

Hindustan Unilever Ltd (HUVR IN)

Well set for long-term growth

INDIA | FMCG | Company Update

We attended Hindustan Unilever Limited (HUL)'s annual investor meet and came back with a positive outlook on the foods and personal care segments. Over the last five years, HUL has made significant strides in expanding its distribution reach (3x), time to market, tapping new platforms for advertising and promotion (c.30% non-TV), and improving the backend systems. All these factors will help the company to grow faster than the market over the medium to long term. However, the current market growth rate is at a ten-year low and we cannot see major perceptible improvements in the near term. Apart from this, HUL is trading at 10-year peak valuation of 41x one-year forward earnings, which is compounded by high investor expectations — this leaves limited room for negative surprises. We continue to maintain our Neutral recommendation, valuing the company at 35x FY17E (unchanged) earnings at Rs 844 (unchanged).

Home care: The company will focus on three aspects for home-care category growth – premiumisation, category creation, and profitability. Premium laundry grew at 2x mass laundry in 2014 and Surf Excel displaced Wheel to become the largest HUL brand. The company continues to invest in new categories like 'matic' powders, fabric conditioners, liquid detergents and water purifiers, which have grown at more than 20% in 2014. Pureit has broken even in the last few years and the category continues to deliver superior growth.

Personal Care: Fair & Lovely, the largest skin care brand is back on the growth track driven by optimum formulation, right communication, and innovations such as BB and SPF creams. Deodorants, which was losing market share, has started to outperform the market after the launch of Axe Signature. Recently introduced Dove Elixir Oil has struggled since launch and the company will invest in developing the category in the near future. Recently launched products like Ponds Men Facewash and Lakme Lip Love have gained high single-digit market share in just a few months. HUL is currently #1 in face care, hands & body, hair care, skin cleansing & makeup; #2 in oral care, and #3 in deos. The management also indicated that FY16 is likely to be better for oral care compared to FY15.

Foods & refreshments: Tea has grown 1.5x the market; green tea at 6x the overall tea category and it is 2x more profitable than black tea for HUL. Bru (coffee) is the volume market leader and is inching towards becoming the value leader as well. Currently, 21.5mn households have been contacted through the ongoing Bru activation program. Ice creams grew in double digits with recently launched Magnum contributing to 37% of growth. To reduce retailer's costs and investments and to drive reach, the company has innovatively introduced mini cabinets, which are a third the size of retailers' regular refrigeration cabinets. Packaged foods (Kissan and Knorr) grew ~15% in FY15 and 3.5x the market.

Maintain estimates, recommendation (Neutral), and target price: Currently, the company trades at 43x/37x FY16/FY17 estimated earnings. We value the company at 35x FY17E earnings at Rs 844. Our target multiple of 35x is at a premium to the FMCG sector's multiple of 33x based on HUL's ahead-of-market growth prospects, highly diversified product portfolio, and market leadership position across categories. Taking into account the slight downside from current levels and sluggishness of growth in FY16, we maintain our recommendation at Neutral.

26 June 2015

Neutral (Maintain)

CMP RS 886

TARGET RS 844 (-5%)

COMPANY DATA

O/S SHARES (MN) :	2164
MARKET CAP (RSBN) :	1918
MARKET CAP (USDBN) :	30.2
52 - WK HI/LO (RS) :	979 / 612
LIQUIDITY 3M (USDMN) :	21.5
PAR VALUE (RS) :	1

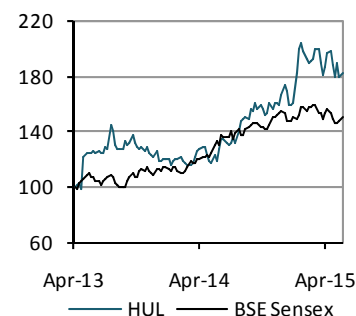
SHARE HOLDING PATTERN, %

PROMOTERS :	67.2
FII / NRI :	15.4
FI / MF :	3.8
NON PROMOTER CORP. HOLDINGS :	1.1
PUBLIC & OTHERS :	12.5

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	3.6	2.4	43.6
REL TO BSE	2.6	1.1	32.6

