

COMPANY UPDATE

Hindustan Unilever (HLL.BO)

Sell

Equity Research

Several headwinds for sustaining high volume growth; Sell**What's changed**

Hindustan Unilever (HLL) reported 3QFY12 sales of Rs58.5 bn (+16% yoy, 1% below our estimate). PAT of Rs7,538 mn was 6% above our estimate due to lower-than-expected A&P spend. EBIT growth in personal products decelerated sharply due to lower-than-expected margins and revenue growth. Soaps & detergents operating profit margin expanded as less intense competition permitted price hikes and a reduction in A&P spend. Key takeaways from the conference call: 1) Oral care showed moderate yoy growth; 2) negative pricing growth yoy in personal products, driven by promotions; 3) reduced A&P spend in commodity-based categories like soaps & detergents and beverages, but continued spend in personal products and processed foods; and 4) continued emphasis in distribution.

Implications

We see headwinds for sustaining volume growth: 1) the latest Nielsen data indicates FMCG growth of 10% yoy in 3QFY12 vs. 15% in 2QFY12. However, management's comments indicated stronger growth; 2) competition remains high overall, with three of HUL's largest competitors willing to operate at low margins to gain market share; 3) a sustained cut in A&P spends could result in a weakening market position for some brands; and 4) high 4QFY11 base. Any softening in raw material prices will likely be balanced by more intense competition, in our opinion.

Valuation

We retain our Sell rating and raise our 12-month target price to Rs304 from Rs298, implying 20% downside from current levels. Our target price is based on 22X FY13E EPS (unchanged). We raise our FY12-13E EPS by 2-3% to account for lower advertising expenses. HUL is trading at 28X 1-yr fwd EPS, which is more than 1-SD above its 10-yr average.

Key risks

- (1) Less intense competition and sharp margin rebound in laundry segment;
- (2) higher-than-expected volume growth led by up-trading.

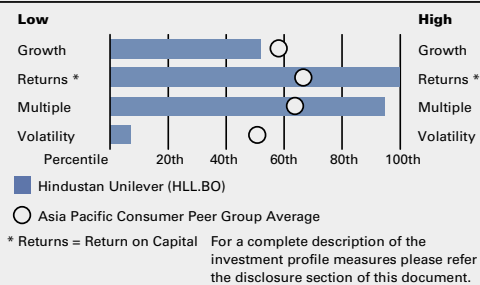
INVESTMENT LIST MEMBERSHIP

Asia Pacific Sell List

Coverage View: Neutral

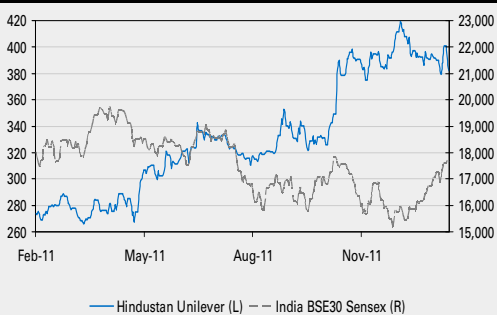
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Investment Profile

Key data	Current
Price (Rs)	382.00
12 month price target (Rs)	304.00
Market cap (Rs mn / US\$ mn)	833,073.1 / 16,980.7
Foreign ownership (%)	--

	3/11	3/12E	3/13E	3/14E
EPS (Rs) New	10.62	12.55	13.81	15.68
EPS revision (%)	0.0	3.3	1.8	3.0
EPS growth (%)	5.2	18.1	10.0	13.6
EPS (dil) (Rs) New	10.62	12.52	13.78	15.65
P/E (X)	36.0	30.4	27.7	24.4
P/B (X)	31.3	23.4	18.6	15.3
EV/EBITDA (X)	21.4	23.9	20.5	17.4
Dividend yield (%)	1.7	2.0	2.2	2.6
ROE (%)	88.4	88.0	74.9	68.8
CROCI (%)	119.2	154.2	127.6	124.8

Price performance chart

Share price performance (%)	3 month	6 month	12 month
Absolute	0.8	20.0	39.5
Rel. to India BSE30 Sensex	0.5	17.8	42.8

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 2/07/2012 close.

