Index

Hindustan Unilever

Reco: Reduce

Stock Update

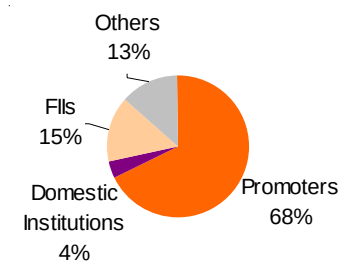
Volume growth sustains at 5%, GPM disappoints; price target revised to Rs710

CMP: Rs722

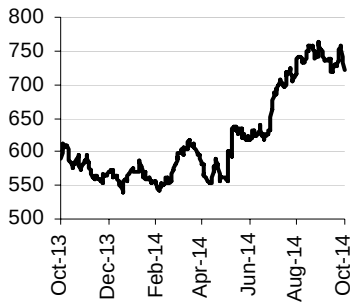
Company details

Price target:	Rs710
Market cap:	Rs156,133 cr
52 week high/low:	Rs771 / 536
NSE volume: (no. of shares)	11.6 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Sharekhan code:	HINDUNILVR
Free float: (no. of shares)	70.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.3	19.7	29.0	26.1
Relative to Sensex	1.9	16.2	8.5	-4.1

Key points

- HUL's stand-alone revenues grew by 11% in Q2FY2015 with the volume growth in the domestic consumer business standing at 5% (vs 6% in Q1FY2015). Despite a correction in commodity prices and a stable rupee against the dollar, the GPM declined by 160BPS YoY to 47.0 which surprised us negatively. The company managed to post a marginal improvement in the OPM at 14.3% by cutting down its advertisement spending, which is not sustainable. The operating profit grew by 14% while a higher depreciation charge and a higher incidence of tax led to just an 8% growth in the PAT to Rs952.1 crore.
- Compared with some of the other FMCG majors, a substantial revival in the volume growth of HUL is expected to get delayed by a few more quarters due to the company's relatively higher dependence on rural India. The demand from rural India is likely to remain subdued as this year's below-normal rainfall will have an impact on the rural economy. Also, we expect the competition in the soap & detergent segment to intensify in the coming quarters, as small and regional players would become more aggressive in a falling raw material price environment.
- We have fine-tuned our earnings estimates for FY2015 and FY2016 to factor in the lower than expected GPM and the higher depreciation charge (we have also introduced our FY2017 estimates in this note). At 36x FY2016E earnings the stock continues to trade at a premium valuation. Hence, we maintain our Reduce rating on the stock with a rolled-over revised price target of Rs710 (valuing HUL at 30x FY2017E earnings, which is equal to the average one-year forward PE multiple of the last three years).
- **Risk to our call:** Any announcement on a potential buy-back by the promoter at price higher than the current stock price remains a risk to our rating on the stock.

