

Growth has bottomed out; happier times ahead

We expect a better 2HFY17F

Cutting FY17F/FY18F/FY19F EPS by 7.7%/12.4%/9.7%; maintain Buy as we expect demand to revive in 2HFY17F.

The weakness in HUVR's results continued in 2Q, with the company reporting slow domestic business growth of 2% driven by volume growth of -1%.

Numbers at the EBITDA level too disappointed, with the company now facing headwinds due to increasing input prices despite consumption not picking up.

We accordingly cut our revenue growth and EBITDA margins estimates for FY17F and FY18F by 7.7% and 12.4%, respectively, but continue to build in a recovery in 2HFY17F backed by rising discretionary spending, and triggers such as normal monsoons and government stimulus in rural areas.

Results largely below on weak market growth and declining volumes after price hikes in personal wash and rising commodity prices. We expect this is the bottom

Normal monsoons after two years of deficient rainfall, along with recent implementation of the Pay Commission recommendations, should allow for an up-tick in consumption, we think. Apart from this, increased incomes in the rural markets should allow companies to take pricing action more effectively in the current environment of rising input costs. In our view, HUL should be a key beneficiary of this trend given its product portfolio, distribution network and new innovations. Management too guides for both volume and EBITDA margin improvement.

TP cut to INR983; premium to sector has narrowed – maintain Buy

We value the stock using a 38x target multiple and maintain our Buy rating, but reduce our TP by 8.6% to INR983 due to a cut in our EPS estimates. The stock trades at ~35.8 FY18F P/E (EPS: INR23.5), and we note that the premium to the sector P/E has narrowed. Given its leadership position in the industry, coupled with its marketing prowess and brand equity, we maintain our Buy rating as we expect a recovery in 2HFY17F.

Year-end 31 Mar	FY16		FY17F		FY18F		FY19F	
Currency (INR)	Actual	Old	New	Old	New	Old	New	
Revenue (mn)	331,937	385,843	351,254	443,719	388,798	510,175	435,561	
Reported net profit (mn)	40,824	49,698	45,891	58,226	50,987	64,082	57,876	
Normalised net profit (mn)	41,210	49,698	45,891	58,226	50,987	64,082	57,876	
FD normalised EPS	19.05	22.97	21.21	26.91	23.56	29.61	26.74	
FD norm. EPS growth (%)	11.8	20.6	11.3	17.2	11.1	10.1	13.5	
FD normalised P/E (x)	44.2	N/A	39.7	N/A	35.8	N/A	31.5	
EV/EBITDA (x)	30.2	N/A	27.5	N/A	24.9	N/A	21.9	
Price/book (x)	48.8	N/A	51.1	N/A	46.7	N/A	50.6	
Dividend yield (%)	1.9	N/A	2.6	N/A	2.6	N/A	3.3	
ROE (%)	107.9	129.3	125.6	130.0	136.5	123.9	154.1	
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash	net cash	net cash	

Source: Company data, Nomura estimates

Key company data: See next page for company data and detailed price/index chart.

Global Markets Research

27 October 2016

Rating Remains	Buy
Target Price Reduced from 1076	INR 983
Closing price 26 October 2016	INR 843
Potential upside	+16.6%

Anchor themes

HUVR is the biggest player in India's consumer space, with the widest product portfolio. We believe the company is in a strong position to benefit from any revival in rural and urban consumption.

Nomura vs consensus

Our FY17F EPS estimate is in line with consensus.

Research analysts

India Consumer Related

Manish Jain - NFASL

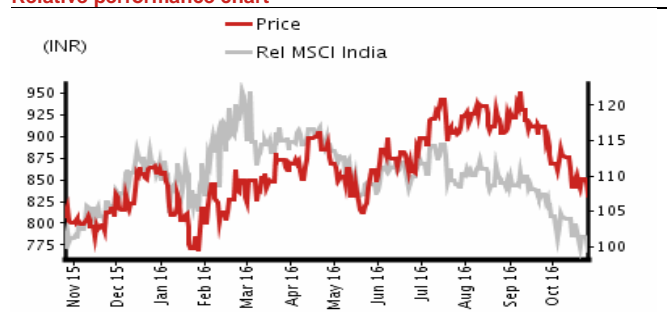
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Key data on Hindustan Unilever

