

23 January 2013

Hindustan Unilever

Royalty increase to impact earnings; Sell

Rating: **Sell**

Target Price: ₹466

Share Price: ₹482

Key takeaways

Subdued volume growth. Hindustan Unilever (HUL) reported 10.1% yoy revenue growth, with volumes increasing just 5% yoy, the lowest in the past 12 quarters. Soaps & detergent revenues were up 19.8%, personal products 13%, beverages 18.2% and foods 7.7%. Despite the 100-bp rise in ad-spend (as percent of net sales), volume growth came at a disappointing 5%.

Higher other income drives earnings. Higher ad-spend pulled the EBITDA margin down 120bps. The soaps and detergents EBIT margin was down 102bps, but those of personal products, beverages and foods expanded 142bps, 203bps and 115bps respectively. Other income was up 85% yoy. The effective income tax rate was up 110bps. Net profit expanded 14.7% yoy.

Increase in royalty payments. For the second time in the past three years higher royalties have had to be paid to the parent company. They would be further raised from 1.4% now to 3.15% by FY18, increasing by 0.5% of net sales in FY14 and 30-70bps each year till FY18. We believe earnings would thus be impacted 3.1% in FY14 and 7.7% in FY15.

Entry in small segments to result in higher ad-spend. HUL has continued to enter small segments such as Dove Elixir hair oil. Previously it had entered segments such as health-food drinks, spreads and liquid blue. These would require more investment in brand building without contributing meaningfully to revenues or profits, at least in the short term.

Our take. Less ad-spend is causing volume growth to drop. Ahead we expect savings in lower raw material prices to be ploughed back into ad-spend. Royalty payments to the parent would also rise and eat into profits and return ratios. Chances of margin expansion in the next two years are slim. The earnings CAGR in the next two years is expected to be subdued, at 12%. We value the stock at a target PE of 27x FY14e earnings and arrive at a target of ₹466. **Risks.** Lower raw material prices.

Quarterly results (YE Mar)	3QFY12	3QFY13	% yoy	9MFY12	9MFY13	% yoy
Sales (₹m)	58,443	64,337	10.1	168,704	188,393	11.7
EBITDA (₹m)	8,593	8,677	1.0	22,764	25,268	11.0
EBITDA margin (%)	14.7	13.5	(120) bps	13.5	13.4	(10) bps
Interest (₹m)	5	75	1,573.3	10	191	1,795.0
Depreciation (₹m)	568	593	4.3	1,701	1,746	2.6
Other income (₹m)	1,913	3,549	85.5	4,834	9,000	86.2
PBT (₹m)	9,933	11,557	16.3	25,887	32,331	24.9
Tax (₹m)	2,271	2,771	22.0	6,096	8,027	31.7
Tax rate (%)	22.9	24.0	110 bps	23.5	24.8	130 bps
PAT (₹m)	7,662	8,786	14.7	19,791	24,305	22.8

Source: Company

Key data	HUVR IN / HLL.BO
52-week high / low	₹580 / ₹375
Sensex / Nifty	19982 / 6049
3-m average volume	US\$21.8m
Market cap	₹1041bn / US\$19bn
Shares outstanding	2,162m

Shareholding pattern (%)	Dec '12	Sep '12	Jun '12
Promoters	52.5	52.5	52.5
- of which, Pledged	0.0	0.0	0.0
Free Float	47.5	47.5	47.5
- Foreign Institutions	21.7	21.1	20.1
- Domestic Institutions	8.5	9.0	9.9
- Public	17.3	17.4	17.5

Financials (YE Mar)	FY13e	FY14e
Sales (₹m)	269,332	309,163
Net profit (₹m)	32,644	37,314
EPS (₹)	15.1	17.3
Growth (%)	21.9	14.3
PE (x)	31.9	27.9
PBV (x)	23.4	19.3
RoE (%)	82.3	75.6
RoCE (%)	86.4	89.8
Dividend yield (%)	1.9	2.3
Net gearing (%)	(98.4)	(102.8)

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Net revenues	196,910	234,363	269,332	309,163	353,925
Revenue growth (%)	12.0	18.9	14.9	14.8	14.5
- Op. expenses	173,139	199,528	227,090	260,476	299,779
EBITDA	23,771	34,836	42,241	48,687	54,146
EBITDA margin (%)	12.1	14.9	15.7	15.7	15.3
- Interest expenses	10	17	606	131	56
- Depreciation	2,293	2,335	2,566	2,923	3,213
+ Other income	5,893	2,596	4,589	4,926	5,854
- Tax	5,919	8,215	10,915	13,145	15,318
Effective tax rate (%)	21.6	23.4	25.0	26.0	27.0
Reported PAT	21,442	26,865	32,744	37,414	41,415
+/- Extraordinary items	1,624	1,137	-	-	-
+/- Minority interest	106	95	100	100	100
Adjusted PAT	22,961	27,907	32,644	37,314	41,315
Adj. FDEPS (₹/share)	9.9	12.4	15.1	17.3	19.1
Adj. FDEPS growth (%)	2.8	25.3	21.9	14.3	10.7

