2 June 2017

Update | Sector: Consumer

Hindustan Unilever

BSE SENSEX	S&P CNX
31,273	9,654

Hindustan Unilever Limited

Stock Info

Bloomberg	HUVR IN
Equity Shares (m)	2164.246
52-Week Range (INR)	1101 / 783
1, 6, 12 Rel. Per (%)	13/11/9
M.Cap. (INR b)	1937.3
M.Cap. (USD b)	28.9
Avg Val, INRm	1208
Free float (%)	32.8

Financials Snapshot (INR b)

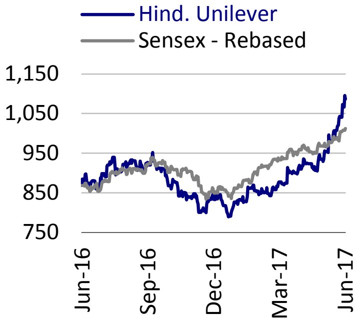
Y/E Mar	2017	2018E	2019E
Net Sales	313.0	348.3	395.0
EBITDA (Rs b)	60.5	70.0	82.3
Net Profit	42.5	49.3	58.4
EPS	19.6	22.8	27.0
EPS Gr. (%)	1.9	16.1	18.4
BV/Sh. (INR)	30.8	31.8	33.6
P/E (x)	55.4	47.7	40.3
P/BV (x)	35.3	34.2	32.4
RoE (%)	65.6	72.8	82.5
RoCE (%)	87.3	96.6	109.6

Shareholding pattern (%)

As On	Mar-17	Dec-16	Mar-16
Promoter	67.2	67.2	67.2
DII	5.7	5.8	4.8
FII	13.3	13.1	14.2
Others	13.9	13.9	13.8

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR1,087 TP: INR1,215(+12%) Buy

Strengthening the Core

Higher premiumization to drive earnings

We attended HUVR annual investor meet 2017. Following are the key takeaways:

- **Clear focus on thought leadership far ahead of peers and improving accessibility of their core brands in each segment.**
- **Far more emphasis on premiumization across segments than earlier.**
- **Strengthening the Naturals portfolio across segments keeping *Lever Ayush* as the master brand in addition to other specific natural brands like Indulekha, St' Ives and the new skin and hair brand Citra.**
- **Zero based budgeting across all areas will we believe yield far more in terms of margins than we had anticipated, particularly when allied with strong premiumization.**
- **Increase in sampling and sachets to drive market development of premium products and formats of the future.**
- **Building strong capabilities across channels.**
- **A confluence of positives including expectations of normal monsoon, moderate inflation, government schemes aiding consumption growth, weak base of the past three years, end of commodity price deflation, continued premiumization, and cost savings is leading to outlook for rural-focused companies being brighter than in the past few years**
- **For HUVR, the salience of rural sales is one of the highest, brand portfolio is the widest, and distribution reach is the broadest among peers, making it uniquely positioned to take advantage of the confluence of positive factors.**
- **We expect earnings CAGR of 17% over FY17-19, far superior than the 6-11% for the past 3/5/10 years. This along with best-of-the-breed return ratios and dividend yield justifies HUVR's premium valuations. The stock trades at 40x FY19E EPS. We reiterate Buy with a price target of INR1,215 (45x FY19E EPS; 5% premium to 3-year average).**

- **Delivery and Strategy going forward**: FY17 was a challenging year with markets remaining subdued (urban and rural), commodity cost inching up and extreme climatic conditions. In the latter half of the year when the markets were just witnessing an uptick in demand, demonetization pulled the demand back. Even in this tough environment HUVR has delivered a resilient performance of 4% USG and 1% UVG with 40bp improvement in margins. Going forward things looks even more positive for rural-focused consumer companies like HUVR than in the past four years ("Juggernaut moves forward"). For the company's core strategy remains the same but with renewed focus.