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (INR)	-5.6	-6.6	4.2	M cap (USDmn)	27,306.6
Absolute (USD)	-5.7	-6.0	1.4	Free float (%)	33.0
Rel to MSCI India	-5.3	-7.6	0.6	3-mth ADT (USDmn)	18.2

Income statement (INRmn)

Year-end 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
Revenue	319,722	331,937	351,254	388,798	435,561
Cost of goods sold	-161,761	-158,664	-169,110	-187,185	-211,868
Gross profit	157,961	173,274	182,145	201,613	223,693
SG&A	-89,809	-99,928	-102,659	-113,267	-123,383
Employee share expense	-17,239	-17,422	-18,398	-20,365	-22,819
Operating profit	50,913	55,923	61,087	67,981	77,492
EBITDA	54,137	59,496	64,947	72,055	81,853
Depreciation	-3,224	-3,573	-3,860	-4,073	-4,362
Amortisation	0	0	0	0	0
EBIT	50,913	55,923	61,087	67,981	77,492
Net interest expense	-177	-45	0	0	0
Associates & JCEs	0	0	0	0	0
Other income	5,667	3,973	6,400	7,000	7,500
Earnings before tax	56,403	59,851	67,487	74,981	84,992
Income tax	-19,440	-18,525	-21,596	-23,994	-27,116
Net profit after tax	36,963	41,326	45,891	50,987	57,876
Minority interests	-124	-117	0	0	0
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	36,839	41,210	45,891	50,987	57,876
Extraordinary items	6,792	-385	0	0	0
Reported NPAT	43,631	40,824	45,891	50,987	57,876
Dividends	-32,453	-34,624	-47,608	-47,608	-60,592
Transfer to reserves	11,178	6,200	-1,717	3,379	-2,717

Valuations and ratios

Reported P/E (x)	41.8	44.7	39.7	35.8	31.5
Normalised P/E (x)	49.5	44.2	39.7	35.8	31.5
FD normalised P/E (x)	49.5	44.2	39.7	35.8	31.5
Dividend yield (%)	1.8	1.9	2.6	2.6	3.3
Price/cashflow (x)	44.9	44.5	27.9	37.5	23.2
Price/book (x)	47.6	48.8	51.1	46.7	50.6
EV/EBITDA (x)	33.2	30.2	27.5	24.9	21.9
EV/EBIT (x)	35.3	32.1	29.2	26.4	23.2
Gross margin (%)	49.4	52.2	51.9	51.9	51.4
EBITDA margin (%)	16.9	17.9	18.5	18.5	18.8
EBIT margin (%)	15.9	16.8	17.4	17.5	17.8
Net margin (%)	13.6	12.3	13.1	13.1	13.3
Effective tax rate (%)	34.5	31.0	32.0	32.0	31.9
Dividend payout (%)	74.4	84.8	103.7	93.4	104.7
ROE (%)	121.4	107.9	125.6	136.5	154.1
ROA (pretax %)	45.0	47.7	50.1	52.1	52.9

Growth (%)

Revenue	9.4	3.8	5.8	10.7	12.0
EBITDA	14.2	9.9	9.2	10.9	13.6
Normalised EPS	-0.6	11.8	11.3	11.1	13.5
Normalised FDEPS	-0.6	11.8	11.3	11.1	13.5

Source: Company data, Nomura estimates

Cashflow statement (INRmn)

Year-end 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
EBITDA	54,137	59,496	64,947	72,055	81,853
Change in working capital	1,145	3,229	17,972	-6,479	16,700
Other operating cashflow	-14,650	-21,721	-17,498	-16,994	-19,871
Cashflow from operations	40,633	41,004	65,421	48,582	78,682
Capital expenditure	-4,766	-6,023	-191	-4,933	-9,647
Free cashflow	35,867	34,981	65,230	43,649	69,036
Reduction in investments	-1,869	2,777	-10,000	-5,000	-9,000
Net acquisitions					
Dec in other LT assets	0	0	0	0	0
Inc in other LT liabilities	0	0	0	0	0
Adjustments					
CF after investing acts	33,997	37,758	55,230	38,649	60,036
Cash dividends	-32,453	-34,624	-47,608	-47,608	-60,592
Equity issue	41	215	185	0	0
Debt issue	208	-25	2,117	0	0
Convertible debt issue	0	0	0	0	0
Others					
CF from financial acts	-32,203	-34,435	-45,306	-47,608	-60,592
Net cashflow	1,794	3,323	9,924	-8,959	-557
Beginning cash	25,160	26,955	30,278	40,202	31,243
Ending cash	26,954	30,278	40,202	31,242	30,686
Ending net debt	-26,524	-27,730	-37,654	-28,695	-28,139