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Hindustan Unilever: Summary Financials

Profit model (Rs mn)					Balance sheet (Rs mn)				
	3/11	3/12E	3/13E	3/14E		3/11	3/12E	3/13E	3/14E
Total revenue	194,011.1	222,996.1	243,116.0	274,127.6	Cash & equivalents	16,400.1	19,541.3	27,263.1	36,371.9
Cost of goods sold	(102,776.9)	(122,956.1)	(131,618.7)	(145,666.6)	Accounts receivable	9,432.0	10,841.1	11,819.3	13,326.9
SG&A	(69,790.3)	(72,185.3)	(78,695.4)	(89,567.7)	Inventory	28,112.6	34,427.7	36,853.2	40,786.6
R&D	--	--	--	--	Other current assets	7,007.2	7,707.9	7,707.9	7,707.9
Other operating profit/(expense)	3,340.9	3,340.9	3,340.9	3,340.9	Total current assets	60,951.9	72,518.1	83,643.6	98,193.4
EBITDA	26,993.1	33,733.8	38,910.1	45,354.5	Net PP&E	24,682.4	26,604.1	28,699.2	31,061.5
Depreciation & amortization	(2,208.3)	(2,538.2)	(2,767.2)	(3,120.2)	Net intangibles	0.0	0.0	0.0	0.0
EBIT	24,784.8	31,195.6	36,142.9	42,234.3	Total investments	14,703.4	14,703.4	14,703.4	14,703.4
Interest income	0.0	492.0	586.2	817.9	Other long-term assets	0.0	0.0	0.0	0.0
Interest expense	(2.4)	0.0	0.0	0.0	Total assets	100,337.7	113,825.6	127,046.2	143,958.4
Income/(loss) from uncons. subs.	0.0	0.0	0.0	0.0	Accounts payable	47,262.3	50,529.9	52,286.9	55,872.1
Others	4,587.7	3,500.0	2,500.0	1,500.0	Short-term debt	0.0	0.0	0.0	0.0
Pretax profits	29,370.1	35,187.6	39,229.1	44,552.2	Other current liabilities	26,736.2	28,051.8	30,417.5	34,011.5
Income tax	(6,310.4)	(8,093.1)	(9,415.0)	(10,692.5)	Total current liabilities	73,998.5	78,581.7	82,704.3	89,883.6
Minorities	0.0	0.0	0.0	0.0	Long-term debt	0.0	0.0	0.0	0.0
Net income pre-preferred dividends	23,059.7	27,094.4	29,814.1	33,859.7	Other long-term liabilities	0.0	0.0	0.0	0.0
Preferred dividends	0.0	0.0	0.0	0.0	Total long-term liabilities	0.0	0.0	0.0	0.0
Net income (pre-exceptionals)	23,059.7	27,094.4	29,814.1	33,859.7	Total liabilities	73,998.5	78,581.7	82,704.3	89,883.6
Post-tax exceptionals	0.0	0.0	0.0	0.0	Preferred shares	0.0	0.0	0.0	0.0
Net income	23,059.7	27,094.4	29,814.1	33,859.7	Total common equity	26,339.2	35,243.9	44,341.8	54,074.8
EPS (basic, pre-exception) (Rs)	10.62	12.55	13.81	15.68	Minority interest	0.0	0.0	0.0	0.0
EPS (basic, post-exception) (Rs)	10.62	12.55	13.81	15.68	Total liabilities & equity	100,337.7	113,825.6	127,046.2	143,958.4
EPS (diluted, post-exception) (Rs)	10.62	12.52	13.78	15.65	BVPS (Rs)	12.20	16.32	20.53	25.04
DPS (Rs)	6.47	7.50	8.50	10.00					
Dividend payout ratio (%)	60.9	59.8	61.6	63.8					
Free cash flow yield (%)	2.8	2.6	3.4	4.0					
Growth & margins (%)					Ratios				
	3/11	3/12E	3/13E	3/14E		3/11	3/12E	3/13E	3/14E
Sales growth	10.7	14.9	9.0	12.8	CROCI (%)	119.2	154.2	127.6	124.8
EBITDA growth	(1.8)	25.0	15.3	16.6	ROE (%)	88.4	88.0	74.9	68.8
EBIT growth	(3.4)	25.9	15.9	16.9	ROA (%)	23.8	25.3	24.8	25.0
Net income growth	4.7	17.5	10.0	13.6	ROACE (%)	273.7	208.4	179.2	191.1
EPS growth	5.2	18.1	10.0	13.6	Inventory days	88.6	92.8	98.8	97.3
Gross margin	47.0	44.9	45.9	46.9	Receivables days	15.3	16.6	17.0	16.7
EBITDA margin	13.9	15.1	16.0	16.5	Payable days	151.4	145.1	142.6	135.5
EBIT margin	12.8	14.0	14.9	15.4	Net debt/equity (%)	(62.3)	(55.4)	(61.5)	(67.3)
					Interest cover - EBIT (X)	NM	NM	NM	NM
Cash flow statement (Rs mn)					Valuation				
	3/11	3/12E	3/13E	3/14E		3/11	3/12E	3/13E	3/14E
Net income pre-preferred dividends	23,059.7	27,094.4	29,814.1	33,859.7	P/E (analyst) (X)	36.0	30.4	27.7	24.4
D&A add-back	2,208.3	2,538.2	2,767.2	3,120.2	P/B (X)	31.3	23.4	18.6	15.3
Minorities interests add-back	0.0	0.0	0.0	0.0	EV/EBITDA (X)	21.4	23.9	20.5	17.4
Net (inc)/dec working capital	(1,534.3)	(3,841.7)	718.9	1,738.2	EV/GCI (X)	39.0	34.8	29.3	25.4
Other operating cash flow	(3,860.3)	0.0	0.0	0.0	Dividend yield (%)	1.7	2.0	2.2	2.6
Cash flow from operations	19,873.4	25,790.9	33,300.3	38,718.1					
Capital expenditures	(3,096.5)	(4,459.9)	(4,862.3)	(5,482.6)					
Acquisitions	0.0	0.0	0.0	0.0					
Divestitures	3,476.4	0.0	0.0	0.0					
Others	0.0	0.0	0.0	0.0					
Cash flow from investments	379.9	(4,459.9)	(4,862.3)	(5,482.6)					
Dividends paid (common & pref)	(16,556.1)	(18,189.8)	(20,716.1)	(24,126.7)					
Inc/(dec) in debt	0.0	0.0	0.0	0.0					
Common stock issuance (repurchase)	(6,187.9)	0.0	0.0	0.0					
Other financing cash flows	(31.3)	0.0	0.0	0.0					
Cash flow from financing	(22,775.3)	(18,189.8)	(20,716.1)	(24,126.7)					
Total cash flow	(2,522.0)	3,141.2	7,721.8	9,108.8					

