



# Hindustan Unilever

BSE SENSEX 18,694 S&P CNX 5,647

**CMP: INR527**

**TP: INR515**

**Neutral**



| Bloomberg             | HUVR IN  |
|-----------------------|----------|
| Equity Shares (m)     | 2,159.5  |
| 52-Week Range (INR)   | 554/319  |
| 1,6,12 Rel. Perf. (%) | -4/18/44 |
| M.Cap. (INR b)        | 1,138    |
| M.Cap. (USD b)        | 21.3     |

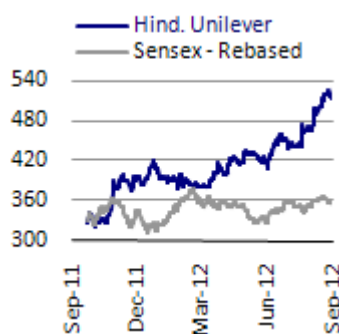
## Valuation summary (INR b)

| Y/E March      | 2012        | 2013E       | 2014E       |
|----------------|-------------|-------------|-------------|
| Net Sales      | 217.4       | 258.1       | 288.8       |
| EBITDA         | 32.9        | 41.4        | 47.6        |
| NP             | 25.7        | 33.5        | 39.0        |
| EPS (INR)      | 11.9        | 15.5        | 18.0        |
| EPS Gr. (%)    | 19.5        | 30.3        | 16.2        |
| BV/Sh. (INR)   | 16.0        | 21.5        | 28.5        |
| <b>P/E (x)</b> | <b>44.2</b> | <b>33.9</b> | <b>29.2</b> |
| P/BV (x)       | 33.0        | 24.5        | 18.5        |
| EV/EBITDA (x)  | 33.6        | 27.4        | 23.8        |
| EV/Sales (x)   | 5.0         | 4.4         | 3.9         |
| RoE (%)        | 87.3        | 92.0        | 81.2        |
| RoCE (%)       | 124.1       | 118.8       | 103.6       |

## Shareholding pattern %

| As on     | Jun-12 | Mar-12 | Jun-11 |
|-----------|--------|--------|--------|
| Promoter  | 52.5   | 52.5   | 52.5   |
| Dom. Inst | 9.9    | 10.3   | 11.8   |
| Foreign   | 20.4   | 19.8   | 18.7   |
| Others    | 17.2   | 17.4   | 17.0   |

## Stock performance (1 year)



Investors are advised to refer through disclosures made at the end of the Research Report.

## Demand as usual; high base awaits 2HFY13

Positive on medium- and long-term prospects; Neutral on rich valuations

Key takeaways from our recent interaction with Hindustan Unilever (HUVR) management:

- Consumer demand remains healthy except for moderation in some discretionary categories in Foods and Personal Care. This moderation seems temporary; long-term potential of these categories remains unchanged.
- HUVR does not rule out entering the premium Hair Oil category. However, it would not play in the commoditized part of the segment.
- Correction in input prices may increase competition in the lower end of HPC categories. However, HUVR is seeing growth across all segments (premium, mid and mass), and hence sees limited impact, if any, of rising regional competition induced by potential correction in input costs.
- Recovery in Oral care category will be gradual. Recent launches in sensitive part of the category (Pepsodent Expert Protection Range and Mouthwash) have been well accepted. More corrective actions are likely in the category.
- We expect 8-9% volume growth in 2QFY13. However, limited pricing action and comparatively higher base should restrict margin expansion. We estimate 60bp YoY operating margin expansion.
- HUVR's medium-term growth will be driven by tailwind benefits from the recent distribution expansion as well as aggressive innovation/new launch funnel. While we are positive on HUVR's medium- and long-term prospects, the stock trades at multi-year high P/E of 34x FY13E and 29x FY14E, which adequately captures the positives. Maintain Neutral.

## No major change in demand scenario barring moderation in some discretionary segments

- HUVR has not seen any material change in consumer demand for its categories. Despite concerns around monsoon (which later has improved significantly), demand remains healthy barring some moderation in discretionary part of the Foods and Personal Care categories.
- Growth moderation in Processed Foods and Premium Personal Care (e.g. skin lightening) is owing to prevailing high consumer price inflation and uncertain macroeconomic environment.
- Secular, long-term potential of these categories remains unchanged. Low per capita consumption and under-penetration coupled with favourable demographics will sustain long-term growth.

