Hindustan Unilever HLL.NS HUVR IN .

GENERAL CONSUMER

NOMURA
EQUITY RESEARCH

Maintain Reduce on elevated expectations

Expectations set at elevated levels; risk of disappointment high; maintain Reduce

November 2, 2011

Rating Remains	**Reduce**
Target price Increased from 232	INR 296
Closing price October 31, 2011	INR 376
Potential downside	-21.3%

Action: Risk of disappointment high; maintain Reduce

While HUVR's 2QFY12 results were ahead of our and street estimates, they were helped by cost lines being much more subdued, which we believe may not be sustainable. However, we think street expectations are now factoring that in, which leaves HUVR vulnerable to a disappointment. With valuations now at 28.2x FY13, we maintain our Reduce rating.

Catalysts: Competitive intensity perking up

Companies across the HPC space have guided for increased A&P spending in 2HFY12, as gross margin pressures start to ease. India remains one of the most attractive consumer markets in the world and we think competitive intensity is likely to perk up from current levels. This, we believe, is likely to again have an impact on margins, as companies 're-invest' the 'savings' on the gross margin front into higher levels of spending on advertising. This may not be fully factored in by the street and is where the risk of disappointment lies into 2HFY12, in our view.

Valuation: Still one of the most expensive stocks

Post the recent run-up, HUVR is trading at 28.2x FY13F EPS, which is higher than the sector average of ~25.4x. HUVR is likely to deliver 12-13% earnings growth in FY13F, on our estimates, vs a sector average of ~19%. We believe given the potential for disappointment and valuations that are trading above sector average, as well as HUVR's own long-term average, risk reward at current levels remains unattractive. We raise our TP to INR296, from INR232, largely on account of a roll-forward, with earnings upgrades accounting for 8%, and a target multiple change of 4%.

31 Mar	FY11		FY12F		FY13F		FY14F
Currency (INR)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	200,185	215,378	230,526	238,176	257,470		287,132
Reported net profit (mn)	22,960	23,782	25,490	26,563	28,734		32,392
Normalised net profit (mn)	21,336	23,782	25,490	26,563	28,734		32,392
Normalised EPS	9.88	10.90	11.81	12.18	13.31		15.00
Norm. EPS growth (%)	2.8	11.9	19.5	11.7	12.7		12.7
Norm. P/E (x)	38.0	N/A	31.8	N/A	28.2	N/A	25.0
EV/EBITDA (x)	27.0	17.5	22.5	15.5	19.9		17.5
Price/book (x)	32.4	N/A	29.5	N/A	26.7	N/A	24.1
Dividend yield (%)	2.4	N/A	2.8	N/A	3.2	N/A	3.6
ROE (%)	93.3	85.0	97.1	87.1	99.3		101.3
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash		net cash

Source: Nomura estimates

Key company data: *See page 2 for company data and detailed price/index chart.*

Anchor themes

Hindustan Unilever is the largest consumer company in India, with market leadership across segments. However, high competitive intensity will keep margins under pressure, which we believe is not captured in the current stock price.

Nomura vs consensus

We are largely in line with consensus on earnings for FY12 and FY13, but our TP is 15% lower on account of the lower multiple we assign.

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See Appendix A-1 for analyst certification, important disclosures and the status of non-US analysts.