Note: Last actual year may include reported and estimated data.

Source: Company data, Goldman Sachs Research estimates.

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Exhibit 1: Personal products sales below expectations as pricing was negative for the quarter
 3QFY12 results summary

Rs mn	3QFY12 Actual	3QFY12 GS est.	var	3QFY11 Actual	yoy	2QFY12 Actual	qoq
Net Sales	58,527	59,073	-1%	50,270	16%	55,222	6%
Other operating Income	849	850		1,007		883	
Total Income	59,376	59,923		51,277		56,105	
COGS	30,751	31,581	-3%	25,692	20%	30,010	2%
Gross Profit	28,626	28,342	1%	25,586	12%	26,095	10%
Employee Cost	2,741	2,800		2,310		2,873	
A&P	6,902	7,500		7,433		6,514	
Other expenditure	9,278	8,850		8,593		8,441	
EBITDA (adjusted)	9,705	9,192	6%	7,250	34%	8,267	17%
Depreciation	568	672		563		571	
EBIT (adjusted)	9,137	8,519	7%	6,687	37%	7,696	19%
Other income	801	600		1,413		1,221	
Interest expense	5	-		1		5	
PBT (bei)	9,933	9,119	9%	8,099	23%	8,911	11%
Exceptionals	(124)	100		-		-	
PBT	9,809	9,219	6%	8,099	21%	8,911	10%
Tax expense	2,271	2,120		1,724		2,022	
PAT (post Extraordinary and minorities)	7,538	7,099	6%	6,375	18%	6,889	9%