Balance sheet (INRmn)

As at 31 Mar	FY15	FY16	FY17F	FY18F	FY19F
Cash & equivalents	26,955	30,278	40,202	31,243	30,686
Marketable securities	0	0	0	0	0
Accounts receivable	10,112	12,685	11,277	12,483	13,987
Inventories	28,488	27,521	28,593	31,129	34,880
Other current assets	13,191	14,079	14,050	15,593	16,843
Total current assets	78,745	84,562	94,122	90,448	96,396
LT investments	30,251	27,474	37,474	42,474	51,474
Fixed assets	33,373	37,279	33,609	34,469	39,754
Goodwill					
Other intangible assets	0	0	0	0	0
Other LT assets	0	0	0	0	0
Total assets	142,369	149,315	165,205	167,390	187,624
Short-term debt	0	0	0	0	0
Accounts payable	66,383	68,410	80,822	79,058	97,909
Other current liabilities	37,027	40,723	45,919	46,488	50,842
Total current liabilities	103,410	109,133	126,740	125,546	148,751
Long-term debt	430	2,548	2,548	2,548	2,548
Convertible debt	0	0	0	0	0
Other LT liabilities	0	0	0	0	0
Total liabilities	103,841	111,681	129,288	128,094	151,299
Minority interest	248	251	251	251	251
Preferred stock					
Common stock	2,164	2,164	2,164	2,164	2,164
Retained earnings					
Proposed dividends					
Other equity and reserves	36,117	35,220	33,503	36,882	33,911
Total shareholders' equity	38,281	37,384	35,667	39,046	36,075
Total equity & liabilities	142,369	149,315	165,205	167,390	187,624

Liquidity (x)

Current ratio	0.76	0.77	0.74	0.72	0.65
Interest cover	287.6	1,231.8	na	na	na

Leverage

Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash

Per share

Reported EPS (INR)	20.17	18.87	21.21	23.56	26.74
Norm EPS (INR)	17.03	19.05	21.21	23.56	26.74
FD norm EPS (INR)	17.03	19.05	21.21	23.56	26.74
BVPS (INR)	17.69	17.28	16.48	18.04	16.67
DPS (INR)	15.00	16.00	22.00	22.00	28.00

Activity (days)

Days receivable	11.7	12.6	12.5	11.2	11.1
Days inventory	65.3	64.6	60.6	58.2	56.9
Days payable	156.0	155.5	161.0	155.9	152.4
Cash cycle	-79.1	-78.3	-88.0	-86.5	-84.5

Source: Company data, Nomura estimates

2QFY17 results: disappointing quarter, but hopefully one of the last

Fig. 1: Result synopsis

Above or below	2Q numbers disappointed both us and consensus in terms of both revenue growth and EBITDA, but were higher than expectations at the PAT level
What to make of it	A poor quarter – market growth continues to be soft while the operating environment is challenging. However, we think this may be the last of the worst – the company expects gradual improvement in the near-term on the back of good monsoons
Key numbers	Overall revenue growth of 1.3% was driven by volume growth of -1%; gross margins contracted by 17bp but EBITDA margin expanded by 65bp on the back of lower advertising costs.
What next	We expect market growth to improve after the normal monsoons, and HUVR should be a key beneficiary of the same. The impact of reduced promotions and increased pricing should help revenue growth in H2FY17F.

Source: Nomura estimates

Above or below estimates

HUVR's 2QFY17 results were below both our and consensus expectations at the revenue growth and EBITDA level, while PAT surprised positively. While we were building in 3% volume growth, the company reported volume growth of -1% for the quarter, which led to a miss at the revenue and EBITDA level. Higher-than-expected financial income led to a beat at the PAT level.

