty on net sales of specific products manufactured with technical inputs developed by Unilever and as per the Trade Mark License Agreement (TMLA), it pays 1% of net sales on specific brands, where Unilever owns the trade mark and HUL is the licensed user. On an aggregate, HUL pays 1.4% of the annual turnover to Unilever. However, as per the new agreement, the royalty cost will increase to 3.15% in a phased manner until March 31, 2018.

In the first phase i.e. starting from February 1, 2013 to March 31, 2013, the royalty payment will increase by 50bps from the current level.

Thereafter, the royalty payment will increase by 30-70 bps annually to reach 3.15% by FY2018

Headwinds persist: HUL's Q3FY13 results were not very encouraging. Moreover, we see more headwinds than catalysts for future growth. We believe that the headwinds related to – (1) escalating completion (2) unfavourable base and (3) firm commodity prices will act as hurdles to future growth.

Lowering FY13 and FY14 estimates: HUL's earnings came in below our estimates due higher than expected A&P spend and lower volume growth. Moreover, an increase in royalty payment is likely to act as a drag on future growth. Consequently, we have lowered our earnings estimates for FY13 and FY14 from Rs15.3 and Rs17.1 to Rs15.1 and Rs16.0.

Exhibit 2: Q3FY13 results marginally below our estimates

Rs mn	Dec 2012A	Dec 2012E	% Difference	Dec 2011A	% yoy growth	Sep 2012A	qoq growth
Revenue	66,548	64,803	2.7%	59,555	11.7%	63,108	5.5%
EBITDA	10,888	11,002	-1.0%	9,705	12.2%	9,767	11.5%
OPM (%)	16.4%	17.0%	0 bps	16.3%	70 bps	15.5%	30 bps
PAT	8,786	8990	-2.3%	7,662	14.7%	8,053	9.1%
EPS	4.1	4.2	-2.3%	3.5	14.7%	3.7	9.1%

Source: BRICS Research, Company

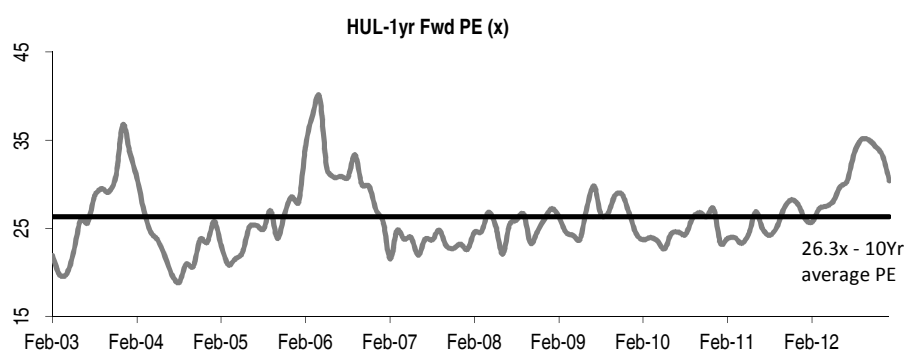
Exhibit 3: Lowering estimates

Rs Mn	Old Estimates		New Estimates		% Change	
	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Revenue	257,097	291,204	257,097	291,204	0.0%	0.0%
EBITDA	40,641	44,110	39,629	42,496	-2.5%	-3.7%
OPM (%)	15.8%	15.1%	15.4%	14.6%	70 bps	40 bps
PAT	32,939	36,848	32,512	34,565	-1.3%	-6.2%
EPS	15.3	17.1	15.1	16.0	-1.3%	-6.2%

Source: BRICS Research

Lowering valuation multiple assigned to HUL, in view of higher risks attached to the stock: In light of the headwinds that could impact the company's performance in the coming quarters, we are lowering our target multiple from 29x to 28x – though it is still at a premium to its peer group. Consequently, we have arrived at our revised target price of Rs448. Maintain Reduce.