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY15E	FY16E	FY17E
Net Sales	301,705	331,592	370,907
EBIDTA	58,266	67,121	77,951
Net Profit	38,445	45,002	52,062
EPS, Rs	17.8	20.8	24.1
PER, x	50.0	42.7	36.9
EV/EBIDTA, x	32.5	28.1	24.1
P/BV, x	51.6	49.0	44.5
ROE, %	103.2	114.8	120.6

Source: PhillipCapital India Research Est.

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Key Highlights:

Innovations in segments

Foods and refreshments:

- To increase Kissan Ketchup's penetration, HUL introduced a 90g SKU at a price point of Rs 15 — it increased penetration 6 times.
- Introduced three new variants — Kissan Twist Chilly Tomato, Kissan Twist Sweet & Spicy, and Kissan Mango Jam
- To increase penetration of Knorr Soups, introduced a recruiter pack at price point of Rs 20 for single serve. This variant has grown at 18x the category growth.
- The company has innovatively introduced mini refrigeration cabinets (1/3rd the size of regular equipment), which helped drive sales by reducing investment and electricity expenses of retailers.

Personal Care:

- The company recently launched Ponds Men and Lakme Lip Love — both brands have gained high single-digit market share in just six months.
 - Launched Axe Signature recently — it has helped drive market share growth in deodorants.
- Home Care:
 - The company continues to invest in new categories like 'matic' (washing machine) powders, fabric conditioners, liquid detergents, and water purifiers (the last category grew at more than 20% in 2014).

Customer development and emerging online channel:

The company has increased its distribution reach to 3.2mn outlets in 2014 from 0.9mn outlets in 2009; it now plans to consolidate the distribution network by increasing business from each outlet. HUL also has plans to grab a fair share of business in the emerging channels of modern trade, ecommerce, and chemists, and has concrete plans towards that goal. It has adapted to the explosion of digital media and other non-TV media successfully. Currently 30% of ad spends are on non-TV media (such as digital media) against 10% few years back.

Winning in many Indias initiative:

New sales structure formed involving five branches and 14 clusters (earlier structure was four sales branches). The company now focuses on each cluster individually for innovation, price value equation, and promotion needs. For example, the company recently took pricing actions in UP in some categories to improve value proposition and drive penetration. The management also indicated that growth prospects for the central branch look the most promising as penetration levels are low. It has introduced state-specific variants in some states in categories such as oral care and tea, which have helped drive sales in the particular states.

Sustainability plan:

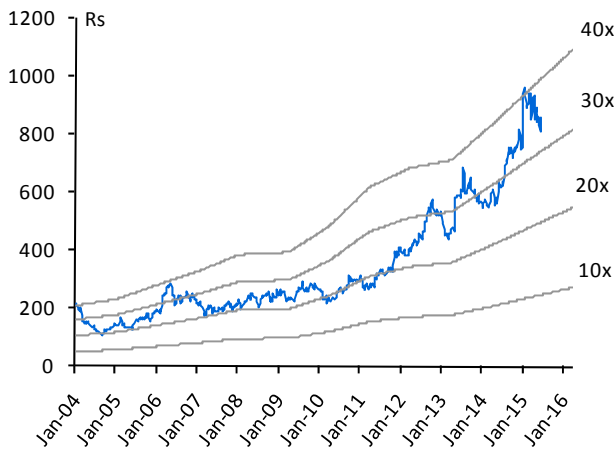
HUL sources 100% of palm oil from sustainable sources that have 100% green certification. It has conserved 100bn litres of water till date and plans to conserve another 100bn litres of water in the next one year. Project Shakti (Hindustan Unilever's rural direct-to-consumer retail distribution initiative) now has over 70,000 Shakti Entrepreneurs (Shakti Ammas) and 48,000 Shaktimaans covering 165,000 villages and reaching over four million rural households. The company has also increased the number of women in managerial positions to 32% from 18% earlier, in line with its gender-diversity objective. Since majority of the consumers for the company are women, it believes that it makes a business case to increase the share of women in the organisation.