Fig. 2: HUVR – 2QFY17 results

INR mn	Actual	Consensus	Nomura	vs. consensus	vs. Nomura
Net Sales	76,976	80,392	79,754	-4.2%	-3.5%
Operating Profit	14,046	14,620	14,828	-3.9%	-5.3%
Margin	18.2%	18.2%	18.6%		
Net Profit	10,774	10,549	10,263	2.1%	5.0%

Source: Company data, Bloomberg, Nomura estimates

Key numbers

- Volume growth at -1% was below our expectation of 3% (1QFY17: 4.0%) The company attributes this decline to the price increases taken in its personal wash portfolio.
- As a result, net sales increased by only 1.3% to INR76.9bn, vs our expectation of 3% revenue growth
- Operating profit was INR14.0bn, vs our estimate of INR14.8bn and consensus of INR14.6bn.
- Gross margins contracted by 17bp to 48.5%, vs our expectation of an expansion of 30bp.
- EBITDA margin for the quarter was 18.2%, vs our expectation of 18.6%.
- Adjusted PAT was INR10.7bn, vs our forecast of INR10.2bn and consensus of INR10.5bn.
- Segment-wise details: Home Care revenue was up 3.2%, while Personal Care revenue was down 0.3%.
- Segment-wise margins: Home Care witnessed 170bp margin expansion, and Personal Care recorded a 90bp increase.

Key surprises

- Negative volume growth of 1% was significantly lower than our expectations.

- Gross margins contracted, compared with our assumption of a slight expansion.
- Financial income was higher than expected by us, largely due to the higher dividend received from its subsidiaries.

What do the results mean?

Growth appears to have taken a massive hit in this quarter, and while these results are below our and consensus expectations, we believe the worst may be over. With normal monsoons this year, and the company indicating that market growth is improving, we believe consumption rates may pick up, albeit slowly, and HUVR should be a key beneficiary of the same.

Fig. 3: 2QFY17 results

INR mn	Quarter ended				
	Sep'16	Sep'15	% Chg	Jun'16	% Chg
Income from operations	76,976	75,956	1.3	79,877	(3.6)
Operating Profit	14,046	13,366	5.1	16,359	(14.1)
Other income	2,528	1,944	30.1	1,076	135.0
PBIDT	16,575	15,310	8.3	17,435	(4.9)
Depreciation	945	761	24.1	933	1.3
Interest	49	45	na	60	(17.0)
PBT	15,580	14,503	7.4	16,442	(5.2)
Tax	4,807	4,560	5.4	5,411	(11.2)
PAT pre exceptionals	10,774	9,943	8.4	11,031	(2.3)
Extra ordinary income/ (exp.)	182	(121)	(250.2)	708	(74.2)
Reported PAT	10,956	9,822	11.5	11,739	(6.7)
No. of shares (mn)	2,164	2,164		2,164	
EBIDTA margins (%)	18.2	17.6		20.5	
PBIDT margins (%)	21.5	20.2		21.8	
EPS (INR)	5.0	4.6	8.4	5.1	(2.3)

Source: Bloomberg, company data, Nomura research

Fig. 4: Segment details

Segment Revenue

INR mn	Quarter ended				
	Sep'16	Sep'15	% Chg	Jun'16	% Chg
Home Care	27,770	26,908	3.2	28,760	(3.4)
Personal Care	40,280	40,413	(0.3)	42,216	(4.6)
Foods	2,778	2,712	2.4	2,723	2.0
Refreshments	11,692	10,789	8.4	12,149	(3.8)
Others	2,181	2,571	(15.2)	2,038	7.0

Segment Profits

INR mn	Quarter ended				
	Sep'16	Sep'15	% Chg	Jun'16	% Chg
Home Care	2,800	2,246	24.7	3,559	(21.3)
Personal Care	9,226	8,906	3.6	10,214	(9.7)
Foods	137	164	(16.2)	170	(19.2)
Refreshments	1,726	1,469	17.5	1,921	(10.1)
Others	91	43	112.6	(95)	(196.5)

Segment margins

Segment EBIT (%)	Quarter ended				
	Sep'16	Sep'15	% Chg	Jun'16	% Chg
Home Care	10.1%	8.3%	1.7	12.4%	(2.3)
Personal Care	22.9%	22.0%	0.9	24.2%	(1.3)
Foods	4.9%	6.0%	(1.1)	6.2%	(1.3)
Refreshments	14.8%	13.6%	1.1	15.8%	(1.0)
Others	4.2%	1.7%	2.5	-4.6%	8.8