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Key thrusts for the future are:

- **Strengthening the Core brands (*Surf Excel*, *Lux*, *Red Label*, *Kissan*, *Vim* and *Dove*)**: The core portfolio for HUVR is distinctive for different parts of India. Apart from gaining market share, the key focus is on making the core business aspirational, increasing the size of the pie and lead market penetration. Every 12-24 months, company looks to renovate or innovate the brands to make it relevant and aspirational. They have been investing behind market development to increase its size and also making it more sustainable. Categories like male grooming, hair conditioners, cleaning liquids, fabric conditioners, hand wash and face wash are witnessing strong double digit growths led by market development efforts by HUVR. With greater reach across channels the company is in a better position to lead the market and gain share across categories.
- **Accelerating premiumization across categories**: Company is looking to accelerate the process of premiumization across categories and brands. By premiumizing the company offers higher order benefits at a higher price. Premiumization in detergents is far more important compared to other categories due to the 100% penetration levels. The premium brands (Rin + Surf Excel) have been growing ahead of the market for HUVR and still there is huge scope as only 1 in 10 washes in India uses a HUVR premium laundry powder. 'Matics' has been another big success. Unlike detergents, premiumization has been slower in soaps as liquid soaps and body wash gels are still very small as of now. In the skin care segment company is also looking to accelerate the through trend setting innovations across brands like Ponds, Lakme and Fair & Lovely. E.g. for premiumisation – Introduced water saving detergent bar that delivers superior brightness. In dish wash the company has introduced Vim bar with Pudina to fight grease and smell and in detergents Wheel has been fortified with lemon. In skin care, introduced weightless mousse.
- **Strengthening the Naturals Portfolio**: Company has now built a strong naturals portfolio based on expertise & efficacy through the existing brands (*Tresemme*, *Clinic plus*, *Vim* and *Fair & Lovely*) as well as extending their presence in new/ recent Ayurvedic brand (*Ayush*, *Indulekha*, *St. Ives* and *Citra*). Company is now looking to strengthen its natural portfolio using existing brands, building Ayush as the master brand (will be rolled out across the country from just South India as of now, where it has received excellent response) and also bringing specialist brands (Indulekha - Ayurvedic medicinal hair oil brand and Citra – mainly focused on skin care, using natural herbs from ASEAN and Japan, price positioning at a premium to Ayush) in the market place.
- **Zero based budgeting (ZBB) & Symphony to drive savings**: ZBB which is a 6-stage approach for driving sustainable cost reduction by changing the mindset of the employees. Symphony program (for end to end value chain) is an organization wide engagement to drive savings in material costs, non-material costs, marketing & trade spends and overheads. This will help reduce any cost which doesn't add value. There was a 1.5x increase in savings from 2014 to 2016 through these programs. We think that ZBB across all areas will yield far more on margins than what the market was expecting earlier particularly when it ends up questioning all set practices of the company. The company has identified 5 out of its 29 factories for implementation of first stage of ZBB. Assuming overall costs were 100 as much as 45 was identified as non- value added. Of the 45, ~16

were targeted for culling and savings are being made on 12. There has also been healthy improvement in inventory days through robust sales and operations planning, optimization of networks and learnings from other industries.

- **Increasing use of Sampling and sachets**: Company has been increasing the use of science based sampling across categories for market development. This has helped company drive trials of their products and thus better growth. Product experience has been elevated through the use of food ambassadors, dry sampling (small SKUs free with a large one) and partnering (giving samples with other FMCG company's products). Access packs CAGR growth in case of foods for example has increased from 30% in 2012 to 100% by 2016.
- **Building strong capabilities across channels:** Company is strengthening the existing channels (Wholesale, General trade [GT] and Pharmacy) by increasing number of stores for its products, more assortment across stores and increasing frequency of refill. Technology and talent will play a key role in effective coverage and increasing throughput from current store. Technology is helping company to make tailor made assortment for every store. Apart from the traditional channels, it has been building channels of the future (Modern trade and E-commerce) to be present across all relevant channels for consumers and also be in top in that channel. The market share for HUVR in e-commerce is higher than Modern trade (MT) and the market share in MT is higher than in GT. If GT market share is 100, MT is 118 and e-commerce is 130-140. Management believes they can sustain this advantage over peers because of wider product offerings, their leading brands appearing earlier on screens, focusing on better presentation for faster conversion, ahead of time skills developed on ecommerce and modern trade and learning's from Unilever's global experience.
- **Valuation and view:** We expect HUVR to report 17% PAT CAGR over FY17-19 against 6.1% CAGR in the last three years, 10.6% CAGR in the last five years and 10.7% CAGR in the last 10 years. Valuations are not cheap at 40.1x FY19E EPS, but we believe that given the potentially strong earnings growth, premium valuations are justified, particularly as return ratios and dividend yield remain best of the breed. We had upgraded the stock to BUY after the strong 4QFY17 results. We maintain our Buy rating and target price of INR1,215 (45x FY19E EPS; 5% premium to 3-year average).