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹m)

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
Share capital	2,160	2,162	2,162	2,162	2,162
Reserves & surplus	24,934	34,649	44,533	54,028	62,466
Net worth	27,094	36,811	46,694	56,190	64,628
Minority interest	146	183	283	383	483
Total debt	27	10,060	2,060	560	560
Def. tax liab. (net)	(2,070)	(2,099)	(2,099)	(2,099)	(2,099)
Capital employed	25,196	44,954	46,938	55,033	63,571
Net fixed assets	25,231	24,905	27,339	29,416	31,204
Investments	11,885	27,030	35,030	43,030	51,030
- of which, Liquid	11,885	27,030	35,030	43,030	51,030
Net working capital	(29,793)	(26,945)	(31,135)	(35,431)	(40,408)
Cash and bank balance	17,873	19,964	15,704	18,019	21,747
Capital deployed	25,196	44,954	46,938	55,033	63,571
Net debt	(31,801)	(39,034)	(50,773)	(62,588)	(74,316)
WC days	(15.1)	(11.5)	(11.6)	(11.5)	(11.4)
Book value (₹/sh)	11.6	16.1	20.6	25.0	28.9

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹m)

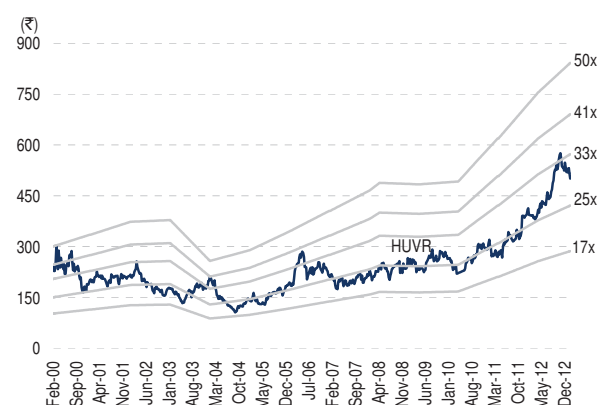
Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
PAT	22,961	27,907	32,644	37,314	41,315
+ Non-cash items	2,293	2,335	2,566	2,923	3,213
Cash profit	25,253	30,242	35,210	40,237	44,527
- Incr./Decr. in WC	(1,521)	(7,545)	4,190	4,297	4,977
Operating cash-flow	20,688	22,571	39,500	44,633	49,604
- Capex	(3,106)	(2,734)	(5,000)	(5,000)	(5,000)
Free cash-flow	17,582	19,837	34,500	39,633	44,604
- Dividend	(16,619)	(8,762)	(22,761)	(27,819)	(32,876)
+ Equity raised	(6,219)	336	-	-	-
+ Debt raised	(82)	-	(8,000)	(1,500)	-
- Investments	848	(5,794)	(8,000)	(8,000)	(8,000)
- Misc. items	2,239	1,307	-	-	-
Net cash-flow	(2,251)	6,925	(4,260)	2,315	3,728
+ Op. cash & bank bal.	20,124	2,505	19,964	15,704	18,019
Cl. cash & bank bal.	17,873	9,430	15,704	18,019	21,747