Margins	3QFY12 Actual	3QFY12 GS est.	var bps	3QFY11 Actual	yoy bps	2QFY12 Actual	qoq bps
Gross	48.9%	48.0%	93	50.9%	(199)	47.3%	166
EBITDA	16.6%	15.6%	102	14.4%	216	15.0%	161
EBIT	15.6%	14.4%	119	13.3%	231	13.9%	167
PBT (bei)	17.0%	15.4%	153	16.1%	86	16.1%	83
A&P - % of sales	11.8%	12.7%	(90)	14.8%	(299)	11.8%	(0)
Tax rate	23.2%	23.0%	15	21.3%	187	22.7%	46

Segment	3QFY12 Actual	3QFY12 GS est.	var bps	3QFY11 Actual	yoy bps	2QFY12 Actual	qoq bps
Revenue							
Soaps and detergents	26,460	25,900	2%	21,929	21%	25,926	2%
Personal Products	18,862	19,500	-3%	16,547	14%	16,126	17%
Beverages	6,704	6,829	-2%	6,022	11%	6,533	3%
Processed foods	3,064	3,267	-6%	2,700	13%	3,318	-8%
Exports	3,375	3,206	5%	2,909	16%	2,909	16%
Others	982	1,189	-17%	1,111	-12%	1,161	-15%
Total	59,446	59,892	-1%	51,218	16%	55,973	6%
Less: Inter segment	-	(12)		-		-	
Net segment revenue	59,446	59,879	-1%	51,218	16%	55,973	6%

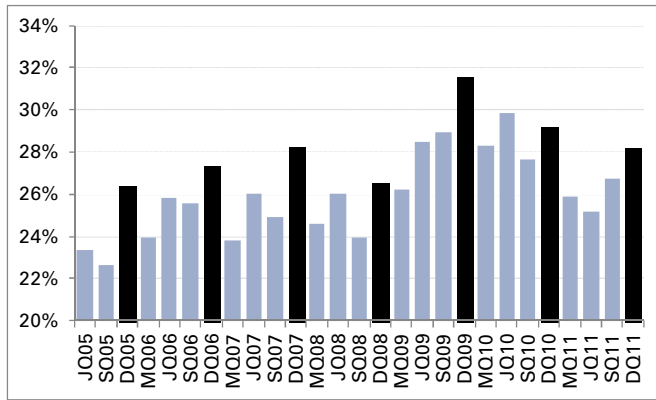
Results	3QFY12	3QFY12	var	3QFY11	yoy	2QFY12	qoq
Soaps and detergents	3,559	na	na	1,693	110%	3,212	11%
Personal Products	4,881	na	na	4,769	2%	3,940	24%
Beverages	1,052	na	na	1,014	4%	877	20%
Processed foods	(60)	na	na	(166)	-64%	165	-136%
Exports	446	na	na	227	97%	240	86%
Others	(103)	na	na	(185)	-44%	(78)	32%
Total	9,776	na	na	7,351	33%	8,357	17%

Margins	3QFY12	3QFY12	var	3QFY11	yoy	2QFY12	qoq
Soaps and detergents	13.5%	na	na	7.7%	573	12.4%	106
Personal Products	25.9%	na	na	28.8%	(294)	24.4%	144
Beverages	15.7%	na	na	16.8%	(115)	13.4%	226
Processed foods	-1.9%	na	na	-6.2%	421	5.0%	(691)
Exports	13.2%	na	na	7.8%	542	8.3%	496
Others	-10.5%	na	na	-16.6%	617	-6.7%	(374)
Total	16.4%	na	na	14.4%	209	14.9%	151

Note: 3Q EBIT is adjusted for an exceptional.