Exhibit 1: Changes to the model have resulted in 1.6%/4.3% change in FY18/FY19 EPS

	New		Old		Change	
	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Sales	354,778	402,179	354,778	398,676	0.0%	0.9%
EBITDA	69,997	82,323	68,910	78,893	1.6%	4.3%
PAT	49,312	58,367	48,556	55,973	1.6%	4.3%

Source: Company, MOSL

Other key highlights from presentations by divisional heads

GST

- Implementation of GST is a business project and will have significant impact across value chain for all companies. Areas like procurement, manufacturing, distribution, customer development, accounting, controls, taxation and IT will have significant impact. The company is working upon 100 business whitepapers.
- Currently the company is in the phase of IT readiness which is the most important phase.
- It is also working with the eco-system to be compliant by 1st of July and this engagement will only increase in coming days.
- Compliance for companies will become simpler and effective after the initial phase. This will lead to a level playing field and efficient supply chain operations.
- Consumer likely to see cheaper and better products after GST implementation. Soaps, toothpastes and detergent bars have seen lower rates under GST. The net benefits of lower GST rates (on soaps, toothpastes and detergent bars and of 100% input credit will be passed on to the consumer.
- In terms of P&L, turnover and margins are likely to see changes as there will be interplay between line items. Once all clarifications are received the company will hold a separate session on GST accounting as there will be implications on multiple line items.
- In terms of trade channel, the company is conducting extensive communication to clarify that the trade will be compensated appropriately.

Home Care

- Premiumization under Home Care: 40% of water used in a household is for laundry purpose; so introduced Rin (with half water usage but same shine) to drive premiumisation and sustainability. One and a half years ago the company introduced Surf Excel Liquid Matic to drive premiumisation. In dish wash, introduced anti smell dishwash bar under Vim.
- Developing formats of the future (fabric conditioner and dish wash liquids) through education and sampling along with strengthening of the core portfolio.

Refreshments

- HUL grew ahead of the market in the refreshments portfolio in FY17. The segment grew by 8% USG even in the demonetization impacted quarter of Decemeber'16.
- In instant coffee, HUVR has been the volume leader for last 2 years and has now become the value market leader as well. Coffee penetration in India is only 20% of which only 25% (5% of overall coffee market) is instant coffee.
- In its core portfolio (which is mainly tea and some part of Southern coffee business), company will introduce better products through the use of science. Tea, despite fairly high penetration only reaches around half of the total outlet reach of HUL in India.
- Company sees immense opportunity in the tea business as 40% of the tea is still sold loose, only 1% of tea in India is sold in tea bags and value added tea are currently exploding in India. In the fast growing category of Green Tea, it has

doubled its market share to ~40% in a category that has grown by 30% in the last 3 years. In terms of accessibility there is huge scope as tea only reaches half of HUVR covered outlets.

- Initiatives like Taj Mahal tea house and massive physical sampling of coffee to convert customers to instant coffee in South India will help develop the market going forward.

Personal care

- Personal care business has a lot of heritage and is the crown business of HUVR.
- It is the 2nd largest personal care business for Unilever globally.
- HUVR has led the development of personal care market in India. HUVR made consumer move from water to shampoo and now from shampoo to conditioners.
- There is still headroom to grown in the various personal care categories if compared to Indonesia. Even if Per Capita Consumption of these categories reaches Indonesia's levels the growth opportunity is high at 1.6x the market in personal wash, 2.7x in face creams, 2.6x in shampoos, 4x in deodorants and 2x in toothpastes.
- It aims to make its core brands aspirational by re-launching, premiumizing and introducing new formats. For eg. It re-launched Sunsilk last year which resulted in the brand reaching highest market share in last 7 years.
- Premiumizing the category along with market development through trend setting innovations in all categories.
- Using sampling to drive trails of the brands.
- Using Naturals platform based on expertise and efficacy.
- Entering emerging segments such as the INR10b baby care segment. Penetration of baby care products is only 1% in India with even urban India as low as 2%.
- Personal care business sales from e-commerce in India are already the fifth largest among all countries for Unilever worldwide.