## SOAPS & DETERGENTS: Growth to be price led; limited room for margin expansion

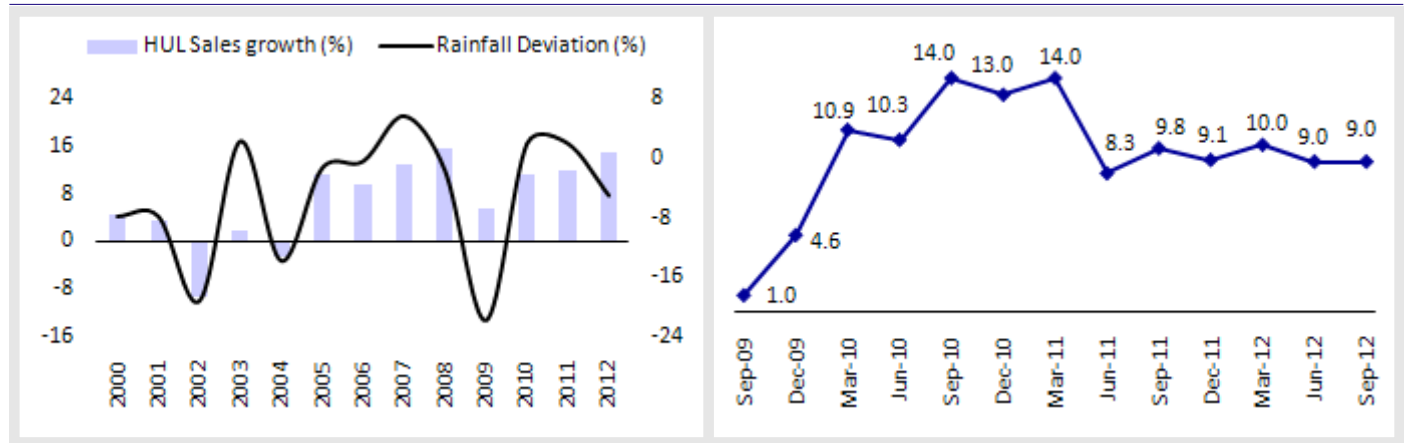
- Expect growth in the Soaps & Detergents segment to be price driven. The category has not seen material pricing action during the quarter; thus, pricing

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**Monsoon no longer as relevant for HUVR's revenue growth**

**Expect healthy volume growth to sustain in 2QFY13...**



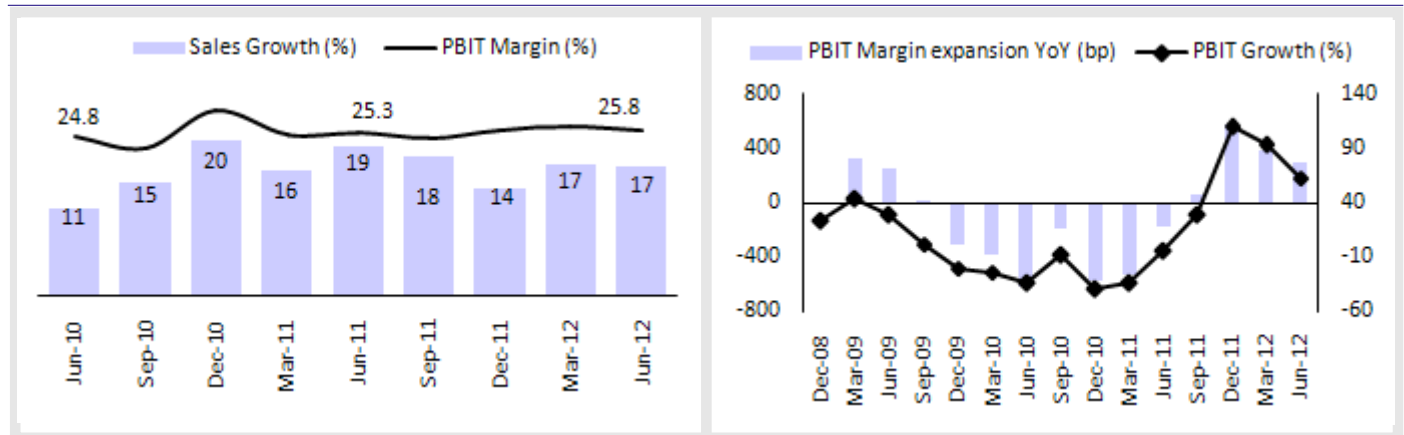
Source: Company, MOSL

growth is an impact of price hikes taken during previous quarters. Impact of price hikes will start fading once the price hikes start “anniversarizing” going forward.