Other observations:

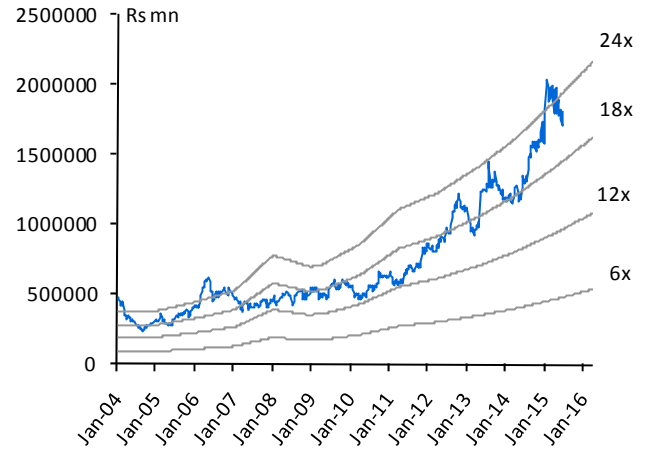
- Last year, it culled 31% of its SKUs that were not contributing to the business and offered no value to the customers.
- Reduced the number of defects per million units by 10% in 2014
- Reduced the number of customer complaints by 40% in 2014
- 17 brands with turnover of more than Rs 50bn:
 - Six brands — Surf Excel, Brookebond, Active Wheel, Rin, Lifebuoy, and Fair & Lovely — have a turnover of more than Rs 20bn.
 - Lux, Dove, Clinic Plus, Ponds and Vim have a turnover between Rs 10bn and Rs 20bn
 - Close Up, Lakme, Bru, Vaseline, Pears and Kissan have a turnover between Rs 5bn and Rs 10bn.

Stock valuations have adjusted to muted earnings and sector derating.

One-year forward P/E band



EV/EBITDA band



Source: PhillipCapital India Research Estimate

Segment operating performance
Sales schedule as per annual report

	CY2006	CY2007	FY2009 (15 months)	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015
Total	121034	137178	202393	175238	193810	217356	252064	274083	301705
Soaps	28,087	30,408	43,019	37,273	39,397	43,034	53,626	56,945	61,412
Synthetic Detergents	25,084	29,552	49,085	39,092	41,601	53,737	60,779	65,398	71,760
<u>Total Soaps & Detergents</u>	<u>53,171</u>	<u>59,960</u>	<u>92,104</u>	<u>76,365</u>	<u>80,998</u>	<u>96,771</u>	<u>114,406</u>	<u>122,344</u>	<u>133,171</u>
Personal products	34,575	38,608	56,161	51,073	59,262	65,098	74,288	80,927	89,967
Tea	14,095	15,512	21,567	19,251	20,975	19,824	22,246	25,780	28,119
Frozen Desserts & Ice Creams	1,344	1,585	2,294	2,289	2,720	3,543	4,134	4,549	5,515
Canned & processed fruits & vegetables	2,332	2,929	4,831	4,273	5,757	6,479	6,767	7,702	9,057
Branded Staple Foods	1,779	2,773	3,854	3,242	3,389	3,776	4,250	4,348	4,651
Others**	12,493	14,713	20,856	18,469	20,548	21,673	25,794	28,201	30,987