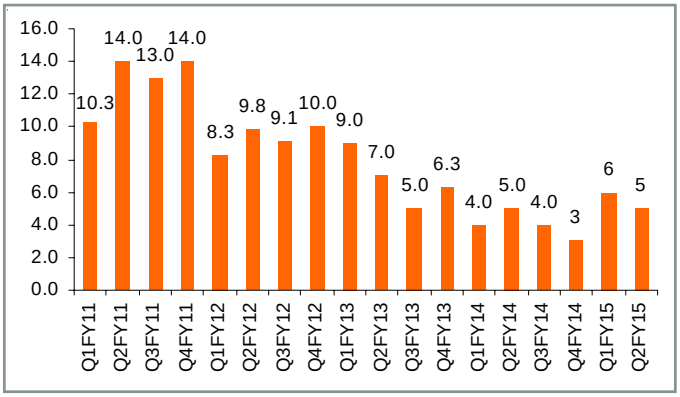
Results (stand-alone) Rs cr

Particulars	Q2FY15	Q2FY14	YoY %	Q1FY15	QoQ %
Net sales	**7465.5**	**6747.2**	**10.6**	**7570.8**	**-1.4**
Total expenditure	6397.3	5807.3	10.2	6432.2	-0.5
Operating profit	1068.2	939.9	13.7	1138.5	-6.2
Other income	371.6	296.4	25.4	347.7	6.9
EBIDTA	1439.8	1236.3	16.5	1486.2	-3.1
Interest	6.3	6.3	-	6.3	-
PBDT	1433.5	1230.0	16.5	1480.0	-3.1
Depreciation	76.4	63.9	19.5	66.7	14.5
PBT	1357.1	1166.1	16.4	1413.2	-4.0
Tax	405.0	285.7	41.7	416.6	-2.8
Adjusted PAT	**952.1**	**880.4**	**8.2**	**996.7**	**-4.5**
Extraordinary items	-36.0	-33.4	-	-59.7	-39.7
Reported PAT	**988.2**	**913.8**	**8.1**	**1056.4**	**-6.5**
Adjusted EPS (Rs)	4.4	4.1	8.2	4.6	-4.5
GPM (%)	47.0	48.6	(160)BPS	47.3	(33)BPS
OPM (%)	14.3	13.9	(38)BPS	15.0	(73)BPS

Volume growth to sustain in the range of 5-6% in the near term

As expected, Hindustan Unilever Ltd (HUL)'s volume growth in the domestic consumer business stood at 5% in Q2FY2015 as against 6% in Q1FY2015. We don't expect the volume growth to improve substantially in the coming quarters, as more than 50% of the company's revenues come from rural India. The demand from rural India is expected to remain subdued as this year's below-normal rainfall will have an impact on the rural economy. Also, we expect the competition in the soap & detergent segment to intensify in the coming quarters, as small and regional players would become more aggressive in a falling raw material price environment.

Underlying volume growth sustained at 5%



GPM likely to improve, OPM to see modest growth in the coming quarters

With a correction in the prices of palm oil and crude oil and the rupee settling at Rs61-62 against the dollar, we expect the gross profit margin (GPM) of the company to start improving from the second half of the current fiscal. However, a large part of the benefits of savings on the raw material cost is likely to be used for brand building and promotional activities in the coming quarters. Going ahead, increase in the excise duty would eat-out some of the benefits of lower raw material prices. Hence, the gains in the operating profit margin (OPM) would be limited to 20-30 basis points (BPS) on a year-on-year basis in the near to medium term.

Soap and detergent segment: a double-digit revenue growth; PBIT margin declined YoY

- In Q2FY2015 HUL's soap and detergent segment grew by 11.1% year on year (YoY) to Rs3,755.1 crore. The soap segment grew in double digits, largely a price-led growth. In the detergent space, *Surf* continues to post volume-led growth.
- The profit before interest and tax (PBIT) margin of the soap & detergent segment declined by 40BPS YoY largely on account higher input cost inflation.

Personal product segment: revenues grew 10%, PBIT margin improved YoY

- The personal product segment's revenues grew by 10% YoY to Rs3,755.1crore. In the skin care segment, the brands *Fair & Lovely* (FAL) and *Pond's* registered a double-digit volume growth. FAL continued to build up momentum while the growth of *Pond's* was led by the strong performance of premium skin lightening and talc segments. *Vaseline* performance was impacted by high base of corresponding quarter last year.
- The hair care segment registered a double-digit volume growth, driven by a strong performance of *Dove* and *Clinic Plus* hair care brands.
- The oral care segment posted a subdued performance in Q2FY2015, as high competition affected its performance.
- The PBIT margin of the personal product segment improved by 156BPS to 24.4%.

Home and personal care business' performance

Particulars	Q2 FY15	Q2 FY14	YoY %	Q1 FY15	QoQ %
Revenue					
Soaps and detergents	3755.1	3380.8	11.1	3847.6	-2.4
Personal products	2142.7	1950.3	9.9	2159.6	-0.8
Total	**5897.8**	**5331.1**	**10.6**	**6007.1**	**-1.8**
PBIT					
Soaps and detergents	511.2	473.9	7.9	531.8	-3.9
Personal products	522.3	444.9	17.4	596.7	-12.5
Total	**1033.5**	**918.8**	**12.5**	**1128.5**	**-8.4**
PBIT margins (%)					
Soaps and detergents	13.6	14.0	-40	13.8	-21
Personal products	24.4	22.8	156	27.6	-325
Total	**17.5**	**17.2**	**29**	**18.8**	**-126**

Food business: packaged food segment delivered double-digit revenue growth

- In Q2FY2015, the packaged food segment posted a decent performance with a revenue growth of 13.4% and a double-digit growth across brands. The brands *Kissan* and *Knorr* continued to perform well while the ice cream segment delivered another quarter of strong performance with the premium ice cream brand, *Magnum*, gaining good acceptance. The PBIT margin of the packaged food business improved by 108BPS YoY to 10.9%.
- The beverage segment maintained its 10% revenue growth with the tea segment delivering a healthy quarter of strong volume growth. The PBIT margin of the segment improved by 40BPS to 17.3%.