- Competitive intensity in key categories of HPC remains high. While rationality has returned to pricing in detergents (~20% price hikes in mid detergents in past 12 months), there is no let down in intensity from P&G. Our recent channel checks suggest P&G delivered ~20% volume growth in July 2012 in Detergents category.
- Advantage of low base for EBIT margins will no longer be available for HUVR beginning 2QFY13. Hence, extent of margin expansion will be limited vis-a-vis recent quarters.

**Pricing will drive Soaps & Detergents topline ....**

**... but margins will not have the advantage of low base from 2QFY13**



Source: Company, MOSL

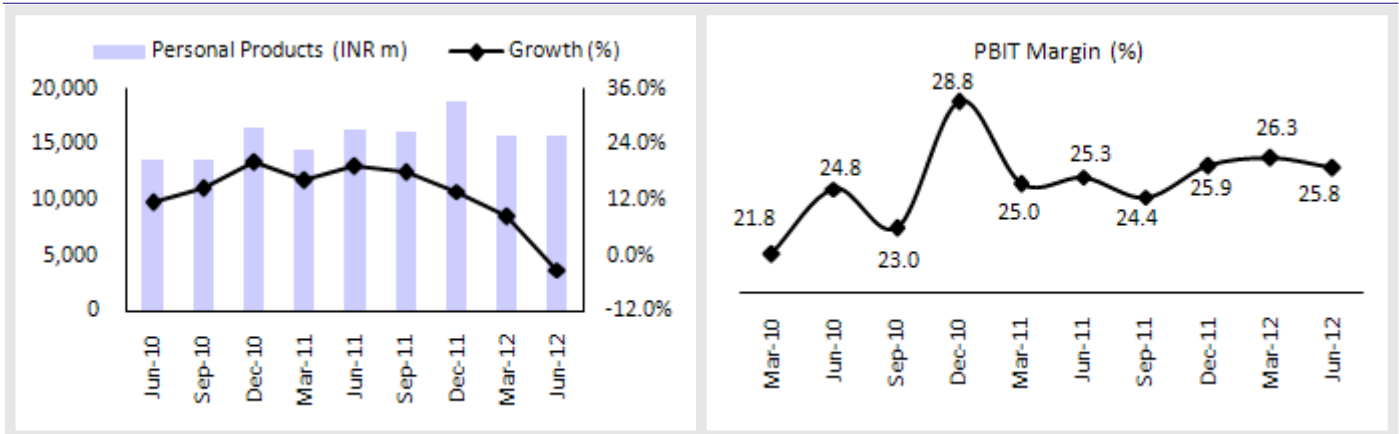
**PERSONAL CARE: Volumes to drive growth**

- Performance of Personal Care will be volume led, notwithstanding the deceleration in discretionary part of the skin care portfolio.
- Oral care should witness gradual recovery. While recent launches in *Pepsodent* (intended to fill category gaps e.g. Expert Protection Range) are well accepted, more corrective actions are likely.
- HUVR does not rule out the possibility of entering the Premium Hair Oil category. It is already present through Clinic Plus and Clear brands. However, it does not intend to focus on commoditized part of the category. This, in our view, precludes its entry into Coconut Hair Oil segment. HUVR had sold its Nihar brand in 2006 to Marico and vacated the space.

- HUVR’s latest launch in Hair Care, Tressme Shampoo is positioned on a niche platform (consumers who need salon experience). Hence, it does not expect any meaningful cannibalization.

Personal Care growth will be volume led ...