Source: Company, Anand Rathi Research

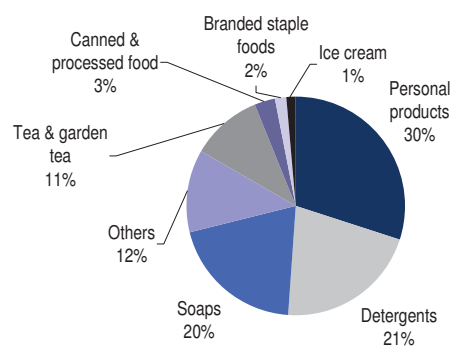
Fig 4 – Ratio analysis @₹482

Year-end: Mar	FY11	FY12	FY13e	FY14e	FY15e
P/E (x)	48.8	38.9	31.9	27.9	25.2
P/B (x)	41.6	30.0	23.4	19.3	16.7
EV/Sales (x)	5.1	4.3	3.7	3.3	2.9
EV/EBITDA (x)	42.4	29.0	23.9	20.7	18.6
RoAE (%)	86.7	89.6	82.3	75.6	70.9
RoACE (%)	86.6	92.7	86.4	89.8	85.9
Dividend yield (%)	1.3	1.6	1.9	2.3	2.7
Dividend payout (%)	65.8	60.6	59.6	63.7	68.0
RM to sales (%)	51.3	53.3	52.0	52.0	52.4
Ad spend to sales (%)	14.2	11.5	12.0	12.0	12.0
EBITDA growth (%)	(7.7)	46.5	21.3	15.3	11.2
EPS growth (%)	2.8	25.3	21.9	14.3	10.7
PAT margin (%)	10.9	11.5	12.2	12.1	11.7
Volume growth (%)	-	-	-	-	-
Real. growth (%)	-	-	-	-	-

Source: Company, Anand Rathi Research

Fig 5 – Valuation chart (PE band)


Source: Bloomberg, Anand Rathi Research

Fig 6 – Revenue break-up (FY12)


Source: Company

Result highlights

Fig 7 – Segment-wise break-up

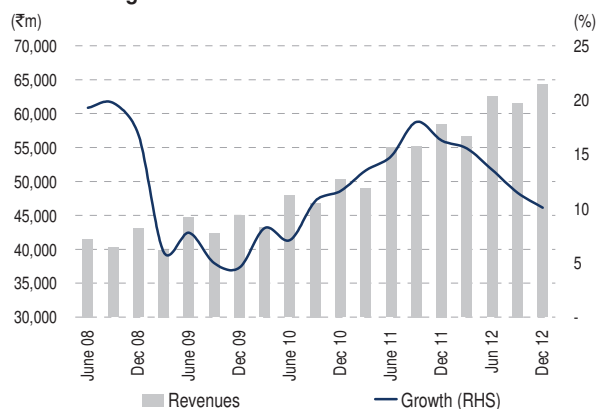
(₹m)	3QFY12	3QFY13	Growth (%)	9MFY12	9MFY13	Growth (%)
Soaps & Detergents	26,481	31,712	19.8	78,019	95,104	21.9
Personal Products	18,134	20,489	13.0	49,519	56,405	13.9
Beverages	6,709	7,929	18.2	19,343	21,666	12.0
Foods	3,067	3,301	7.7	10,114	11,334	12.1
Other Operations	5,104	2,902	(43.1)	14,400	8,425	(41.5)
Total	59,495	66,334	11.5	171,394	192,935	12.6
EBIT						
Soaps & Detergents	3,559	3,937	10.6	9,132	12,325	35.0
Personal Products	4,865	5,789	19.0	12,937	14,771	14.2
Beverages	1,052	1,404	33.5	2,683	3,384	26.1
Foods	(60)	(26)	(55.9)	279	231	(17.3)
Other Operations	359	(186)	(151.9)	734	(209)	(128.5)
Total	9,776	10,917	11.7	25,765	30,501	18.4
EBIT Margin						
Soaps & Detergents	13.4	12.4		35.0	38.9	
Personal Products	26.8	28.3		78.3	78.2	
Beverages	15.7	17.7		41.5	46.5	
Foods	(1.9)	(0.8)		7.7	5.1	
Other Operations	7.0	(6.4)		15.1	(7.4)	
Total	16.4	16.5		45.0	47.4	

Source : Company

Weaker volume growth

HUL reported 10.1% yoy revenue growth. Volume growth was 5% yoy, the lowest of the past 12 quarters. The soaps and detergents segment reported 19.8% yoy revenue growth. Personal products revenues were up 13% yoy, beverages revenues 18.2%, and foods reported 7.7% yoy revenue growth. Despite the 100-bp increase in ad-spend, volume growth was subdued.

Fig 8 – Revenues and growth rates

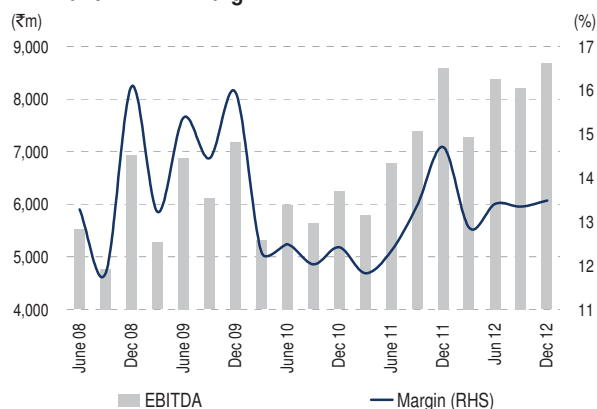


Source : Company

EBITDA margin lower due to higher ad-spend

The EBITDA margin was down 120bps yoy due to the 100-bp increase in ad-spend (as percent of net sales). The EBIT margin in the soaps and detergents division was down 102bps. Other segments such as personal products, beverages and foods saw margins expanding 142bps, 203bps and 115bps respectively.