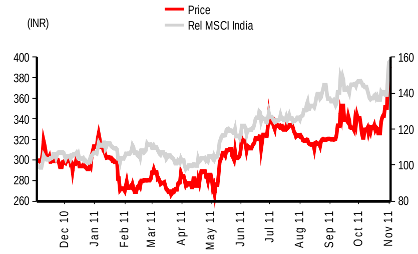
Key data on Hindustan Unilever

Income statement (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Revenue	**180,256**	**200,185**	**230,526**	**257,470**	**287,132**
Cost of goods sold	-90,115	-105,346	-119,273	-133,323	-148,726
Gross profit	**90,141**	**94,839**	**111,253**	**124,147**	**138,406**
SG&A	-53,152	-57,367	-66,514	-73,825	-81,830
Employee share expense	-9,709	-10,102	-11,633	-13,003	-14,505
Operating profit	**27,279**	**27,371**	**33,106**	**37,319**	**42,070**
EBITDA	**29,198**	**29,663**	**35,531**	**39,920**	**44,864**
Depreciation	-1,919	-2,293	-2,424	-2,600	-2,794
Amortisation					
EBIT	27,279	27,371	33,106	37,319	42,070
Net interest expense	-75	-10	-3	-3	-3
Associates & JCEs	0	0	0	0	
Other income					
Earnings before tax	**27,204**	**27,360**	**33,104**	**37,317**	**42,068**
Income tax	-6,153	-5,919	-7,614	-8,583	-9,676
Net profit after tax	**21,051**	**21,442**	**25,490**	**28,734**	**32,392**
Minority interests	-80	-106	0	0	0
Other items					
Preferred dividends					
Normalised NPAT	**20,971**	**21,336**	**25,490**	**28,734**	**32,392**
Extraordinary items	594	1,624	0	0	0
Reported NPAT	**21,566**	**22,960**	**25,490**	**28,734**	**32,392**
Dividends	-18,874	-19,202	-22,941	-25,860	-29,153
Transfer to reserves	**2,691**	**3,758**	**2,549**	**2,873**	**3,239**
Valuation and ratio analysis					
FD normalised P/E (x)	38.7	38.0	31.8	28.2	25.0
FD normalised P/E at price target (x)	30.9	30.4	25.4	22.5	20.0
Reported P/E (x)	38.0	35.3	31.8	28.2	25.0
Dividend yield (%)	2.3	2.4	2.8	3.2	3.6
Price/cashflow (x)	26.9	35.9	28.1	24.7	20.8
Price/book (x)	33.9	32.4	29.5	26.7	24.1
EV/EBITDA (x)	27.4	27.0	22.5	19.9	17.5
EV/EBIT (x)	29.3	29.3	24.1	21.3	18.7
Gross margin (%)	50.0	47.4	48.3	48.2	48.2
EBITDA margin (%)	16.2	14.8	15.4	15.5	15.6
EBIT margin (%)	15.1	13.7	14.4	14.5	14.7
Net margin (%)	12.0	11.5	11.1	11.2	11.3
Effective tax rate (%)	22.6	21.6	23.0	23.0	23.0
Dividend payout (%)	87.5	83.6	90.0	90.0	90.0
Capex to sales (%)	2.8	1.0	0.5	0.9	0.8
Capex to depreciation (x)	2.7	0.9	0.5	0.9	0.8
ROE (%)	100.2	93.3	97.1	99.3	101.3
ROA (pretax %)	40.1	35.3	39.5	41.8	43.7
Growth (%)					
Revenue	-13.3	11.1	15.2	11.7	11.5
EBITDA	-10.5	1.6	19.8	12.4	12.4
EBIT	-10.9	0.3	21.0	12.7	12.7
Normalised EPS	-15.8	2.8	19.5	12.7	12.7
Normalised FDEPS	-14.9	1.7	19.5	12.7	12.7
Per share					
Reported EPS (INR)	9.88	10.64	11.81	13.31	15.00
Norm EPS (INR)	9.61	9.88	11.81	13.31	15.00
Fully diluted norm EPS (INR)	9.71	9.88	11.81	13.31	15.00
Book value per share (INR)	11.10	11.59	12.73	14.06	15.57
DPS (INR)	8.65	8.89	10.63	11.98	13.50

Source: Nomura estimates

Relative performance chart (one year)



Source: ThomsonReuters, Nomura research

(%)	1M	3M	12M
Absolute (INR)	10.3	16.0	27.5
Absolute (USD)	10.9	5.2	16.3
Relative to index	2.5	18.3	41.0
Market cap (USDmn)	16,835.4		
Estimated free float (%)	41.2		
52-week range (INR)	378.15/264.45		
3-mth avg daily turnover (USDmn)	20.53		
Major shareholders (%)			
LIC of India	6.9		
New India Assurance	1.3		

Source: Thomson Reuters, Nomura research

Notes

Margin pressures now easing

Cashflow (INRmn)

Year-end 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
EBITDA	29,198	29,663	35,531	39,920	44,864
Change in working capital	13,278	-3,103	501	1,760	4,140
Other operating cashflow	-12,354	-3,944	-7,145	-8,884	-9,951
Cashflow from operations	**30,123**	**22,617**	**28,887**	**32,796**	**39,054**
Capital expenditure	-5,102	-2,066	-1,163	-2,420	-2,231
Free cashflow	**25,021**	**20,551**	**27,724**	**30,376**	**36,823**
Reduction in investments	-9,368	360	0	0	0
Net acquisitions	0	0	0	0	
Reduction in other LT assets	0	0	0	0	0
Addition in other LT liabilities	0	0	0	0	0
Adjustments					
Cashflow after investing acts	**15,653**	**20,910**	**27,724**	**30,376**	**36,823**
Cash dividends	-18,874	-19,202	-22,941	-25,860	-29,153
Equity issue	394	322	-726	-9	0
Debt issue	4,341	-4,233	-82	0	0
Convertible debt issue	0	0	0	0	0
Others	-31	-53	-65	0	0
Cashflow from financial acts	**-14,170**	**-23,166**	**-23,813**	**-25,869**	**-29,153**
Net cashflow	**1,483**	**-2,256**	**3,911**	**4,507**	**7,670**
Beginning cash	18,641	20,124	17,868	21,191	25,626
Ending cash	20,124	17,868	21,778	25,698	33,295
Ending net debt	-20,016	-17,841	-21,165	-25,599	-33,203