... margins to remain in a range



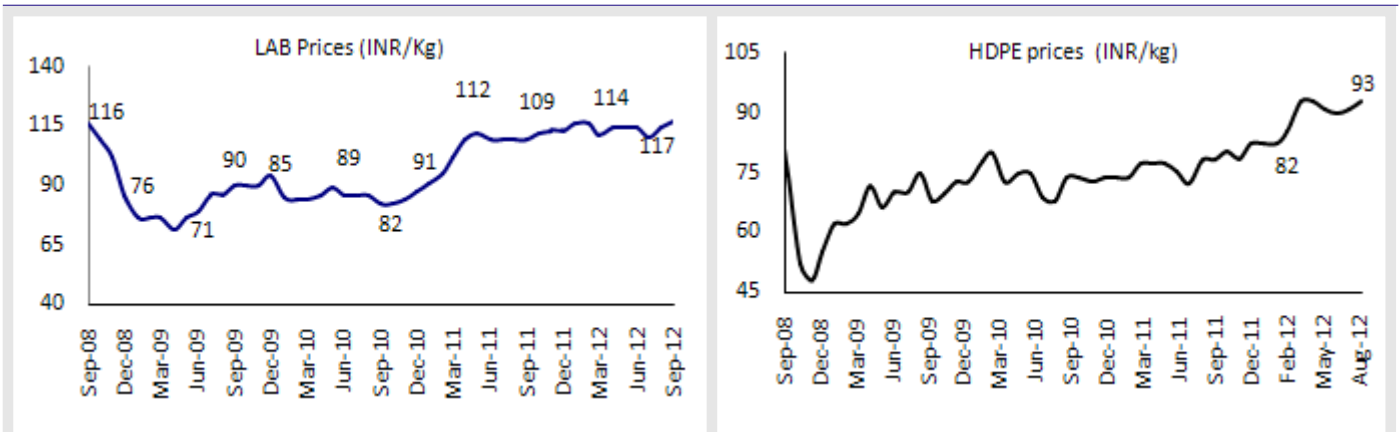
Source: Company, MOSL

**Significant correction in input costs may increase competition at lower end**

- PFAD prices have started to cool off; however, INR depreciation has negated the impact. Palm oil prices are down 15% in past six months (flat YoY), and are expected to correct further owing to inventory build-up post higher production in Indonesia and Malaysia.
- We note that strong volume growth for branded Consumer players in the past three years was partly driven by weakened market position of regional unbranded players. Rising and volatile RM costs caused them to concede market shares to organized players.
- Empirical evidence points towards resurgence of regional and fringe players during periods of sustained benign input costs. Thus, competitive intensity could rise in some categories, especially at the lower end of HPC.
- From HUVR’s perspective, it has seen growth across income segments (premium, mid and mass). Hence, resurgence of regional competition should have limited impact on its portfolio. Secondly, in our view, HUVR is better prepared today in terms of (a) go-to-market capabilities, and (b) response time to competition.

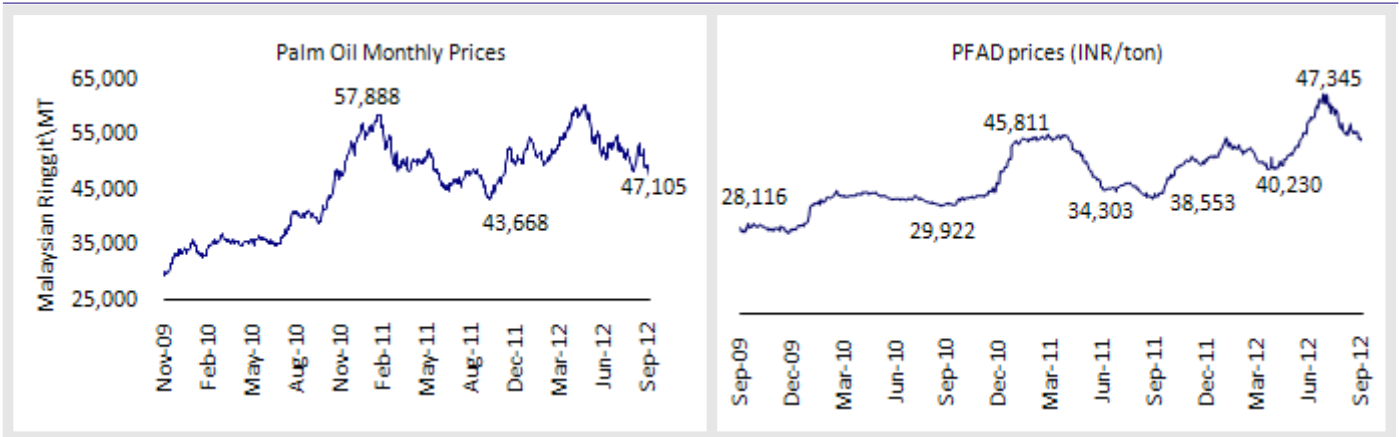
LAB prices inch up in 2QFY13....

