HINDUSTAN UNILEVER » RATING: OUTPERFORMER

Whitest of them all

Resurgence of the leader could see mid-tier rivals de-rating

Segmental performance

₹ million	Revenues			Ebit (%)		
	Q2FY12	Q2FY11	y-o-y growth	Q2FY12	Q2FY11	Chg (bp)
Soaps & Detergents	25,926	21,294	22		12.4	11.7 65
Personal Products	16,126	13,649	18	24.4	23.0	143
Beverages	6,533	5,700	15	13.4	15.4	(193)
Processed Foods	3,318	2,195	51	5.0	4.6	39
Exports	2,909	2,647	10	8.3	7.1	111
Others	1,161	1,527	(24)	(6.7)	(12.0)	528

HINDUSTAN Unilever (HUL) reported a brilliant set of numbers, with a revenue growth of 18% to ₹55.2 bn (our estimate, ₹53.6 bn), Ebitda growth of 31% to ₹7.4 bn (our estimate, ₹6.6 bn), and profit after tax growth of 23% to ₹6.5 bn (our estimate, ₹5.9bn). Domestic volume growth came in at a strong 9.8%. Ebitda (earnings before interest, taxes, depreciation and amortisation) margin—before other operational income—improved by 140 basis points to 13.4% (our estimate, 12.3%) as price increases improved gross margins, sequentially, after five quarters.

Core domestic businesses reported 15%+ growth rates across categories with Ebit margin improvements. Soaps & detergents and personal products registered 22% and 18% growth respectively, with Ebit margins improving to 12.4% and 24.4%. With an excellent performance this quarter, we raise our EPS (earnings per share) estimates for FY12 and FY13 by 2% to reflect 17% EPS growth over FY11-FY13.

Valuations & view: An excellent quarter with 18% revenue growth, 10% volume growth, and PAT growth of 23% (after six quarters of consistent volume growth) vindicate the change in our long-held bearish call. We sensed that a change in the organisational DNA would translate to a far superior performance from HUL. The company's focus on NPD (new product development) and a shift towards a more premium portfolio are creating a more relevant, fast growing and increasingly profitable portfolio (visible in 15%+ growth in domestic categories and improving margins).

Our comfort in the stock increased post the Q3FY11 results as we believed that soaps & detergents margins were sub-optimal and would inherently improve going forward (Ebit margins have improved from 7.7% to 12.4%). Further, we said that a strong HUL with a domestic focus would outperform mid-tiers (Dabur, Marico, Godrej), which would eventually de-rate as they turned increasingly international while acquiring companies at 10x (times) earnings.

We stand vindicated yet again as HUL has transformed from the worst performing consumer stock globally to the best over the last year while mid-tiers underperformed. Our core thesis has played out as HUL outperforms its peers, outperforms itself (premium portfolio) and focuses on NPD. Our sense is that ₹340 would be the new floor price and expect material gains on the stock only on declines. Maintain Outperformer with a revised price target of ₹400.

Soaps and Detergents Ebit margins are off record lows of 7.5% seen in Q2FY11 and Q3FY11 and have moved up smartly to 12.4%. Margin improvement has taken place while recording revenue growth of 22% (highest in 12 quarters). We maintained since the December quarter that soaps and detergents, though fully penetrated, was operating at sub-optimum margins and a return to the mean was just a matter of time. With over 50% improvement in margins, we stand vindicated.

HUL outperforms while mid-tiers underperform

We have maintained that the premiumisation of Indian consumer needs will be an increasingly relevant driver of profitable growth for Indian companies and HUL, with its increasing focus on premiumisation (evident in new launches and frequency of management references), looks brilliantly placed to capitalise on this. The premiumisation is visible in the Lux relaunch (superior product and salient advertising), expansion of the personal products range with face washes, and sustained upgradation via vaseline and ponds, etc. As a result, the company has recorded strong revenue growth across its domestic portfolio, with personal products, beverages and foods recording growth rates of 18%, 15% and 21% while improving Ebit margins.

The company's domestic focus vis-à-vis mid-tiers' international focus is resulting in divergent stock performances. Back in December 2010, we said mid-tiers like Dabur, Marico and GCPL, with their acquisition-spree, no longer remain pure proxies to the Indian consumption story (international operations account for over 30% of revenues). Moreover, as they acquire companies at 10-15x earnings but get 25x valuations, a case for de-rating is eventual and a switch to pure domestic plays like the 'revived HUL' makes perfect sense.

—IDFC