Food business' performance

Particulars	Q2 FY15	Q2 FY14	YoY %	Q1 FY15	QoQ %
Revenues (Rs cr)					
Packaged foods	451.3	398.0	13.4	543.8	-17.0
Beverages	899.1	835.4	7.6	836.6	7.5
Total	**1350.4**	**1233.4**	**9.5**	**1380.3**	**-2.2**
PBIT (Rs cr)					
Packaged foods	20.0	13.3	50.1	59.1	-66.2
Beverages	155.7	141.7	9.9	136.3	14.3
Total	**175.7**	**155.0**	**13.4**	**195.3**	**-10.0**
PBIT margins (%)					
Packaged foods	4.4	3.3	108	10.9	-643
Beverages	17.3	17.0	36	16.3	103
Total	**13.0**	**12.6**	**44**	**14.1**	**-114**

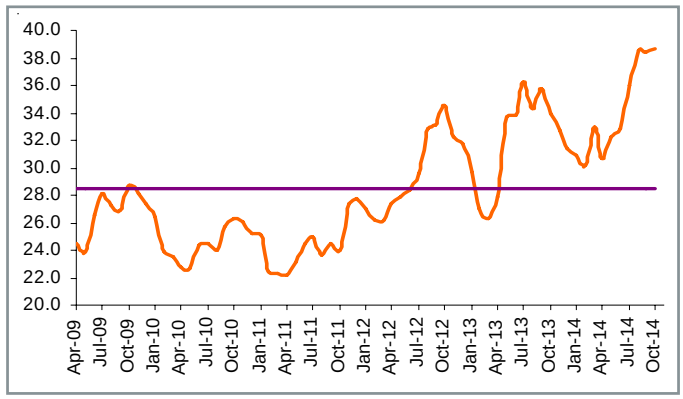
Outlook and valuation

We have fine-tuned our earnings estimates for FY2015 and FY2016 to factor in the lower than expected GPM and the higher depreciation charge (we have also introduced our FY2017 estimates in this note). At 36x FY2016E earnings the stock continues to trade at a premium valuation. Hence, we maintain our Reduce rating on the stock with a rolled-over revised price target of Rs710 (valuing HUL at 30x FY2017E earnings, which is equal to the average one-year forward PE multiple of the last three years).

Valuations (consolidated)

Particulars	FY13	FY14	FY15E	FY16E	FY17E
Net sales (Rs cr)	26317.2	28539.0	32646.5	36860.8	42638.9
Net profit (Rs cr)	3233.7	3717.0	3953.5	4428.1	5100.7
Y-o-Y growth %	20.4	14.9	6.4	12.0	15.2
OPM (%)	13.4	14.2	14.1	14.2	14.4
EPS (Rs)	15.0	17.2	18.3	20.5	23.6
PER (x)	48.7	42.4	39.8	35.6	30.9
P/BV (Rs)	56.4	45.7	32.6	23.6	17.1
EV/EBIDTA (x)	44.7	38.6	33.7	29.3	24.4
RoCE (%)	135.7	154.0	127.6	103.1	86.4
RoNW (%)	98.8	116.1	93.0	74.9	62.6

One-year forward PE (x)



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Apollo Tyres
Ashok Leyland
Bajaj Auto
Gabriel India
M&M
Maruti Suzuki India
TVS Motor Company

Banks & Finance
Allahabad Bank
Andhra Bank
Axis (UTI) Bank
Bajaj Finserv
Bajaj Finance
Bank of Baroda
Bank of India
Capital First
Corp Bank
Federal Bank
HDFC
HDFC Bank
ICICI Bank
IDBI Bank
LIC Housing Finance
Punjab National Bank
PTC India Financial Services
SBI
Union Bank of India
Yes Bank

Consumer goods
GSK Consumers
Godrej Consumer Products
Hindustan Unilever
ITC
Jyothy Laboratories
Marico
Zydus Wellness

IT / IT services
CMC
Firstsource Solutions
HCL Technologies
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Wipro

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Orient Paper and Industries
Shree Cement
The Ramco Cements
UltraTech Cement

Discretionary consumption
Cox & Kings
Eros International Media
Indian Hotel Company
KKCL
Raymond
Relaxo Footwears
Speciality Restaurants
Sun TV Network
Zee Entertainment Enterprises

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