.... HDPE remains firm



Source: Bloomberg, MOSL

**Palm oil and PFAD prices on a downward trend....**

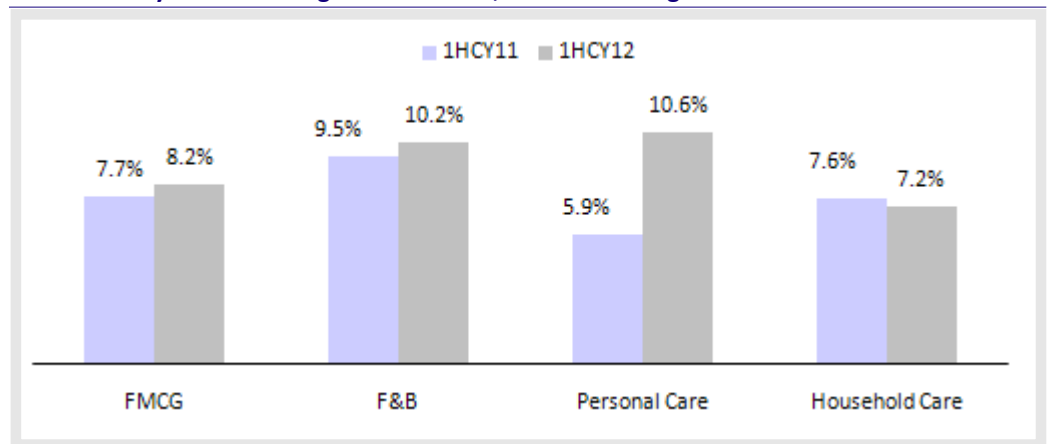


Source: Bloomberg, MOSL

**FOODS & BEVERAGES: Sluggish performance of portfolio continues; new products being launched**

- Processed Foods growth remains subdued for HUVR . Recent IMRB panel data had also pointed towards moderation in the Foods & Beverages category as a whole.
- Canteen Stores Department (CSD) segment continues to remain lackluster on account of reduced allocations. We don't see any recovery in FY13. However, working capital position of FMCG companies with CSD should see an improvement. HUVR derives ~5% of its revenues from CSD.

**IMRB industry Panel: FMCG growth sustains; Food & Beverages come off a bit**



Source: IMRB, MOSL

**Focusing on categories of future to drive uptrading**

- HUVR is leveraging its brand strength and parent's technology/R&D to launch new products and develop categories of the future. Key focus areas include:
  - Conditioners and post-wash applications in hair (Dove, Sunsilk)
  - Premium skin care (Ponds, Vaseline)
  - Face wash (Ponds, Lakme, Dove and FAL)
  - Deodorants (Dove, Axe and Sure)
  - Hand wash (Lifebuoy, Lux and Pears) and
  - Tea Bags (Taj Mahal).
- These categories are growing at 30-50% and can meaningfully aid HUVR's premiumization efforts.

**Snapshot of "categories of the future"**

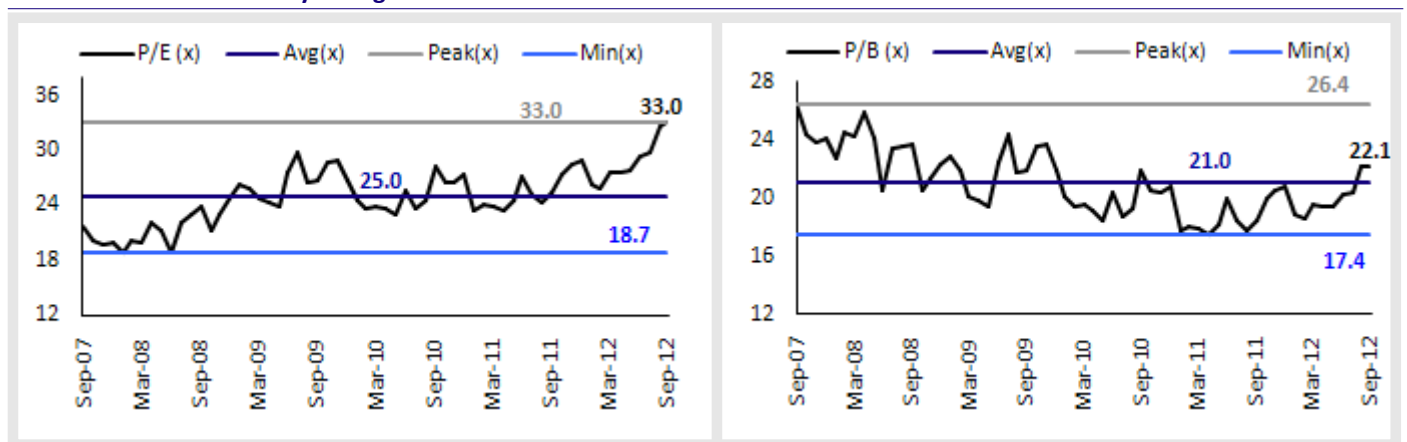
| Categories  | Mkt Size (INR b) | Products                                 |  |
|-------------|------------------|--|--|
|             |                  | HUVR                                     | Competition  |
| Face Wash   | 9.0              | Lakme, Ponds, Fair, Lovely, Pears, Dove, | Himalaya, Garnier, Everyuth, Neutrogena            |
| Hand Wash   | 2.5              | Lifebuoy, Pears, Lux                     | Dettol, Santoor, Fem                               |
| Hand & Body | 2.3              | Lux, Dove, Axe, Pears                    | Palmolive  |
| Noodles     | 17               | Knorr Soupy Noodles                      | Nestle, Nissin, GSK, ITC                           |
| Conditioner | 2.5              | Dove, Sunsilk, Clinic                    | Head & Shoulders, Garnier, Pantene, Fiama Di Wills |
| Anti Ageing | 2.5              | Ponds                                    | Olay, Garnier                                      |
| Tea Bags    | 1.4              | Taj Mahal                                | Tetley, Twinings                                   |