Source: Company data, Nomura research

Feedback from conference call

- The concerns noted by the company in 1QFY17 have played out – Market growth continues to be soft and with increasing input prices, the operating environment has now become challenging.
- Competitive spends are being maintained across all segments.
- Segment-wise performance: **Home Care** – the company has witnessed robust growth and strong momentum in premium laundry, especially Surf. **Personal care** – Growth has been hit by slowing markets and personal wash volumes.
- Impact of the price hike in personal wash: The company took a price hike due to a sharp increase in the prices of vegetable oils; as a result, volumes were affected negatively with a reduction in trade inventory. However, the company believes this is a short-term negative impact due to the rebalancing of its portfolio, and that growth should return in the long term.
- The company remains focused on innovations, especially in the Personal Care segment. With Lux soap facing issues in terms of growth, the company relaunched the brand in the premium segment. The company has also launched a new line of pink Dove and Dove Baby soaps.
- The company continues to build on the Naturals portfolio – within the existing portfolio, by expanding the distribution reach for its current products and building a master brand through Ayush.
- In the near term, the company foresees gradual improvement in market growth on the back of good monsoons and expects sales growth to improve. It will continue to pursue consistent modest improvement in EBITDA margins.

Changes to our earnings estimates

Following the 2QFY17 results, we make the following changes to our estimates:

- We lower our revenue growth estimates, and now build in revenue growth of 5.6% for FY17F, which increases to 10.7% in FY18F and 12.1% in FY19F. The increased growth in FY18F and FY19F comes from growth in the personal products and beverages portfolio.
- We now forecast EBITDA margin to improve by ~60bp y-y in FY17F, and expect a gradual improvement in FY18F and FY19F, respectively.
- As a result, we cut our PAT estimates by 7.7%/12.4%/9.7% for FY17F/FY18F/FY19F, respectively.

Fig. 5: Our earnings estimate changes

Currency INR mn	2017F			2018F			2019F		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
Sales	385,843	351,254	-9.0%	443,719	388,798	-12.4%	510,175	435,561	-14.6%
EBITDA	70,650	64,947	-8.1%	82,970	72,055	-13.2%	95,071	81,853	-13.9%
Net Profit	49,698	45,891	-7.7%	58,226	50,987	-12.4%	63,827	57,621	-9.7%
Margins	Old	New	% chg	Old	New	% chg	Old	New	% chg
EBITDA	18.3%	18.5%	0.2%	18.7%	18.5%	-0.2%	18.6%	18.8%	0.2%

Source: Nomura estimates

Maintain Buy, TP cut to INR983

Cut target multiple to 38x, and TP to INR983

After disappointing 2QFY17 results, we cut our target multiple for HUVR from 40x to 38x, at a slight discount to its historical trading average given the current weak earnings growth. However, our target multiple still is at a premium to its peers given HUVR's brand portfolio and consistent growth.

Following our EPS cuts as noted above, we arrive at our lower TP of INR983, which is down 8.6% from our previous TP of INR1,076.

We believe the worst may be over, maintain Buy

Normal monsoons after two years of deficient rainfall is a key positive, and along with recent implementation of the Pay Commission recommendations, we maintain our view that 2HFY17F will see an up-tick in consumption levels. Apart from this, increased incomes in the rural markets should allow companies to take pricing action more effectively in the current environment of rising input costs. Management too guides for both volume and margin improvement.

The two key reasons why we believe Hindustan Unilever will be a key beneficiary of this expected up-tick in growth are:

- The company's product portfolio and positioning, leadership position in the categories in which it operates and expansive distribution network should allow it to capture any incremental growth from rural markets as well.
- We believe HUVR has adapted to consumer tastes effectively – the company is now working on expanding its 'Naturals' portfolio and has extended its popular portfolio of Surf and Dove extremely well in the past year

Stock trades at 36x FY18 P/E (EPS: INR23.5)

At our revised EPS estimates, the stock trades at 36x one-year forward EPS, close to the four-year average of the stock. As mentioned above, we believe growth has now bottomed out and that the numbers will look much better. We maintain our Buy rating on the stock.