Fig 9 – EBITDA and EBITDA margin

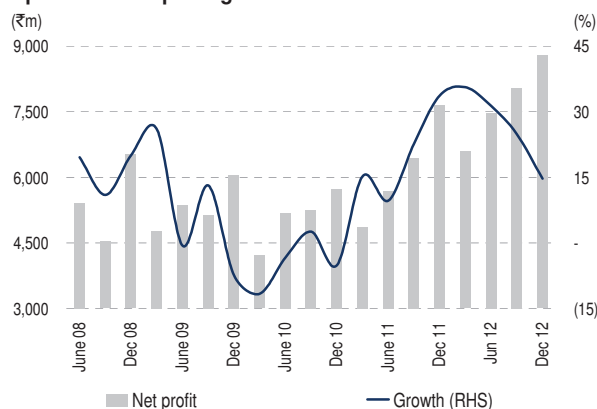


Source : Company

Higher other income helps net profit growth of 14.7%

Despite a weaker operational performance, higher other income (up 85% yoy) resulted in the company posting 14.7% net profit growth. In 3QFY13, other income was 31% of net sales, against 19% in 3QFY12. The effective income tax rate was up 110bps.

Fig 10 – Net profit and net profit growth rates



Source : Company

Increase in royalty payments

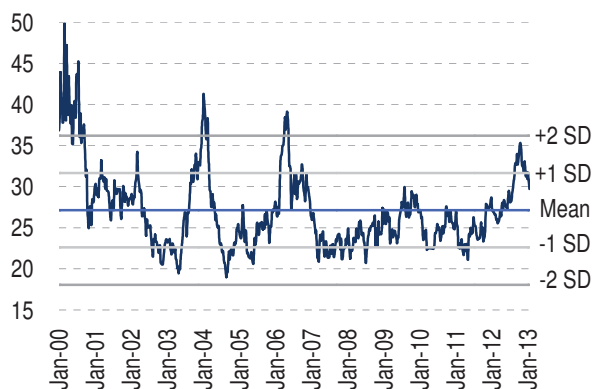
For the second time in the past three years, HUL has had to pay higher royalties to its parent company. From current levels of 1.4% (of net sales) we expect royalty payments to come at 3.15% by FY18. The amount of royalty would increase by 0.5% of net sales in FY14 and by 30-70bps every year till FY18. We believe that this would result in earnings being impacted 3.1% in FY14 and 7.7% in FY15.

Valuation

Less ad-spend has resulted in volume growth dropping. Ahead, we expect any savings in lower raw material prices to be ploughed back into ad-spend. Also, the amount of royalties paid to the parent increasing would cut into profitability. Chances of margin expansion in the next two years appear slim. The earnings CAGR over the next two years is expected to be subdued, at 12%.

We value the stock at a target PE of 27x FY14e earnings and arrive at a price target of ₹466.

Fig 11 – Mean PE and standard deviations



Source : Anand Rathi Research

Risks

- Lower raw material prices.
- Less competitive pressure.

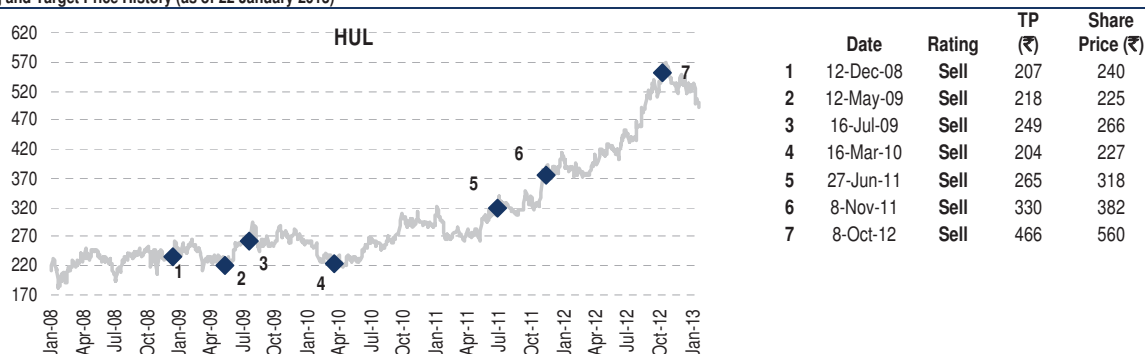
Appendix

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