Growth yoy %

Soaps	10.5	8.3	19.1	(13.4)	5.7	9.2	24.6	6.2	7.8
Synthetic Detergents	15.9	17.8	43.3	(20.4)	6.4	29.2	13.1	7.6	9.7
<u>Total Soaps & Detergents</u>	<u>13.0</u>	<u>12.8</u>	<u>30.9</u>	<u>(17.1)</u>	<u>6.1</u>	<u>19.5</u>	<u>18.2</u>	<u>6.9</u>	<u>8.9</u>
Personal products*	15.4	11.7	29.7	(9.1)	16.0	9.8	14.1	8.9	11.2
Tea	(0.9)	10.1	29.8	(10.7)	9.0	(5.5)	12.2	15.9	9.1
Frozen Desserts & Ice Creams	38.5	17.9	20.8	(0.2)	18.8	30.3	16.7	10.0	21.2
Canned & processed fruits & vegetables	34.1	25.6	44.4	(11.5)	34.7	12.5	4.4	13.8	17.6
Branded Staple Foods	6.1	55.8	20.9	(15.9)	4.5	11.4	12.6	2.3	7.0
Others	47.1	17.8	35.0	(11.4)	11.3	5.5	19.0	9.3	9.9

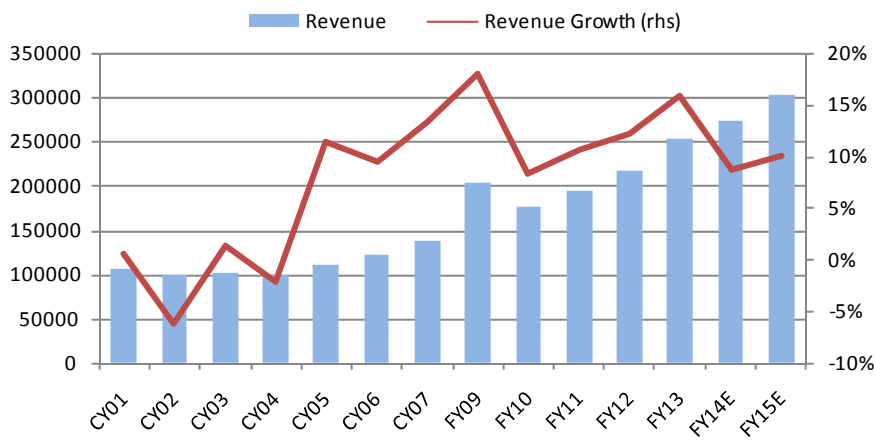
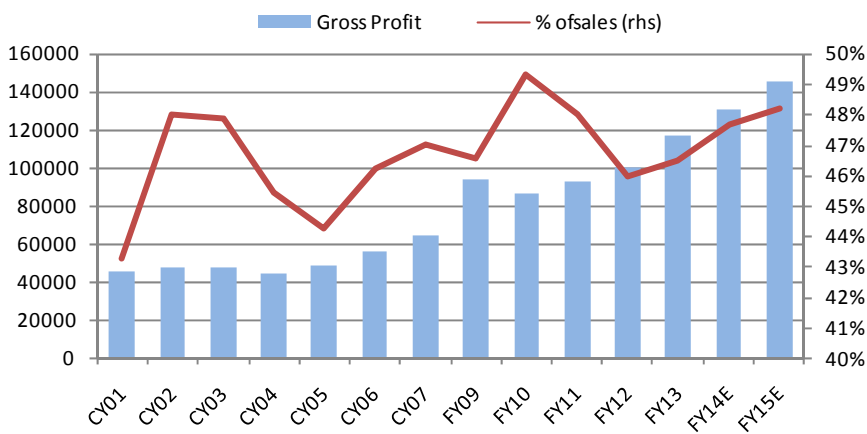
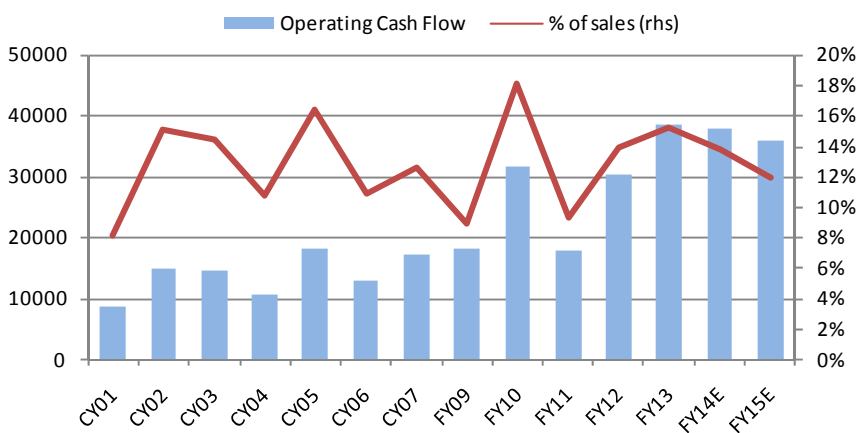
Contribution %