Source: Nomura estimates

Notes

Cash flow continues to be strong

Balance sheet (INRmn)

As at 31 Mar	FY10	FY11	FY12F	FY13F	FY14F
Cash & equivalents	20,124	17,868	21,191	25,626	33,230
Marketable securities					
Accounts receivable	6,848	9,549	9,869	11,661	13,169
Inventories	22,264	28,738	30,756	35,685	39,507
Other current assets	6,157	7,010	7,965	8,963	9,966
Total current assets	**55,393**	**63,164**	**69,782**	**81,936**	**95,872**
LT investments	12,244	11,885	11,885	11,885	11,885
Fixed assets	24,943	25,231	24,876	25,075	24,851
Goodwill					
Other intangible assets					
Other LT assets					
Total assets	**92,580**	**100,280**	**106,543**	**118,896**	**132,608**
Short-term debt					
Accounts payable	53,522	61,726	59,018	65,970	73,592
Other current liabilities	14,638	13,359	19,862	22,390	25,241
Total current liabilities	**68,160**	**75,085**	**78,880**	**88,360**	**98,833**
Long-term debt	108	27	27	27	27
Convertible debt					
Other LT liabilities					
Total liabilities	**68,269**	**75,112**	**78,907**	**88,387**	**98,859**
Minority interest	105	146	146	146	146
Preferred stock					
Common stock	2,182	2,159	2,159	2,159	2,159
Retained earnings					
Proposed dividends					
Other equity and reserves	22,026	22,864	25,331	28,204	31,444
Total shareholders' equity	**24,207**	**25,023**	**27,490**	**30,363**	**33,602**
Total equity & liabilities	**92,580**	**100,280**	**106,543**	**118,896**	**132,608**
Liquidity (x)					
Current ratio	0.81	0.84	0.88	0.93	0.97
Interest cover	365.2	2,710.0	12,446.0	14,029.8	15,816.0
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	12.6	14.9	15.4	15.3	15.8
Days inventory	97.3	88.4	91.3	90.9	92.3
Days payable	196.1	199.7	185.3	171.1	171.3
Cash cycle	-86.2	-96.3	-78.6	-64.9	-63.2

Source: Nomura estimates

Notes

Balance sheet can support increased dividend payouts

Key highlights of 2QFY12 results

- Revenue growth during the quarter was +18% y-y to INR55.2bn on the back of 9.8% volume growth in the domestic business. Volume growth performance has been the key surprise vs. our expectation, and we would look for commentary from HUVR to understand the drivers behind this growth. Revenue growth of 18% means pricing/mix impact has been close to 8.2%. HUVR expects 2HFY12F growth to be more pricing-driven, which builds in an underlying slowdown in volume growth.
- Amongst the various segments, HUVR reported 18.2% revenue growth in the personal product portfolio and a 21.8% growth in soaps & detergents portfolio.
- However, the key surprise was the flat 'other expenditure' on a y-y basis and only a 1% increase in A&P despite an 18% increase in sales. HUVR said that it had recalibrated down the A&P spend in the soaps and detergents segment, while increasing spend in the personal-products portfolio. Margins improved by 140bps y-y vs. our expectation of a 50bp increase.
- Commodity cost inflation remains an issue, with gross margin for the quarter declining 345bps.
- HUVR managed the decline in EBITDA margins by cutting back on A&P spend, which has now reached 12.7% of sales. Other expenditure as a percentage of sales was down to 15.3% vs. 18% in the September 2010 quarter.
- HUVR also recorded extraordinary income/exceptional gains of INR444mn. Excluding that, PAT came in at INR6.45bn, which was 10% ahead of our estimates.

Fig. 1: Hindustan Unilever 2QFY12 result highlights

	Quarter ended				
(INR mn)	Sep'11	Sep'10	% Chg	Jun'11	% Chg
Net Sales	**55,222**	**46,809**	**18.0**	**55,039**	**0.3**
EBIDTA	7,384	5,631	31.1	6,788	8.8
Other income	1,660	1,606	3.3	1,261	31.7
PBIDT	**9,044**	**7,237**	**25.0**	**8,049**	**12.4**
Depreciation	571	554	3.1	562	1.6
Interest	5	1	N.A	0	N.A
PBT	**8,467**	**6,683**	**26.7**	**7,486**	**13.1**
Tax	2,022	1,426	41.8	1,802	12.2
Adjusted PAT	**6,445**	**5,257**	**22.6**	**5,684**	**13.4**
Extra ordinary income/ (exp.)	444	404	9.8	588	(24.4)
Reported PAT	**6,889**	**5,661**	**21.7**	**6,272**	**9.8**
No. of shares (mn)	**2,161**	**2,182**		**2,161**	
EBIDTA margins (%)	13.4	12.0		12.3	
PBIDT margins (%)	16.4	15.5		14.6	
EPS (INR)	3.0	2.4	23.8	2.6	**13.4**

Source: Company data, Nomura research

Divisional details

- In the soaps and detergents segment, revenues rose 21.8% to INR25.93bn. This was a strong performance with a mix of volume and price-driven growth. Last week GCPL said that category growth was flat to negative, and in that context, HUVR's performance was surprisingly good.
- The personal products division recorded solid double-digit-percentage volume growth during the quarter with revenues up 18.2% to INR16.13bn.
- Beverage segment revenues were up 14.6% to INR6.53bn.