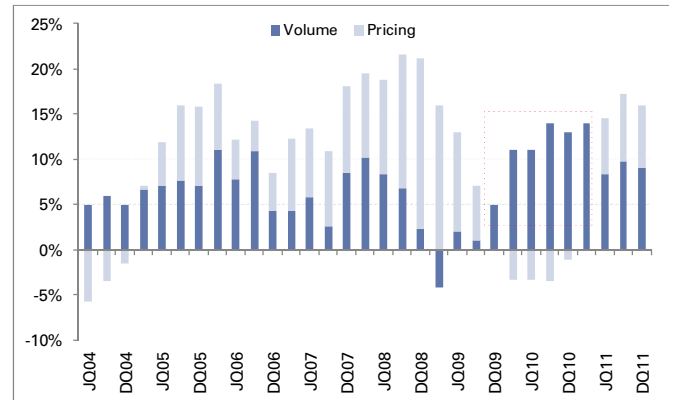
Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: Margins pre-A&P have declined yoy
EBITDA margins pre A&P spend



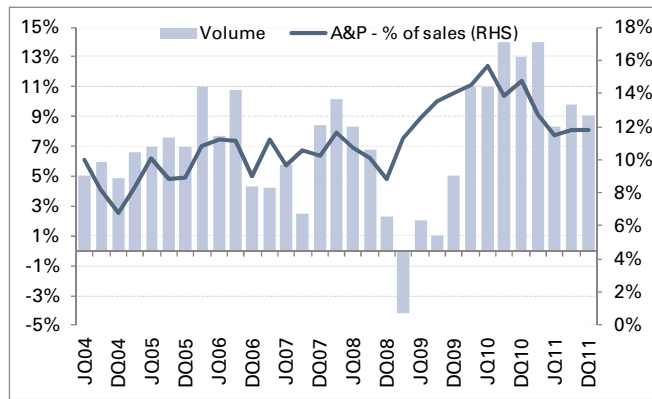
Source: Company data, Goldman Sachs Research.

Exhibit 3: Volume growth has dipped since 1QFY12
Growth split into volume growth and pricing growth (yoy)



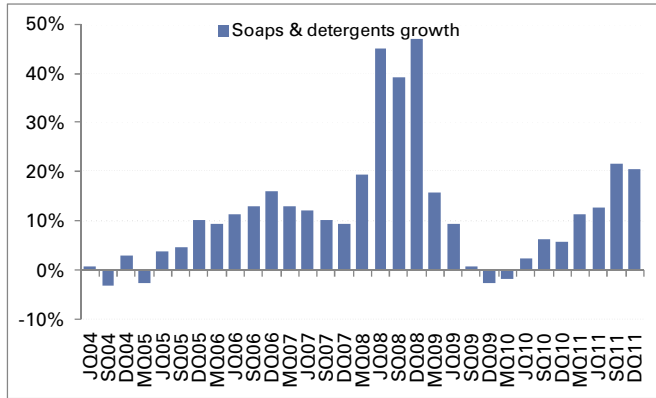
Source: Company data, Goldman Sachs Research.

Exhibit 4: Sustained A&P spend is key ingredient to volume growth, in our view
Quarterly volume growth and A&P spends



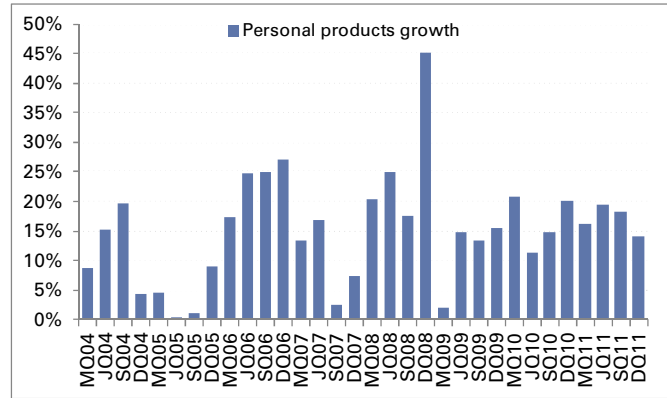
Source: Company data, Goldman Sachs Research.