Foods

- In the foods portfolio the core business (Ketchups, Soups and Jams) have grown profitably.
- The penetration levels of Soups and ketchup are still low with 6% and 24% respectively.
- Company intends to drive penetration through access packs, sampling and Adda model. CAGR sales growth from access packs was 100% in CY16 from 30% in CY12.
- The company is banking on emerging trends of fragmented meals (a diversion from 3 course meal), international cuisines and health & wellness.

This year's thematic presentation was on Supply Chain

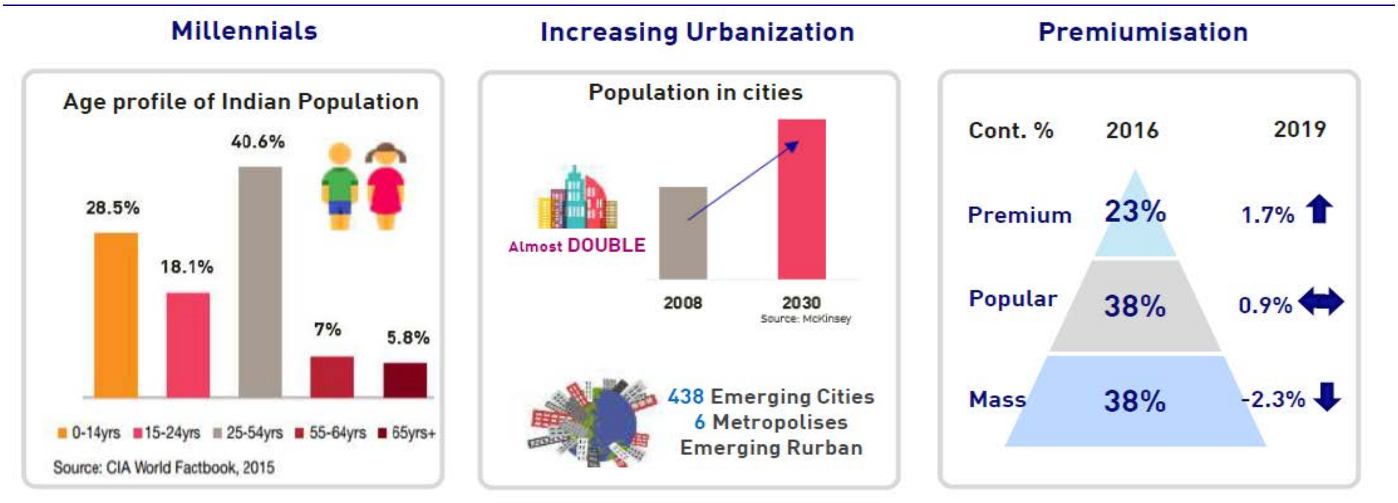
- A few key highlights from initiatives on supply chain in recent years have been 38% reduction in defects per million units over the past year, 96-97% distributor case fills last year, 8% inventory days reduction between 2013-2015 and 5% reduction in the past year due to efforts on robust sales and operations planning, optimization of networks and learning's from other industries.

- There has been 1.5x increase in savings over the past two years.
- The company is committed that there is no holy cow that they will not question when discussing savings with each category heads.
- Out of 29 factories, 5 have been identified as part of the first phase of savings. Assuming total costs as 100, 45 have been identified as non-value added through ZBB. Some of these can be practically reduced which is around 16 and 12 is being culled.
- Use of Big Data and democratization of data is enabling faster decision making.