Soaps	23.2	22.2	21.3	21.3	20.3	19.8	21.3	20.8	20.4
Synthetic Detergents	20.7	21.5	24.3	22.3	21.5	24.7	24.1	23.9	23.8
<u>Total Soaps & Detergents</u>	<u>43.9</u>	<u>43.7</u>	<u>45.5</u>	<u>43.6</u>	<u>41.8</u>	<u>44.5</u>	<u>45.4</u>	<u>44.6</u>	<u>44.1</u>
Personal products	28.6	28.1	27.7	29.1	30.6	30.0	29.5	29.5	29.8
Tea	11.6	11.3	10.7	11.0	10.8	9.1	8.8	9.4	9.3
Frozen Desserts & Ice Creams	1.1	1.2	1.1	1.3	1.4	1.6	1.6	1.7	1.8
Canned & processed fruits & vegetables	1.9	2.1	2.4	2.4	3.0	3.0	2.7	2.8	3.0
Branded Staple Foods	1.5	2.0	1.9	1.9	1.7	1.7	1.7	1.6	1.5
Others	10.3	10.7	10.3	10.5	10.6	10.0	10.2	10.3	10.3

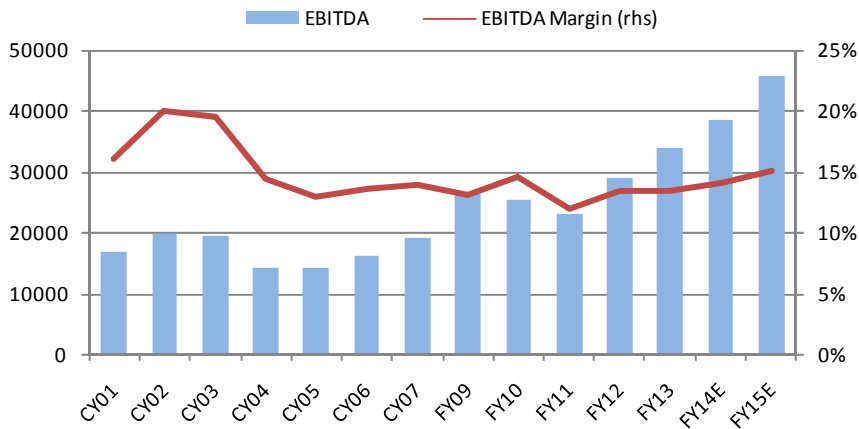
Note: *Personal Products sales in FY12 are lower being adjusted for Other Operating Income. Reported growth is 17% yoy for FY12