Exhibit 5: Soaps & detergents growth was price-led
Soaps & detergents sales growth – yoy



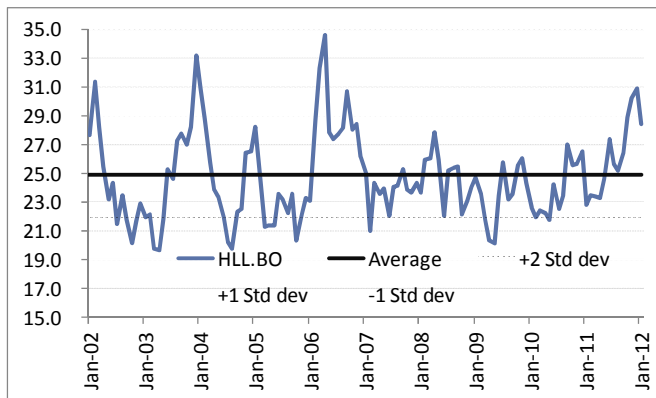
Source: Company data, Goldman Sachs Research.

Exhibit 6: Personal products growth was driven by volume and some pricing declines
Personal products sales growth – yoy



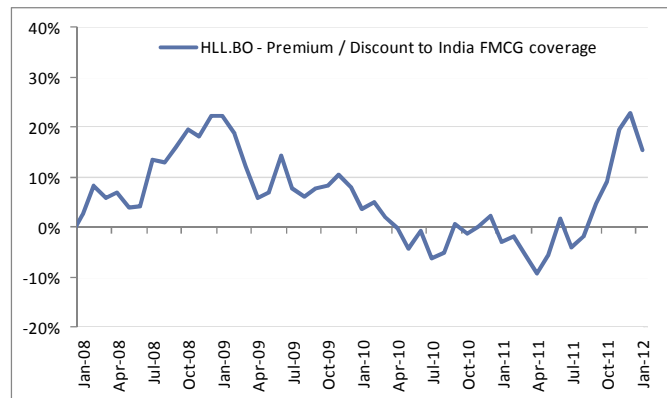
Source: Company data, Goldman Sachs Research.

Exhibit 7: HUL is trading at more than 1 std. dev. above the mean
HUL – Rolling 12-month forward P/E (X)



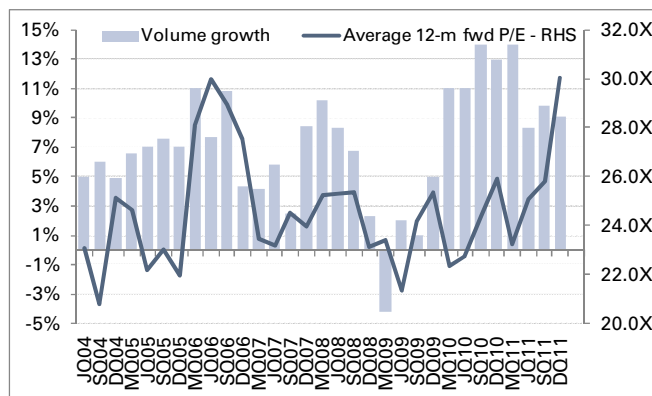
Source: Datastream, company data, Goldman Sachs Research estimates.

Exhibit 8: HUL is trading at premium to our FMCG coverage
HUL – Rolling 12-month forward P/E vs FMCG coverage



Source: Datastream, company data, Goldman Sachs Research estimates.

Exhibit 9: Recent re-rating of stock has followed robust volume growth
Quarterly volume growth and average 12-m fwd P/E (X)



Source: Datastream, Company data, Goldman Sachs Research estimates.

Disclosure Appendix

Reg AC

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India Consumer: Colgate Palmolive (India), Dabur India, Hindustan Unilever, ITC, Marico, Nestle India, Titan Industries.

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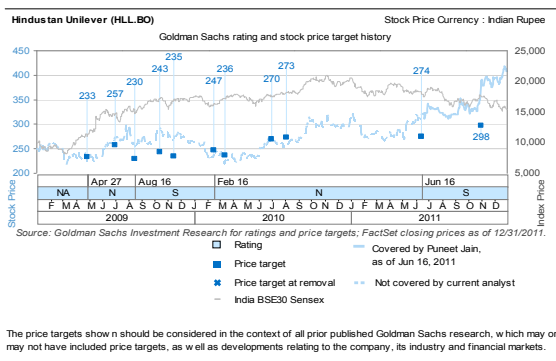
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Price target and rating history chart(s)



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