Fig. 2: Revenue breakdown by division

	Quarter ended				
(INR mn)	Sep'11	Sep'10	% Chg	Jun'11	% Chg
Soaps & Detergents	25,926	21,294	21.8	25,550	1.5
Personal Products	16,126	13,649	18.2	16,307	(1.1)
Beverages	6,533	5,700	14.6	6,086	7.3
Processed Foods and Ice Creams	3,318	2,195	51.2	3,721	(10.8)
Exports	2,909	2,647	9.9	3,063	(5.0)
Others (Chemicals, Water etc)	1,161	1,527	(24.0)	1,066	8.9
Total	**55,973**	**47,560**	**17.7**	**55,793**	**0.3**

Source: Company data, Nomura research

Profitability performance

- Margins in the soaps and detergents segment improved by 65bps y-y. We believe a significant part of this was on account of calibrated A&P spend in the segment, while gross margin remained under pressure.
- Margins in the personal products division improved by 143bps y-y, and we believe this is despite some increases in A&P spend. This was another positive to come out of the results.
- Beverage segment margins were disappointing and saw a near 200bp margin decline y-y.
- The processed foods division performance was solid, with margins up by 40bps y-y.

Fig. 3: Divisional profitability performance

	Quarter ended				
(%)	Sep'11	Sep'10	% Chg	Jun'11	% Chg
Soaps & Detergents	12.4	11.7	65	9.2	315
Personal Products	24.4	23.0	143	25.3	(91)
Beverages	13.4	15.4	(193)	12.4	104
Processed Foods	5.0	4.6	39	4.7	29
Exports	8.3	7.1	111	7.7	52
Others (Chemicals, Water etc)	(6.7)	(12.0)	528	(2.4)	(432)

Source: Company data, Nomura research

Feedback from 2QFY12 conference call

- Volume growth strong, partly due to festive effect . . . but it faces tough comps: While volume growth was maintained at close to 8-10% in 1HFY12, management expects, and we do as well, that comps will become increasingly tougher in 2HFY12, when the average volume growth comp is 13.5%. We believe this level of volume growth will be difficult to sustain, both in terms of having a high base effect, as well as in an environment when A&P spend is relatively low. This was the key surprise in 2Q vs. our expectation, and high expectations here from the street could be at risk into 2HFY12. Management also said that the holiday and festival seasons, which are earlier this year vs. last year, could have had an impact on volumes during the quarter.
- Pricing impact higher: Management commented that the FMCG sector had shown solid growth during the quarter, although this was increasingly being led by pricing impact rather than by volume growth. HUVR does expect some moderation in volume growth and for contribution of pricing to revenue growth to be larger.
- A&P spend recalibrated: HUVR commented that A&P spend, which declined by 240bps as a percentage of sales this past quarter, was a result of meaningful recalibration in the soaps and detergents segment. HUVR said that it had cut back spending significantly in the soaps and detergents segment, and in turn raised spending in the other categories, including personal products, beverages and packaged foods. Management maintained that this was in line with the competitive scenarios in the particular segments. We believe commentary from other companies such as GCPL,

Dabur and Colgate suggests that A&P spend is likely to again see an uptrend across the sector in 2HFY12. In that scenario, HUVR is also likely to follow suit to remain competitive in the market place, in our view.

- Hair care performance weak: Management said that in most of the categories HUVR had grown either in line or ahead of the market, except in hair care, where it has grown less than the market. We believe there were some share losses in the category and we expect HUVR to step up investments in the segment starting 3Q.
- Media inflation remains at elevated levels: While management did not quantify the level of media inflation in the market, the index of media intensity remained high, especially in all categories except soaps and detergents. The overall FMCG ex soaps media intensity index moved to 165 from 157 in the previous quarter. HUVR, with its scale, does have high bargaining power, but in a scenario where other FMCG companies are also looking to increase their spending, there could likely be pressure on media costs in the medium term, we think.
- Input costs remained stable but at elevated levels: HUVR said that input costs had now stabilized and were no longer seeing a rising trend. However, this stabilization has happened at current elevated levels. Additionally, the near 10% depreciation in the INR also had an impact and will continue to impact input costs.
- Innovations remain on the agenda: HUVR continues to have a strong innovation pipeline with new launches and re-launches done during the quarter across the portfolio. This also helped with volume growth in the quarter, although the impact is difficult to quantify.
- Divergence in rural and urban growth: Management mentioned that as per data received from AC Nielsen, urban growth was ahead of rural growth. However, internal data suggest otherwise with rural growth outpacing urban growth. This could also have impacted the overall growth for the company as consumers' aspiration to trade up in rural areas is still high, which could have benefitted HUVR, particularly in the soaps and detergents segment.