Source: Company/MOSL

**VALUATION AND VIEW: Higher base awaits 2H; maintain Neutral on rich valuations**

- HUVR’s medium term growth will be driven by tailwind benefits from its recent distribution expansion as well as aggressive innovation/new launch funnel, in our view. Potential entry into premium Hair Oil underscores HUVR’s efforts to drive growth even if it entails entering categories which have limited global synergies in its portfolio.
- While we are positive on HUVR’s medium- and long-term prospects, the stock trades at multi-year high P/E of 34x FY13E and 29x FY14E. HUVR’s valuations have seen significant re-rating driven by consistent volume growth, improved market positioning and strong earnings growth. However, we believe current valuations factor in most positives with little room for disappointments e.g. limited potential margin expansion in the near term driven by higher base (2HFY12 earnings grew 29%), lower than estimated volume growth, etc.
- The valuation re-rating of HUVR and the Consumer sector was also driven by preference for defensives in an uncertain broader market environment, in our view. Potential recovery in broader markets can cap the premium which defensives have recently enjoyed. Maintain **Neutral**.

**HUVR: Valuations at multi-year high**



## Financials and Valuation

| Income Statement             |                |                |                | (INR Million)        |                     |
|------------------------------|----------------|----------------|----------------|----------------------|---------------------|
| Y/E March                    | 2010           | 2011           | 2012           | 2013E                | 2014E               |
| <b>Net Sales</b>             | <b>175,238</b> | <b>194,011</b> | <b>217,356</b> | <b>258,122</b>       | <b>288,818</b>      |
| Other Oper. Income           | 2,015          | 3,341          | 3,808          | 4,201                | 4,677               |
| <b>Total Revenue</b>         | <b>177,253</b> | <b>197,352</b> | <b>221,164</b> | <b>262,323</b>       | <b>293,494</b>      |
| Change (%)                   | -14.0          | 11.3           | 12.1           | 18.6                 | 11.9                |
| COGS                         | 88,779         | 100,569        | 117,378        | 136,262              | 152,034             |
| <b>Gross Profit</b>          | <b>88,474</b>  | <b>96,783</b>  | <b>103,786</b> | <b>126,061</b>       | <b>141,460.2753</b> |
| Gross Margin (%)             | 49.9           | 49.0           | 46.9           | 48.1                 | 48.2                |
| Operating Exp                | 60,975         | 69,790         | 70,873         | 84,697               | 93,825              |
| % of sales                   | 34.4           | 35.4           | 32.0           | 32.3                 | 32.0                |
| <b>EBIDTA</b>                | <b>27,500</b>  | <b>26,993</b>  | <b>32,913</b>  | <b>41,363</b>        | <b>47,635</b>       |
| Margin (%)                   | 15.5           | 13.7           | 14.9           | 15.8                 | 16.2                |
| Depreciation                 | 1,840          | 2,208          | 2,182          | 2,357                | 2,721               |
| Int. and Fin. Charges        | 70             | 2              | 12             | 70                   | 20                  |
| Other Income - Recurring     | 1,481          | 2,520          | 2,783          | 4,894                | 6,386               |
| <b>Profit before Taxes</b>   | <b>27,071</b>  | <b>27,302</b>  | <b>33,502</b>  | <b>43,830</b>        | <b>51,280</b>       |
| Margin (%)                   | 15.4           | 14.1           | 15.4           | 17.0                 | 17.8                |
