HINDUSTAN UNILEVER: Double Whammy…

Hindustan Unilever Ltd (HUL) has reported inline numbers than street expectations in Q3FY13. However the double whammy came in the form of hike in royalty burden and low volume growth. Company witnessed 12% YoY sales growth led by 13% growth on both Household and Personal Care (FMCG-HPC) and Foods(FMCG-Foods)

Segmental Performance: There was positive response on Company's product portfolio by reporting growth, Soaps & Detergents (contributes half of its revenue) up by 20% led by its Surf and Rin brands and Personal Products growth (contributes 31% of sales) by 9% on (YoY) with double digit growth in skin care, hair care and oral care. Beverages (contributes 12% of sales) by 18% helped by strong growth in tea, However, packaged foods grew just 8% in the last quarter.

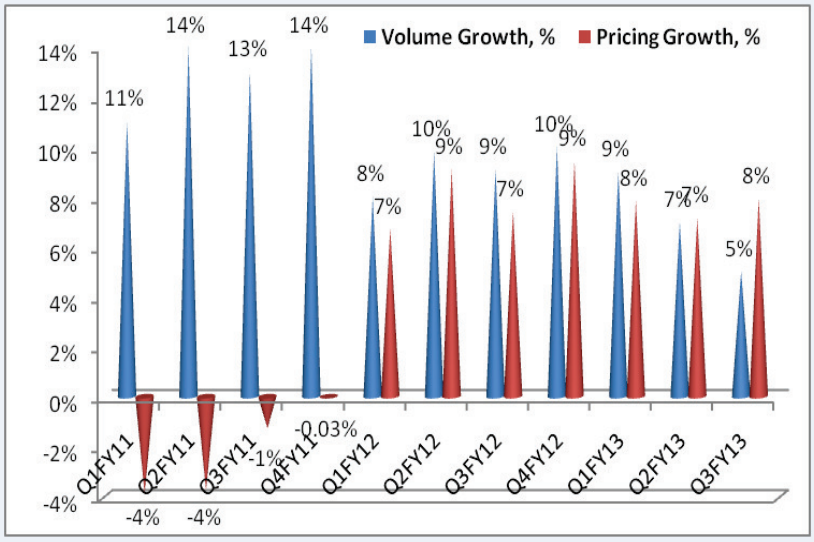
Volume growth: Company reported 5% volume growth along with 8% pricing growth on YoY basis, while due to some slowdown in discretionary part of the portfolio and some specific issue in some channel in 2Q FY13, Volume growth was declined by 7% YoY.

Steady Margin Picture: During the quarter, HUL's EBITDA margin remained unchanged at 16.3% YoY. On Segmental Front, EBIT Margin of Soap and Detergent declined by 110bps to 12.4%, while margin of Personal Product improved by 240bps to 28.3% and Beverages margin increased by 200bps to 17.7% on YoY basis.

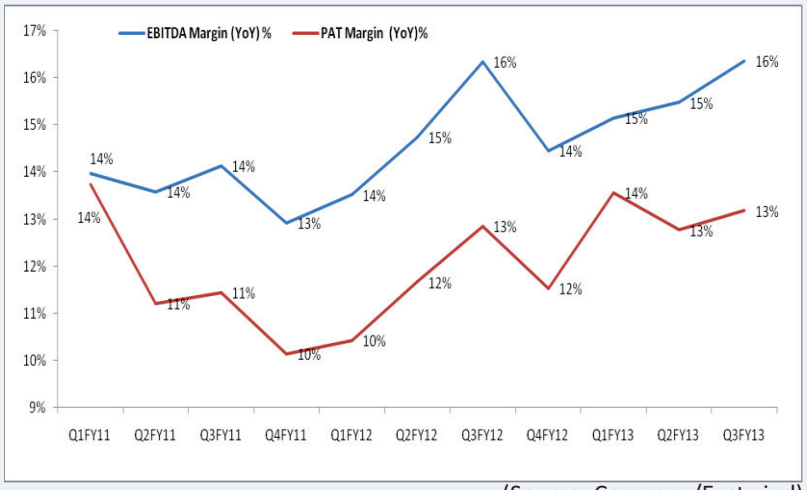
New Royalty Pact: HUL announced a new royalty agreement with its Anglo-Dutch Parent Unilever Plc. As per the new agreement, HUL's royalty that it pays to Unilever will increase to 3.15% of its total turnover by FY18 against the current rate of 1.4%. The Increase in royalty cost, in the period from 1st February 2013 to 31st March 2014 is to be 0.5% of turnover and eventually go up to 3.15% by FY18; *T*hus leading up to a total estimated royalty cost increase of 1.75% of turnover.

Soaps and detergents' competitive intensity increased sharply QoQ. This is a reflection of rising local competition due to softening input costs. HUL's key laundry brands and peers took 20-25% price hikes in the past 12 months and company launched Comfort One Rinse during the quarter. We expect the impact of pricing component to fade, going forward. Recently Company and Future Group have reportedly collaborated to develop a new brand of bakery product that will be sold exclusively at Big Bazaar stores.

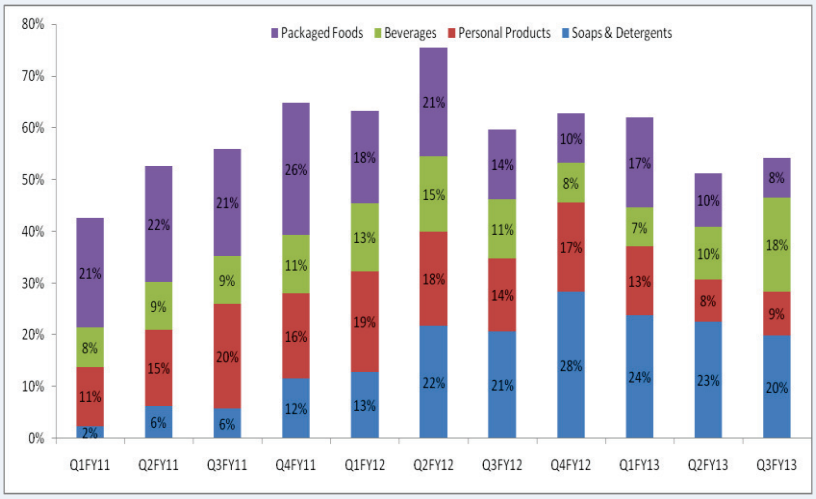
We estimate HUL's PAT to go down by around 5% in FY14 due to the new royalty arrangements. Overall, our PAT estimates go down by 7% for FY14 due the prospects of slowing growth. On the brighter side, the trend of increasing premiumization as well as the prospects of softening RM prices might just help HUL circumvent margin erosion. At a CMP of Rs 483, stock trades at 29.5x FY14E earnings. Subdued volume growth in Q3FY13 and New Royalty burden, makes us go NEUTRAL, with a target price of Rs 425



(Source: Company/Eastwind)



(Source: Company/Eastwind)



Source: Company/Eastwind