Have we been behind the curve on earnings over the past year?

Looking back at the quarterly results there have been some variations over the past 3-4 quarters between our estimate and HUVR's reported numbers. In 3QFY11, HUVR surprised on the downside vs. our estimate, whereas in 4QFY11, it surprised on the upside. 1QFY12 was operationally worse than our expectation, while reported PAT number was largely in line with our expectation.

Over the past four quarters, reported numbers have been 1% ahead of our estimates, while for 1HFY12, numbers have been 3% ahead of our estimate so far. Hence, in terms of earnings the miss has not been as big as it might appear post 2QFY12.

Fig. 4: Adjusted Net Income – Nomura vs. Consensus

Rs. mn	Nomura	Actual	Variance (%)
Q3FY11	6,513	5,732	-12%
Q4FY11	4,209	4,855	15%
Q1FY12	5,886	5,684	-3%
Q2FY12	5,895	6,445	9%
Last 4 Qtrs	**22,503**	**22,717**	**1%**
H1FY12	**11,781**	**12,129**	**3%**

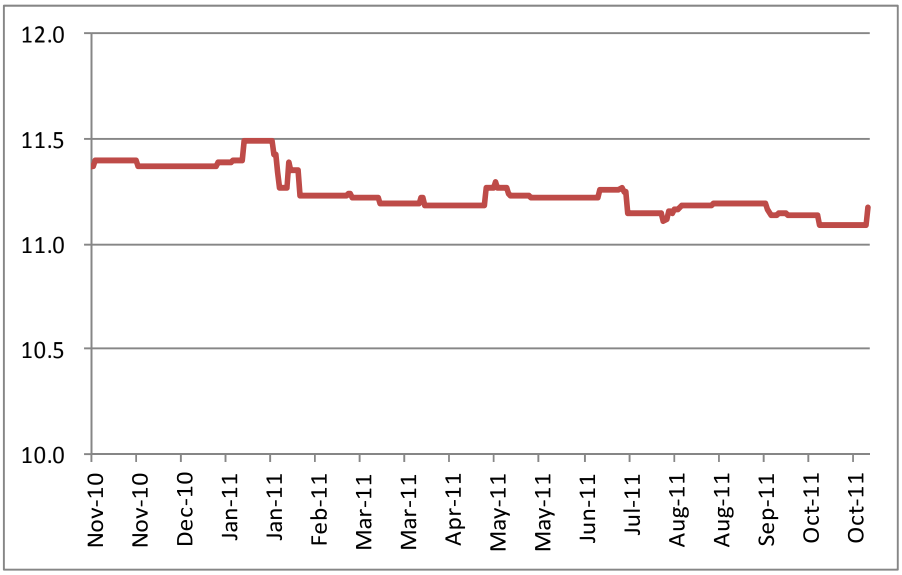
Source: Nomura research

2QFY12 was a surprise, but this we believe is not a trend yet and earnings could surprise negatively over the next couple of quarters. We have analysed the quarterly expectations in sections ahead and believe the downside risks far outweigh the upside risks.

Consensus earnings have also not seen a big swing

Another thing to highlight is that consensus earnings during the last one year have not seen a big swing. If we look at the history of how consensus earnings have moved in the past year or so, the actual movement has been down rather than up. This reflects to us how consensus expectations have been moving in a more rational direction given the environment in which HUVR has been operating vs. the extremely bullish expectations earlier. In that context, 2QFY12 results were a positive surprise, given expectations were not for margins to see such a sharp movement upwards.

Fig. 5: HUVR consensus earnings expectations for FY12F



Source: Bloomberg

Recent move has been on account of P/E re-rating

The sharp share price movement over the past year has been led by a P/E re-rating up from the ~22.5x one-year forward earnings in April 2011, to the current multiple of closer to 30x. In our view, this re-rating upwards has been on account of a couple of reasons:

- Expectations for turning around operationally on the back of a good performance. This essentially means that expectations are now set sky-high and the street is now extrapolating the current quarter over a longer term. This is erroneous, in our view.
- Relative performance against the Sensex historically.

While we do believe that operational performance has improved over the last couple of quarters, it has also been helped by more modest A&P spend vs. expectations, which has led to earnings surprise. This, in our view, is not sustainable.