Fig. 6: Stock currently trades at +1SD above the LT average

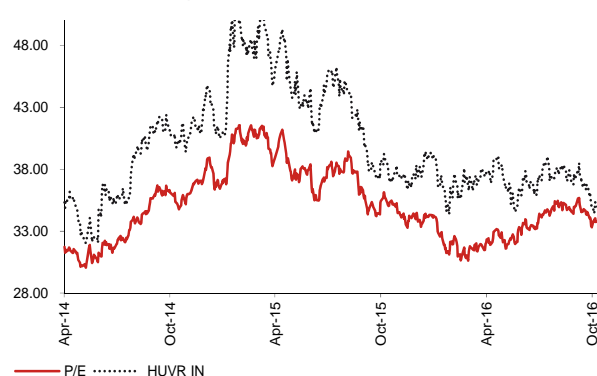
One-year forward P/E chart



Source: Bloomberg, Nomura estimates

Fig. 7: Premium to sector has narrowed

HUL vs. sector - one-year forward P/E



Source: Bloomberg, Nomura estimates

Appendix A-1

Analyst Certification

I, Manish Jain, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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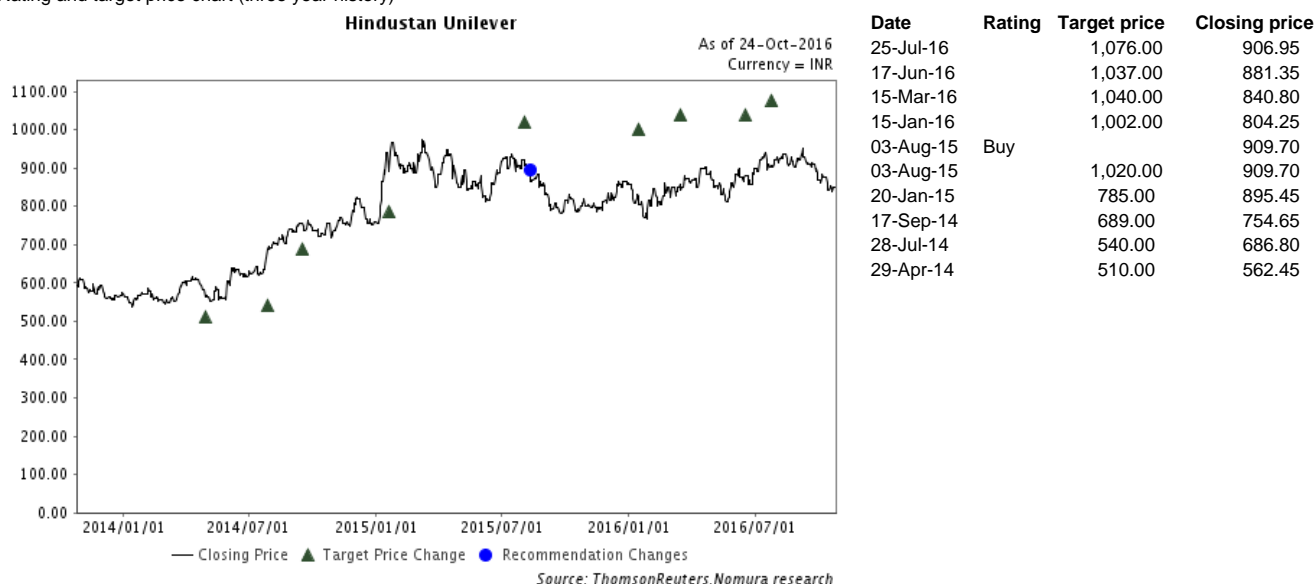
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
Hindustan Unilever	HUVR IN	INR 843	26-Oct-2016	Buy	N/A	

Hindustan Unilever (HUVR IN)

INR 843 (26-Oct-2016) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology We value HUVR at 38x our one-year-forward earnings estimate of INR25.91/share. The multiple is in line with HUVR's historical two-year average multiple. This derives a TP of INR983. The benchmark index for this stock is the MSCI India.

Risks that may impede the achievement of the target price Increasing input prices present a risk to our earnings. Slower-than-expected volume growth in the personal products business is also a risk to our numbers.

Important Disclosures

Online availability of research and conflict-of-interest disclosures

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As at 30 September 2016.

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STOCKS

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SECTORS

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Explanation of Nomura's equity research rating system in Japan and Asia ex-Japan prior to 21 October 2013

STOCKS

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