Exhibit 2: HUVR has built 11 brands which are more than INR5b value

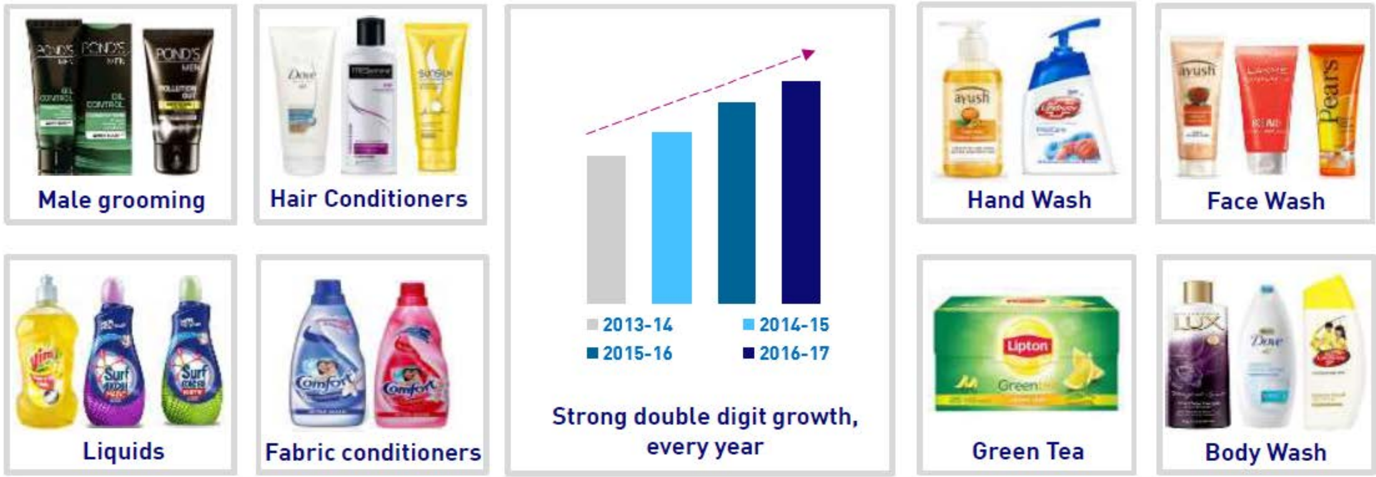
Source: Company, MOSL

Exhibit 3: Outlook looks positive



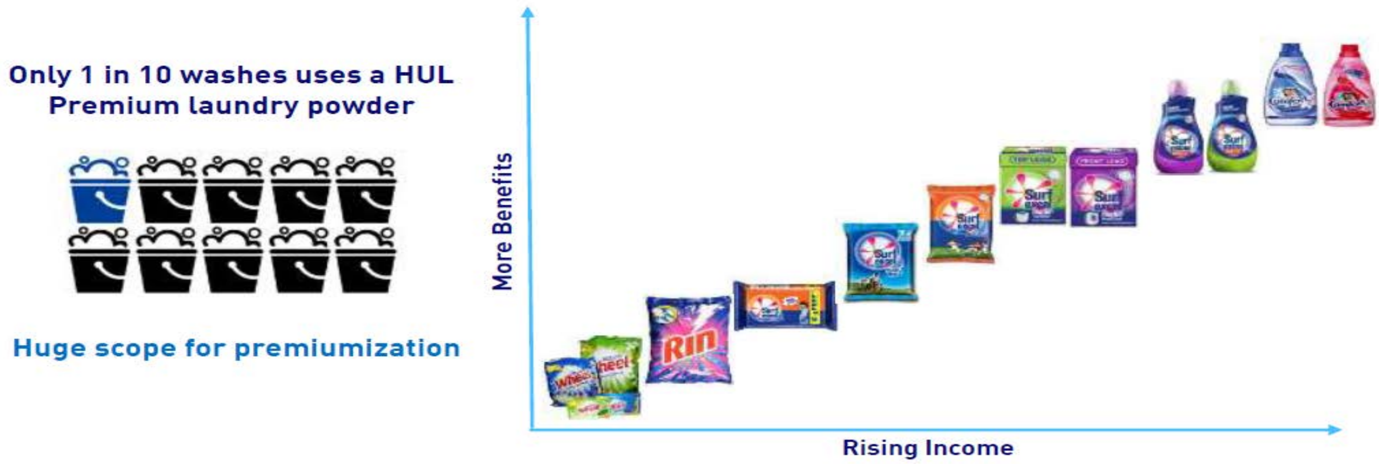
Source: Company, MOSL

Exhibit 4: Building categories for sustainable growth



Source: Company, MOSL

Exhibit 5: Presence at each price point; huge scope of premiumization



Source: Company, MOSL

Exhibit 6: After having built a Naturals portfolio company now looks to strengthen it