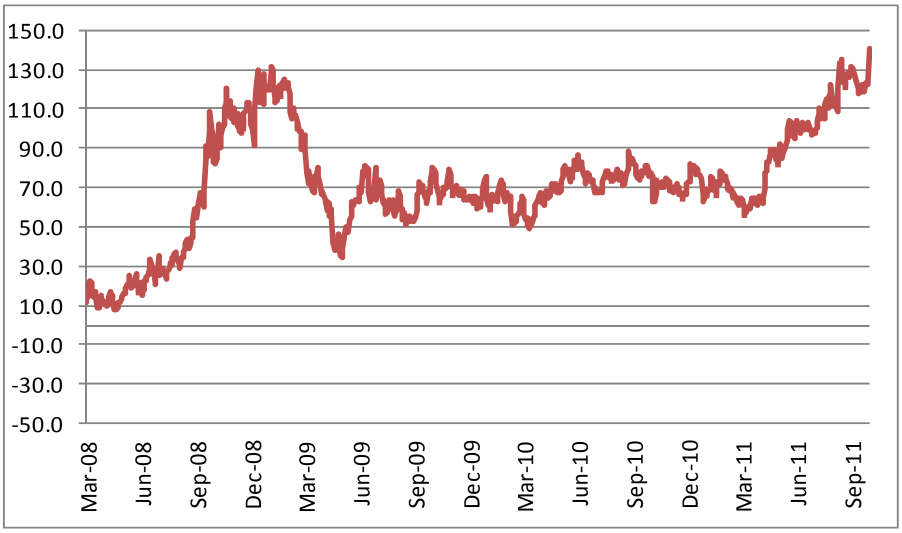
Volume growth has been largely in line with our expectations except for 2QFY12, while on the cost front, gross margins remain under pressure, which clearly means pricing power in most of the segments HUVR operates in is still not as strong.

Fig. 6: Hindustan Unilever one-year forward P/E band

Source: Bloomberg, Nomura research

What is also important to note is that performance of HUVR also has an indirect relationship with performance of the Sensex. As can be seen from the chart below, HUVR has performed well in periods where the performance of the benchmark Sensex Index has been underwhelming.

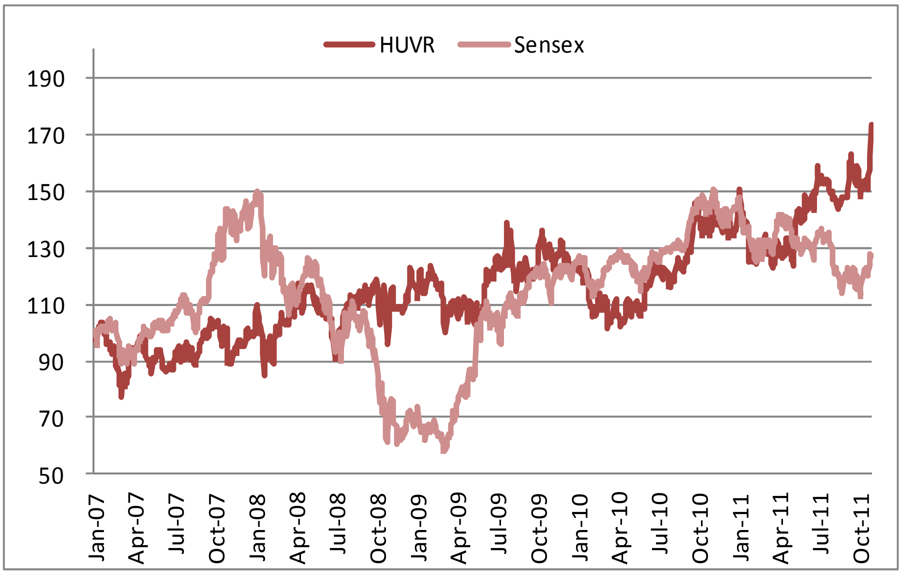
Fig. 7: HUVR premium/discount to Sensex



Source: Bloomberg, Nomura research

We have also looked at performance of HUVR compared with Sensex. What is striking is that in periods where performance of Sensex has been underwhelming, HUVR has performed very well and vice versa. Over the past six months or so, the performance of the Sensex has been underwhelming, given the uncertain macro climate, which has meant HUVR has been one of the best-performing stocks within the Sensex.

Fig. 8: Performance of HUVR vs. Sensex



Source: Bloomberg, Nomura research

If we break down the performance over the past 4-5 years, CY08 and CY11 have seen marked outperformance for HUVR vs. the Sensex, but there have also been years such as CY07,CY08 when HUVR significantly underperformed the Sensex.