** Other business includes Water

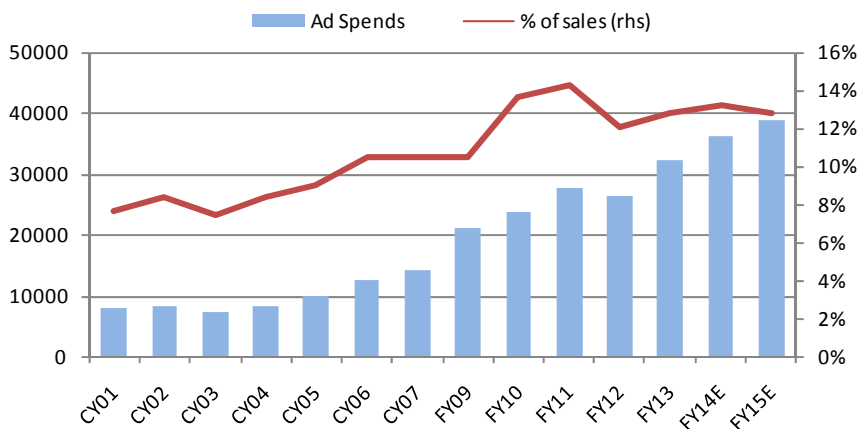
Source: Company, PhillipCapital India Research

Revenue growth slowed in the last two years; we estimate a protracted recovery

Gross margins continue to see improvement. We estimate further improvements driven by mix improvement and savings in raw material sourcing

Operating cash flows have been steady over the years


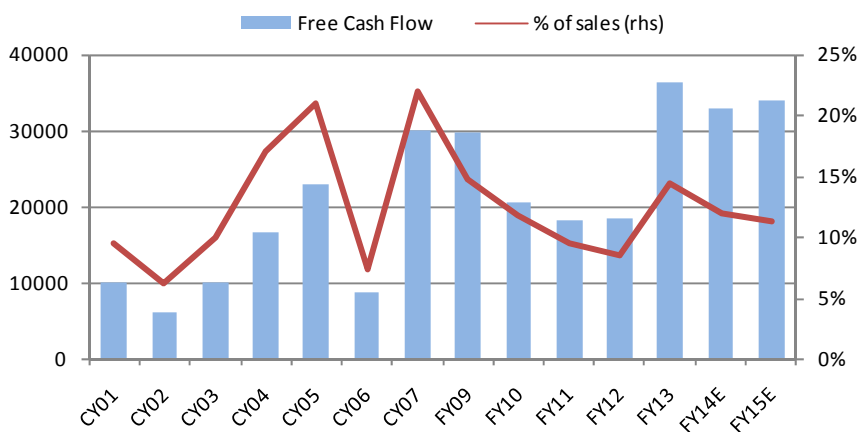
EBITDA margins have been stagnant over last few years and we estimate gradual improvement in the future driven by better cost management



Ad spends have been sustained at high levels since last few years due to prolonged and intense competitive intensity



Free cash flow has been healthy over last few years and we estimate it to be stable for FY16 and FY17



Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15E	FY16E	FY17E
Net sales	274,083	301,705	331,592	370,907
Growth, %	8.7	10.1	9.9	11.9
Other income	12,319	12,535	13,711	15,286
Total income	286,402	314,240	345,303	386,193
Raw material expenses	-143,436	-156,236	-168,361	-186,395
Employee expenses	-14,360	-15,789	-17,466	-19,207
Other Operating expenses	-77,643	-83,949	-92,355	-102,640
EBITDA (Core)	50,963	58,266	67,121	77,951
Growth, %	10.5	14.3	15.2	16.1
Margin, %	18.6	19.3	20.2	21.0
Depreciation	-2,606	-2,867	-3,137	-3,426
EBIT	48,357	55,399	63,984	74,525
Growth, %	10.5	14.6	15.5	16.5
Margin, %	17.6	18.4	19.3	20.1
Interest paid	-360	-168	-168	-168
Pre-tax profit	47,997	55,240	63,827	74,369
Tax provided	-11,014	-16,795	-18,826	-22,307
Profit after tax	36,983	38,445	45,002	52,062
Net Profit	36,983	38,445	45,002	52,062
Growth, %	10.5	4.0	17.1	15.7
Net Profit (adjusted)	36,983	38,445	45,002	52,062
Unadj. shares (m)	2,162	2,162	2,162	2,162
Wtd avg shares (m)	2,162	2,162	2,162	2,162