Source: Company, MOSL

Financials and valuations

Income Statement						(INR Million)
Y/E March	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**
Net Sales	**274,083**	**301,705**	**304,990**	**312,980**	**348,266**	**395,015**
Other Oper. Income	6,108	6,351	5,619	5,920	6,512	7,163
Total Revenue	**280,191**	**308,056**	**310,609**	**318,900**	**354,778**	**402,179**
Change (%)	8.6	9.9	0.8	2.7	11.3	13.4
COGS	143,436	156,236	153,053	156,850	172,565	192,913
Gross Profit	**136,755**	**151,821**	**157,556**	**162,050**	**182,213**	**209,266**
Gros Margin (%)	48.8	49.3	50.7	50.8	51.4	52.0
Operating Exp	92,003	99,738	100,070	101,580	112,216	126,943
% of sales	32.8	32.4	32.2	31.9	31.6	31.6
EBIDTA	**44,753**	**52,082**	**57,487**	**60,470**	**69,997**	**82,323**
Change (%)	11.8	16.4	10.4	5.2	15.8	17.6
Margin (%)	16.0	16.9	18.5	19.0	19.7	20.5
Depreciation	2,606	2,867	3,208	3,960	4,611	4,818
Int. and Fin. Charges	360	168	150	220	242	242
Other Income - Recurring	6,210	6,184	5,640	5,260	5,808	6,718
Profit before Taxes	**47,997**	**55,231**	**59,769**	**61,550**	**70,953**	**83,982**
Change (%)	10.4	15.1	8.2	3.0	15.3	18.4
Margin (%)	17.5	18.3	19.6	19.7	20.4	21.3
Tax	12,196	19,060	18,160	18,650	21,144	25,027
Deferred Tax	248	-338	-70	410	497	588
Tax Rate (%)	25.9	33.9	30.3	31.0	30.5	30.5
Profit after Taxes	**35,553**	**36,510**	**41,679**	**42,490**	**49,312**	**58,367**
Change (%)	11.5	2.7	14.2	1.9	16.1	18.4
Margin (%)	13.0	12.1	13.7	13.6	14.2	14.8
Non-rec. (Exp)/Income	3,122	6,643	-310	2,410	0	0
Reported PAT	**38,675**	**43,153**	**41,369**	**44,900**	**49,312**	**58,367**

Balance Sheet						(INR Million)
Y/E March	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**
Share Capital	2,163	2,164	2,164	2,164	2,164	2,164
Reserves	30,608	35,084	60,627	64,489	66,625	70,496
Net Worth	**32,771**	**37,248**	**62,791**	**66,653**	**68,789**	**72,660**
Capital Employed	**32,771**	**37,248**	**62,791**	**66,653**	**68,789**	**72,660**
Gross Block	41,706	44,306	50,774	65,827	67,827	69,827
Less: Accum. Depn.	-17,409	-19,731	-21,627	-25,587	-30,198	-35,016
Net Fixed Assets	**24,298**	**24,575**	**29,147**	**40,240**	**37,629**	**34,811**
Capital WIP	3,121	4,790	3,860	2,030	2,030	2,030
Investment in Subsidiaries	6,362	6,541	3,190	2,540	2,540	2,540
Current Investments	24,580	26,238	24,606	35,190	35,690	37,690
Deferred Charges	1,617	1,960	1,680	1,600	1,600	1,600
Curr. Assets, L&A	**70,007**	**72,236**	**76,509**	**65,130**	**72,824**	**94,457**
Inventory	27,475	26,027	25,284	23,620	29,766	31,165
Account Receivables	8,164	7,829	10,645	9,280	12,331	13,986
Cash and Bank Balance	22,210	25,376	27,590	16,710	14,708	29,649
Others	12,158	13,005	12,990	15,520	16,020	19,658
Curr. Liab. and Prov.	**97,214**	**99,093**	**76,201**	**80,077**	**83,524**	**100,469**
Account Payables	49,115	48,515	54,980	60,060	61,438	75,993
Other Liabilities	30,558	29,828	12,381	11,297	12,427	13,669
Provisions	17,540	20,749	8,840	8,720	9,659	10,806
Net Current Assets	**-27,206**	**-26,857**	**308**	**-14,947**	**-10,700**	**-6,012**
Application of Funds	**32,771**	**37,248**	**62,791**	**66,653**	**68,789**	**72,659**