Fig. 9: HUVR performance inversely correlated to Sensex performance

	HUVR	Sensex	HUVR outperformance
CY07	-1%	46%	-47%
CY08	15%	-52%	67%
CY09	6%	76%	-71%
CY10	18%	17%	1%
CY11	20%	-14%	34%

Source: Bloomberg, Nomura research

So is stock price performance related to operational performance?

To make more sense of the price performance data above, we looked at whether stock price performance reflects the operational performance of the company. We looked at both margin performance and net profit growth numbers for each of the past four years.

Since CY07, HUVR's net profit growth has been in the range of 11-15%. This number has not moved much in any of the years, but HUVR's stock price performance has seen huge swings, despite no real change in the operational metrics of the company.

Fig. 10: Earnings growth and stock-performance history

Year	Earnings growth (%)	HUVR underperformance
CY07	15%	-47%
CY08	11%	67%
CY09	12%	-71%
CY10	-9%	1%

Source: Company, Nomura research

Note: Earnings growth is based on CY year, underperformance is vs. Sensex

So what are we building in for the 2HFY12?

In the context of the earnings beat in 2QFY12, it is important to lay out what we were building in for 2HFY12. We expect sales growth to continue to be robust led by pricing impact with volumes showing some moderation. We expect input costs to moderate, and hence gross margin pressure should ease in 2HFY12F. While it is natural to build in higher A&P spend, particularly as gross margin pressures ease and competitors step up ad spend, we are not building in a huge increase. We are only building in a moderate uptick in A&P spend in 2HFY12F, which in turn translates to forecast vastly improved EBITDA margins on a y-y basis in 2HFY12F. This puts our expectations for PAT growth at a robust 25% and 41% for 3Q and 4Q FY12 pre-exceptionals.

Fig. 11: Quarterly expectations for 2HFY12F

	Q3FY12	Q4FY12
Sales	54,259	53,415
Growth (%)	17.0	17.0
Op Profit	8,315	8,731
Growth (%)	33%	51%
Net Income	7,193	6,825
Growth (%)	25%	41%

Source: Nomura estimates

Changes to our earnings estimates

As we have highlighted above, the miss or beat vs. our estimates over the past few quarters has not been material. We have now updated our numbers for audited FY11 numbers, which has driven our FY12F numbers higher. We have also now taken into consideration the moderating input costs and have moved our margin expectations higher for FY12F and FY13F.

Fig. 12: Changes to our estimates

	Revenues				Net Income		
	Old	New	Chg (%)		Old	New	Chg (%)
FY12F	212,256	222,479	5%		23,782	25,388	7%
FY13F	234,649	248,748	6%		26,563	28,647	8%

Source: Nomura research

Raising target price

We are raising our target price to INR296 from INR232. This is a 28% upgrade, but more than 16% of this is on account of roll-forward. Our earnings have increased by 8%, and we are now assigning a target multiple of 21x one-year forward earnings vs. our earlier multiple of 20x. This accounts for another 4% change in our target price. We believe that although competitive pressures will likely remain high in the near term, pressure on margins will not be as significant due to the savings on the gross margin line. While we do not expect HUVR to be able to deliver significant margin expansion, we do believe margins are likely to remain largely flat at current levels.

We believe raising the target multiple marginally is justified to account for the following factors.

- Margin pressures are starting to ease and this is now reflected in our valuation of HUVR
- Assigned multiple is still less than the average multiple we assign to other consumer companies of 24x as over the long term HUVR still offers the slowest earnings growth profile, in our view.

Fig. 13: Consumer sector valuations

Company	Ticker	Rating	Price Rs	EPS growth FY12-FY13E %	P/E	
					FY12E	FY13E
Asian Paints	APNT IN	Buy	3,160	25.0%	28.8x	23.1x
Colgate Palmolive	CLGT IN	Reduce	1,002	14.0%	30.4x	27.7x
Dabur	DABUR IN	Buy	101	17.6%	28.9x	22.7x
Godrej Consumer	GCPL IN	Buy	437	28.1%	24.0x	18.7x
Hindustan Unilever	HUVR IN	Reduce	376	12.7%	31.8x	28.2x
ITC	ITC IN	Buy	213	16.2%	28.5x	24.5x
Marico	MRCO IN	Reduce	156	19.0%	29.2x	24.6x
United Spirits	UNSP IN	Neutral	878	20.4%	20.8x	17.3x
Titan Industries	TTAN IN	Buy	217	26.1%	29.9x	23.7x
Nestle *	NEST IN	Neutral	4,244	22.5%	39.9x	32.6x
Jubilant Foodworks	JUBI IN	Buy	807	53.5%	46.9x	30.5x
GSK Consumer *	SKB IN	Buy	2,357	19.2%	28.5x	23.9x
Average				**19.3%**	**30.1x**	**25.4x**

Note: Prices as on 31 Oct 2011. * Calendar year based valuations
Source: Bloomberg, Nomura estimates.