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15E	FY16E	FY17E
Cash & bank	22,210	25,376	33,012	41,375
Debtors	8,164	7,829	8,975	10,420
Inventory	27,475	26,027	28,044	30,097
Loans & advances	11,432	12,407	13,098	14,428
Other current assets	719	593	593	593
Total current assets	70,000	72,232	83,722	96,913
Investments	30,941	32,779	32,779	32,779
Gross fixed assets	44,429	47,214	51,714	56,714
Less: Depreciation	-20,208	-22,638	-25,775	-29,202
Add: Capital WIP	3,198	4,790	4,790	4,790
Net fixed assets	27,418	29,365	30,729	32,302
Non-current assets	7	4	4	4
Total assets	129,984	136,341	149,194	163,958
Current liabilities	78,180	75,590	82,448	89,612
Provisions	19,034	23,502	27,540	31,185
Total current liabilities	97,214	99,093	109,988	120,798
Total liabilities	97,214	99,093	109,988	120,798
Paid-up capital	2,163	2,164	2,164	2,164
Reserves & surplus	30,608	35,084	37,042	40,997
Shareholders' equity	32,770	37,248	39,206	43,160
Total equity & liabilities	129,984	136,341	149,194	163,958

Cash Flow

	FY14	FY15E	FY16E	FY17E
Pre-tax profit	47,997	55,240	63,827	74,369
Depreciation	2,606	2,867	3,137	3,426
Chg in working capital	7,775	-1,653	3,004	2,336
Total tax paid	-12,966	-15,920	-13,706	-20,825
Cash flow from operating activities	45,412	40,535	56,262	59,305
Capital expenditure	-4,939	-4,814	-4,500	-4,999
Cash flow from investing activities	-12,573	-6,649	-4,496	-4,995
Free cash flow	32,839	33,886	51,766	54,310
Dividend (incl. tax)	-29,485	-35,561	-44,113	-45,931
Cash flow from financing activities	-25,533	-35,424	-44,113	-45,931
Net chg in cash	7,306	-1,539	7,653	8,379

Valuation Ratios

	FY14	FY15E	FY16E	FY17E
Per Share data				
EPS (INR)	17.1	17.8	20.8	24.1
Growth, %	10.5	4.0	17.1	15.7
Book NAV/share (INR)	15.2	17.2	18.1	20.0
FDEPS (INR)	17.1	17.8	20.8	24.1
CEPS (INR)	18.3	19.1	22.3	25.7
CFPS (INR)	19.6	18.7	26.0	27.4
DPS (INR)	13.0	15.0	17.0	19.0
Return ratios				
Return on assets (%)	30.4	29.0	31.6	33.3
Return on equity (%)	112.9	103.2	114.8	120.6
Return on capital employed (%)	125.1	110.1	118.0	126.7
Turnover ratios				
Asset turnover (x)	(158.3)	(257.9)	(1,752.4)	(266.6)
Sales/Total assets (x)	2.2	2.3	2.3	2.4
Sales/Net FA (x)	10.4	10.6	11.0	11.8
Working capital/Sales (x)	(0.2)	(0.2)	(0.2)	(0.2)
Working capital days	(65.8)	(63.2)	(65.3)	(64.2)
Liquidity ratios				
Current ratio (x)	0.7	0.7	0.8	0.8
Quick ratio (x)	0.4	0.5	0.5	0.6
Interest cover (x)	134.2	329.4	380.4	443.1
Dividend cover (x)	1.3	1.2	1.2	1.3
Net debt/Equity (%)	(67.8)	(68.1)	(84.2)	(95.9)
Valuation				
PER (x)	52.0	50.0	42.7	36.9
Price/Book (x)	58.6	51.6	49.0	44.5
Yield (%)	1.5	1.7	1.9	2.1
EV/Net sales (x)	6.9	6.3	5.7	5.1
EV/EBITDA (x)	37.3	32.5	28.1	24.1
EV/EBIT (x)	39.3	34.2	29.5	25.2

Source: Company, PhillipCapital India Research Estimates

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