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E
Basic (INR)						
EPS	**16.4**	**16.9**	**19.3**	**19.6**	**22.8**	**27.0**
Cash EPS	17.6	18.2	20.7	21.5	24.9	29.2
BV/Share	15.2	17.2	29.0	30.8	31.8	33.6
DPS	13.0	15.0	16.0	17.0	19.5	23.5
Payout %	79.1	88.9	83.1	86.6	85.6	87.1
Valuation (x)						
P/E		64.4	56.4	55.4	47.7	40.3
Cash P/E		59.7	52.4	50.6	43.6	37.2
EV/Sales		7.7	7.6	7.5	6.7	5.9
EV/EBITDA		44.5	40.4	38.6	33.4	28.2
P/BV		63.1	37.5	35.3	34.2	32.4
Dividend Yield (%)		1.4	1.5	1.6	1.8	2.2
Return Ratios (%)						
RoE	119.5	104.3	83.3	65.6	72.8	82.5
RoCE	141.6	140.6	108.5	87.3	96.6	109.6
RoIC	1,947.5	4,018.2	263.8	106.1	95.8	122.5
Working Capital Ratios						
Debtor (Days)	11	9	13	11	13	13
Asset Turnover (x)	8.4	8.1	4.9	4.7	5.1	5.4
Leverage Ratio						
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0

Cash Flow Statement **(INR Million)**

Y/E March	FY14	FY15	FY16	FY17	FY18E	FY19E
OP/(loss) before Tax	47,997	55,231	59,769	61,550	70,953	83,982
Int./Div. Received	-6,210	-6,184	-5,640	-5,260	-5,808	-6,718
Depreciation	2,606	2,867	3,208	3,960	4,611	4,818
Interest Paid	360	168	150	220	242	242
Direct Taxes Paid	-12,196	-19,060	-18,160	-18,650	-21,144	-25,027
(Incr)/Decr in WC	8,638	2,816	-24,950	4,375	-6,249	10,253
CF from Operations	**41,195**	**35,839**	**14,377**	**46,195**	**42,604**	**67,549**
Extraordinary Items	3,122	6,643	-310	2,410	0	0
(Incr)/Decr in FA	-3,981	-4,269	-5,537	-13,223	-2,000	-2,000
Free Cash Flow	**37,213**	**31,569**	**8,839**	**32,972**	**40,604**	**65,549**
(Pur)/Sale of Investments	-7,635	-1,838	4,983	-9,934	-500	-2,000
CF from Invest.	**-8,494**	**536**	**-864**	**-20,747**	**-2,500**	**-4,000**
Change in Networth	85	137	25,752	2,002	2,193	5,000
change in equity	0	1	0	0	0	0
change in reserves	85	136	25,752	2,002	2,193	5,000
Dividend Paid	-32,730	-38,812	-41,578	-43,040	-49,369	-59,496
Others	5,075	5,467	4,528	4,710	5,070	5,888
CF from Fin. Activity	**-27,570**	**-33,208**	**-11,298**	**-36,328**	**-42,106**	**-48,608**
Incr/Decr of Cash	**5,131**	**3,166**	**2,214**	**-10,880**	**-2,002**	**14,941**
Add: Opening Balance	17,079	22,210	25,376	27,590	16,710	14,708
Closing Balance	**22,210**	**25,376**	**27,590**	**16,710**	**14,708**	**29,648**

E: MOSL Estimates

Disclosures

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