We believe assigning a multiple of 21x for HUVR is prudent, considering the much lower growth profile of the company. We believe the re-rating over the past six months or so has been largely as a result of macro conditions in India, with 'defensive' names such as HUVR having benefitted the most in terms of stock price movement. Operationally, consumer sector performance has been under pressure and, despite that, valuation multiples across the sector have seen a re-rating upwards. We believe this should revert over the next few months as macro conditions improve. Operationally as well, we do see HUVR's performance improving, but, in our view, that still does not justify the P/E of 28.2x FY13F at which that the stock is currently trading.

Maintain Reduce rating

While there are some signs of operational improvement in terms of continuing strong volume growth, a part of this is also due to A&P spend remaining high in absolute terms. HUVR needs to be given credit for recalibrating spends more towards the personal products portfolio than towards the soaps and detergents part of the business. However, given that HPC players have indicated a sharp uptick in A&P spend in 2HFY12F, we see scope for earnings disappointment over the next couple of quarters. With valuations now at 28.2x FY13F, we see limited scope for HUVR's P/E multiple to expand further. We believe that as the market digests the slower earnings growth profile of HUVR over the medium term, its P/E will de-rate back to its mean levels of 22-24x. We maintain our Reduce rating on the stock at these levels.

Valuation methodology

Our P/E-based valuation methodology is unchanged, although we revise our multiple to 21x one-year forward earnings from 20x earlier. As highlighted above, the marginal change in target multiple is on account of:

- Margin pressures are starting to ease at least at the gross margin level and this is now reflected in our valuation of HUVR
- Assigned multiple is still less than the average multiple we assign to other consumer companies of 24x as over the long term, HUVR still offers the slowest earnings growth profile, in our view.

Risks

There are two key upside risks to our target price and estimates:

- First, a sharp decrease in input prices would likely improve gross margins significantly, which would be a risk to our numbers.
- Second, if the company keeps A&P spend low, EBITDA margins could expand by more than our expectations.

Appendix A-1

Analyst Certification

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Mentioned companies

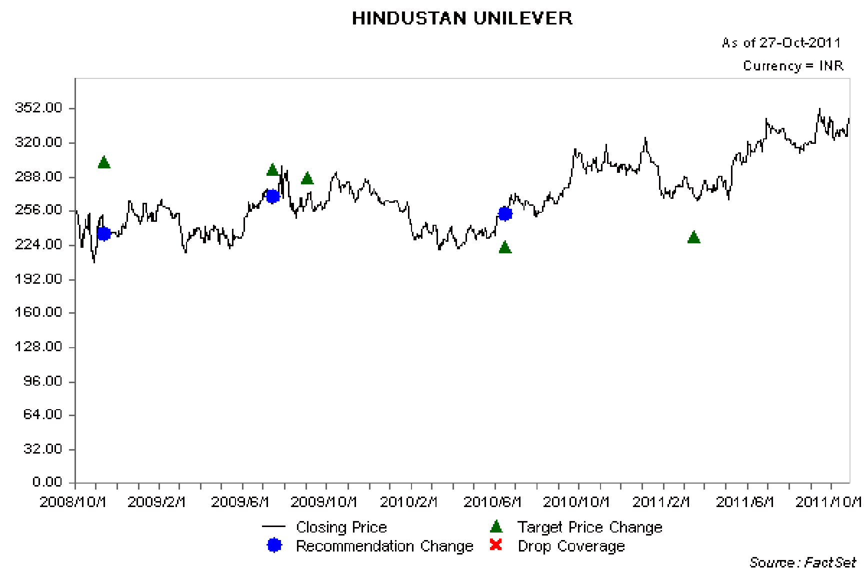
Issuer name	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Hindustan Unilever	HUVR IN	INR 376	31-Oct-2011	Reduce	Not rated	

Previous Rating

Issuer name	Previous Rating	Date of change
Hindustan Unilever	Neutral	17-Jun-2010

Hindustan Unilever (HUVR IN) **INR 376 (31-Oct-2011)** Reduce (Sector rating: Not rated)

Rating and target price chart (three year history)



Date	Rating	Target price	Closing price
17-Mar-2011		232.00	270.80
17-Jun-2010		222.00	252.95
17-Jun-2010	Reduce		252.95
03-Sep-2009		287.00	266.95
14-Jul-2009		295.00	269.40
14-Jul-2009	Neutral		269.40
12-Nov-2008		302.00	234.65
12-Nov-2008	Buy		234.65

For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our PT of INR297 values HUVR at 21x our FY12-FY13 average earnings estimate of INR14.2

Risks that may impede the achievement of the target price First, a sharp decrease in input prices would likely improve gross margins significantly, which would be a risk to our numbers. Second, if the company keeps A&P spend low, EBITDA margins could expand by more than our expectations.

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