| Tax                          | 5,823          | 5,488          | 7,776          | 9,862                | 11,794              |
| Deferred Tax                 | 221            | 281            | 0              | 438                  | 513                 |
| Tax Rate (%)                 | 22.3           | 21.1           | 23.2           | 23.5                 | 24.0                |
| <b>Profit after Taxes</b>    | <b>21,027</b>  | <b>21,533</b>  | <b>25,725</b>  | <b>33,530</b>        | <b>38,973</b>       |
| Margin (%)                   | 12.0           | 11.1           | 11.8           | 13.0                 | 13.5                |
| Non-rec. (Exp)/Income        | 994            | 1,527          | 1,189          | 0                    | 0                   |
| <b>Reported PAT</b>          | <b>22,020</b>  | <b>23,060</b>  | <b>26,914</b>  | <b>33,530</b>        | <b>38,973</b>       |
| <b>Balance Sheet</b>         |                |                |                | <b>(INR Million)</b> |                     |
| Y/E March                    | 2010           | 2011           | 2012           | 2013E                | 2014E               |
| Share Capital                | 2,182          | 2,160          | 2,160          | 2,160                | 2,160               |
| Reserves                     | 23,653         | 24,180         | 32,318         | 44,372               | 59,342              |
| <b>Net Worth</b>             | <b>25,835</b>  | <b>26,339</b>  | <b>34,477</b>  | <b>46,531</b>        | <b>61,501</b>       |
| <b>Capital Employed</b>      | <b>25,835</b>  | <b>26,339</b>  | <b>34,477</b>  | <b>46,531</b>        | <b>61,501</b>       |
| Gross Block                  | 35,820         | 37,596         | 40,596         | 43,596               | 47,096              |
| Less: Accum. Depn.           | -14,199        | -15,905        | -18,250        | -20,608              | -23,329             |
| <b>Net Fixed Assets</b>      | <b>21,621</b>  | <b>21,692</b>  | <b>22,346</b>  | <b>22,988</b>        | <b>23,768</b>       |
| Capital WIP                  | 2,740          | 2,991          | 2,500          | 2,500                | 2,500               |
| Investments                  | 29,249         | 26,188         | 32,571         | 45,136               | 59,455              |
| Deferred Charges             | 2,488          | 2,097          | 2,243          | 2,399                | 2,566               |
| <b>Curr. Assets, L&amp;A</b> | <b>37,854</b>  | <b>47,371</b>  | <b>53,095</b>  | <b>60,250</b>        | <b>68,440</b>       |
| Inventory                    | 21,799         | 28,113         | 31,348         | 35,603               | 39,837              |
| Account Receivables          | 6,716          | 9,432          | 11,131         | 12,729               | 14,243              |
| Cash and Bank Balance        | 2,314          | 2,819          | 3,276          | 4,200                | 6,301               |
| Others                       | 7,025          | 7,007          | 7,340          | 7,718                | 8,059               |
| <b>Curr. Liab. and Prov.</b> | <b>67,332</b>  | <b>73,999</b>  | <b>78,277</b>  | <b>86,743</b>        | <b>95,227</b>       |
| Account Payables             | 43,737         | 47,262         | 52,211         | 58,053               | 63,868              |
| Other Liabilities            | 15,374         | 19,178         | 17,428         | 18,972               | 20,562              |
| Provisions                   | 8,221          | 7,558          | 8,638          | 9,718                | 10,798              |
| <b>Net Current Assets</b>    | <b>-29,478</b> | <b>-26,628</b> | <b>-25,182</b> | <b>-26,493</b>       | <b>-26,788</b>      |
| <b>Application of Funds</b>  | <b>25,835</b>  | <b>26,339</b>  | <b>34,477</b>  | <b>46,531</b>        | <b>61,501</b>       |