Exhibit 4: 10yrs average PE



Source: BRICS Research

Financial summary

Income statement					Balance sheet				
(Rs mn)					(Rs mn)				
Y/E 31 March	2011	2012	2013E	2014E		2011	2012	2013E	2014E
Revenue	196,945	221,164	257,097	291,204	Net fixed assets	24,682	23,629	23,764	23,762
Revenue growth (%)	10.9	12.3	16.2	13.3	Investments	12,607	24,382	24,382	24,382
Operating exp	170,252	187,900	217,468	248,708	Current assets	60,952	56,568	74,064	94,066
EBITDA	26,693	33,264	39,629	42,496	Inventories	28,113	25,166	36,699	41,567
EBITDA margin (%)	13.6	15.0	15.4	14.6	Sundry debtors	9,432	6,790	12,313	13,946
Depreciation	2,208	2,183	2,365	2,502	Cash & bank balance	16,400	15,439	16,013	28,362
EBIT	24,484	31,081	37,264	39,994	Loans & advances	6,654	8,820	8,686	9,838
MTM profit / (loss)	—	—	—	—	Other current assets	354	353	353	353
Other income	2,879	2,590	6,685	7,029	Total assets	100,338	106,722	124,353	144,353
Interest paid	2	12	248	248	Net worth	24,180	30,109	45,680	55,252
PBT	27,361	33,659	43,701	46,775	Share capital	2,160	2,160	2,160	2,160
Tax	5,769	7,776	11,189	12,210	Reserves & surplus	22,020	27,949	43,520	53,092
PAT	23,060	26,914	38,559	34,565	Minority interest	—	—	—	—
Minority interest	—	—	—	—	Total debt	—	—	—	—
EO income	1,468	1,031	6,047	—	Secured loans	—	—	—	—
APAT	21,592	25,883	32,512	34,565	Unsecured loans	—	—	—	—
PAT growth (%)	4.7	16.7	43.3	(10.4)	Current liabilities & prov	73,999	74,453	82,561	92,989
Shares o/s (mn)	2,162	2,162	2,162	2,162	Current liabilities	60,749	64,487	72,594	83,022
Fully diluted o/s shrs (mn)	—	1,959	1,959	1,959	Provisions	13,250	9,966	9,966	9,966
FDEPS (Rs) recurring	10.0	12.0	15.1	16.0	Net deferred tax liab	—	—	—	—
					Total liabilities	100,338	106,722	130,400	150,400
Cash flow statement					Key ratios				
(Rs mn)									
Y/E 31 March	2011	2012	2013E	2014E	Y/E 31 March	2011	2012	2013E	2014E
PBT	27,361	33,659	43,701	46,775	Valuation ratios				
Depreciation	2,208	2,183	2,365	2,502	PE (x)	48.1	40.1	31.9	30.0
Amortisation	—	—	—	—	CEPS (Rs)	11.0	13.0	16.1	17.1
Interest paid	2	12	248	248	PCE (x)	43.7	37.0	29.8	28.0
Tax paid	5,769	7,776	11,189	12,210	BVPS (Rs)	11	14	21	26
Chg in working capital	(1,534)	3,878	(8,814)	2,774	Price/Book (x)	43.0	34.5	22.8	18.8
Int/div in other income	—	—	—	—	EV/EBITDA (x)	38.3	30.8	25.8	23.8
Other operations	1,229	986	—	—	EV/Revenue (x)	5.2	4.6	4.0	3.5
CF from operations (a)	22,681	32,929	26,063	39,841	Dividend yield (%)	1.6	1.7	1.9	2.1
Capital expenditure	(2,992)	(1,129)	(2,500)	(2,500)	Cash flow yield (%)	1.9	1.9	2.3	3.6
Chg in investments	564	(11,775)	—	—	Performance ratios				
Other investing act	—	—	—	—	Raw material to sales (%)	51.1	53.1	52.3	52.0
Int/div in other income	—	—	—	—	SGA to sales (%)	26.8	23.5	23.8	25.0
CF from investments (b)	(2,428)	(12,905)	(2,500)	(2,500)	Effective tax rate (%)	21.1	23.1	25.6	26.1
Free cash flow (a+b)	20,253	20,024	23,563	37,341	PAT margin (%)	11.7	12.2	15.0	11.9
Equity raised/(repaid)	—	—	—	—	DPS (Rs)	7.7	8.4	9.2	10.0
Debt raised/(repaid)	(6,219)	—	—	—	Dividend payout ratio (%)	77	70	61	62
Interest paid	2	12	248	248	Return ratios				
Dividend (incl tax)	(16,556)	(20,985)	(22,989)	(24,993)	RoE avg (%)	90.3	95.4	85.8	68.5
Other fin activities	—	—	—	—	RoCE avg (%)	93.0	96.3	77.9	69.7
CF from financing (c)	(22,775)	(20,985)	(22,989)	(24,993)	Fixed asset turnover (x)	8.0	9.2	10.8	12.3
Net chg in cash (a+b+c)	(2,522)	(961)	574	12,349	Working capital ratios				
Opening balance	18,922	16,400	15,439	16,013	Inventory (days)	52	52	52	52
Closing balance	16,400	15,439	16,013	28,362	Payable (days)	12	12	12	12
					Receivable (days)	17	11	17	17
					Working capital (days)	57	51	57	57
					Leverage ratios				
					Interest cost (%)	—	—	—	—
					Net debt/equity (x)	(0.7)	(0.5)	(0.4)	(0.5)
					Interest coverage (x)	10,201.8	2,506.6	150.3	161.3

BRICS RECOMMENDATION SCALE

BUY:	More than 15% upside
ADD:	Upside up to 15% (between 0% and 15%)
REDUCE:	Downside up to 15% (between 0% and -15%)
SELL:	More than 15% downside

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