E: MOSL Estimates

## Financials and Valuation

### Ratios

| Y/E March          | 2010 | 2011 | 2012 | 2013E | 2014E |
|--------------------|------|------|------|-------|-------|
| <b>Basic (INR)</b> |      |      |      |       |       |
| EPS                | 9.6  | 10.0 | 11.9 | 15.5  | 18.0  |
| Cash EPS           | 10.5 | 11.0 | 13.3 | 16.6  | 19.3  |
| BV/Share           | 11.8 | 12.2 | 16.0 | 21.5  | 28.5  |
| DPS                | 6.5  | 6.5  | 7.5  | 8.5   | 9.5   |
| Payout %           | 67.4 | 65.5 | 63.0 | 54.7  | 52.6  |

### Valuation (x)

|                    |  |  |      |      |      |
|--------------------|--|--|------|------|------|
| P/E                |  |  | 44.2 | 33.9 | 29.2 |
| Cash P/E           |  |  | 39.7 | 31.7 | 27.3 |
| EV/Sales           |  |  | 5.1  | 4.2  | 3.7  |
| EV/EBITDA          |  |  | 33.5 | 26.3 | 22.5 |
| P/BV               |  |  | 33.0 | 24.5 | 18.5 |
| Dividend Yield (%) |  |  | 1.4  | 1.6  | 1.8  |

### Return Ratios (%)

|      |       |       |      |      |      |
|------|-------|-------|------|------|------|
| RoE  | 81.4  | 81.8  | 74.6 | 72.1 | 63.4 |
| RoCE | 105.1 | 103.7 | 97.2 | 94.3 | 83.4 |

### Working Capital Ratios

|                    |     |     |     |     |     |
|--------------------|-----|-----|-----|-----|-----|
| Debtor (Days)      | 14  | 18  | 19  | 18  | 18  |
| Asset Turnover (x) | 6.8 | 7.4 | 6.3 | 5.5 | 4.7 |

### Leverage Ratio

|                 |     |     |     |     |     |
|-----------------|-----|-----|-----|-----|-----|
| Debt/Equity (x) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
|-----------------|-----|-----|-----|-----|-----|

### Cash Flow Statement

(INR Million)

| Y/E March                    | 2010           | 2011           | 2012           | 2013E          | 2014E          |
|------------------------------|----------------|----------------|----------------|----------------|----------------|
| OP/(loss) before Tax         | 27,500         | 26,993         | 32,913         | 41,363         | 47,635         |
| Int./Div. Received           | 1,481          | 2,520          | 2,783          | 4,894          | 6,386          |
| Interest Paid                | -70            | -2             | -12            | -70            | -20            |
| Direct Taxes Paid            | -5,823         | -5,488         | -7,776         | -9,862         | -11,794        |
| (Incr)/Decr in WC            | 12,190         | -2,345         | -989           | 2,235          | 2,396          |
| Change in Deff               | 60             | 392            | -146           | -156           | -167           |
| <b>CF from Operations</b>    | <b>35,338</b>  | <b>22,068</b>  | <b>26,773</b>  | <b>38,404</b>  | <b>44,435</b>  |
| Extraordinary Items          | 994            | 1,527          | 1,189          | 0              | 0              |
| (Incr)/Decr in FA            | -5,021         | -2,028         | -2,509         | -3,000         | -3,500         |
| (Pur)/Sale of Investments    | -10,055        | 3,062          | -6,383         | -12,566        | -14,319        |
| <b>CF from Invest.</b>       | <b>-14,083</b> | <b>2,561</b>   | <b>-7,703</b>  | <b>-15,566</b> | <b>-17,819</b> |
| Change in Networkth          | -240           | -6,136         | 174            | 0              | 0              |
| change in equity             | 2              | -22            | 0              | 0              | 0              |
| change in reserves           | -242           | -6,114         | 174            | 0              | 0              |
| (Incr)/Decr in Debt          | -4,219         | 0              | 0              | 0              | 0              |
| Dividend Paid                | -16,560        | -16,420        | -18,950        | -21,476        | -24,003        |
| Others                       | 172            | -1,568         | 163            | -438           | -513           |
| <b>CF from Fin. Activity</b> | <b>-20,848</b> | <b>-24,124</b> | <b>-18,613</b> | <b>-21,914</b> | <b>-24,516</b> |
| <b>Incr/Decr of Cash</b>     | <b>407</b>     | <b>506</b>     | <b>457</b>     | <b>924</b>     | <b>2,101</b>   |
| Add: Opening Balance         | 1,906          | 2,314          | 2,819          | 3,276          | 4,200          |
| <b>Closing Balance</b>       | <b>2,313</b>   | <b>2,819</b>   | <b>3,276</b>   | <b>4,200</b>   | <b>6,301</b>   |

E: MOSL Estimates

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