



Hindustan Unilever

BSE SENSEX
36,241

S&P CNX
10,884

CMP: INR1,826

TP: INR2,140 (+17%)

Buy



Hindustan Unilever Limited

Stock Info

	HUVR IN
Bloomberg	
Equity Shares (m)	2,164
M.Cap.(INRb)/(USDb)	3952.4 / 56.1
52-Week Range (INR)	1840 / 1241
1, 6, 12 Rel. Per (%)	8/13/35
12M Avg Val (INR M)	2050
Free float (%)	32.8

Financials Snapshot (INR b)

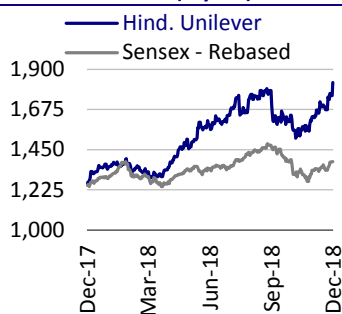
Y/E Mar	2018	2019E	2020E
Net Sales	345.3	383.6	437.3
EBITDA (Rs b)	72.8	86.6	104.7
Net Profit	53.0	62.3	75.4
EPS	24.5	28.8	34.8
EPS Gr. (%)	24.7	17.5	21.1
BV/Share (Rs)	32.7	34.1	34.2
P/E (x)	74.6	63.5	52.4
P/BV (x)	55.9	53.5	53.4
RoE (%)	78.1	86.1	102.0
RoCE (%)	100.2	112.9	134.7

Shareholding pattern (%)

As On	Sep-18	Jun-18	Sep-17
Promoter	67.2	67.2	67.2
DII	7.3	7.3	5.8
FII	12.1	12.2	13.3
Others	13.4	13.4	13.7

FII Includes depository receipts

Stock Performance (1-year)



A healthy deal for HUVR

Significant medium-term benefits for growth and margins

The Board of Directors of Hindustan Unilever Limited (HUVR) have approved a scheme of amalgamation between HUVR and GlaxoSmithKline Consumer Healthcare Limited (GSKCH) in an all-equity merger with 4.39 shares of HUVR being allotted for every share in GSKCH India, valuing the total business at INR317b, subject to requisite approvals from statutory authorities and shareholders.

- We believe HUVR has obtained a good deal, which is EPS accretive from the beginning. The company also benefits because (a) the merger is at a reasonable valuation, (b) GSKCH has agreed to a share-swap deal, (c) HUVR has not been saddled with the global business, and (d) being listed, transparency of GSKCH is extremely high.
- While we continue to have our reservations on category growth in malt-based beverages (MFD), we appreciate what HUVR can bring to the table on premiumization, low unit packs, increased distribution and marketing strength.
- Planned cost savings even on a highly profitable business is massive at 800-1,000bp from wide-ranging factors like materials and packaging, advertising and infrastructure costs.
- The deal also pushes HUVR among the market leaders in the only key category where it did not have market leadership (Food and Refreshments) unlike Beauty & Personal Care and Home Care where it is the dominant player.
- Even in its existing Foods and Refreshment (F&R) portfolio with high penetration levels (especially in Tea), the company has demonstrated ~10% CAGR topline growth and ~500bp margin improvement in the past 10 years.
- As the transaction may take around a year to conclude and is subject to approvals, we have not made any changes to our forecasts. Prior to this deal the four key trends particularly relevant for HUVR, which could result in an elevation in its earnings growth trajectory of ~20% compared to the past are: (a) rapidly improving adaptability to market requirements exemplified by its 'Winning In Many Indias' (WIMI) strategy, (b) recognition and strong execution on Naturals, (c) continuous strong trend towards premiumization, and (d) extensive plans to employ technology, thus creating further entry barriers. We see the proposed merger as another demonstration of HUVR's ability to generate shareholder value, going forward, through acquisitions, thereby elevating growth prospects. HUVR offers the best earnings growth visibility in the large-cap Indian consumer space, and also has the highest return ratios, justifying premium valuations. On a target multiple of 54x (~20% premium to 3-year average, due to significantly improving business fundamentals) and rolling forward to December 2020 EPS, we arrive at a target price of INR2,140. Maintain **Buy**.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

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Details of the transaction

- The transaction is an all-equity merger with 4.39 shares of HUVR being allotted for every share in GSKCH India. This transaction values the total business at INR317b.
- As at closing price on 3 Dec'18, the deal value is in line with GSKCH's market capitalization.
- The merger includes GSKCH's total operations i.e. the health food drinks (HFD) business (*Horlicks, Boost, Maltova* and *Viva*).

Exhibit 1: *Horlicks* Brand in India and International markets* currently owned by GSK Plc (including Group Companies) is being acquired by Unilever and brands owned by GSK CH India (*Boost, Viva* and *Maltova*) to be retained by merged entity



* Bangladesh and 20 other markets, predominantly in Asia

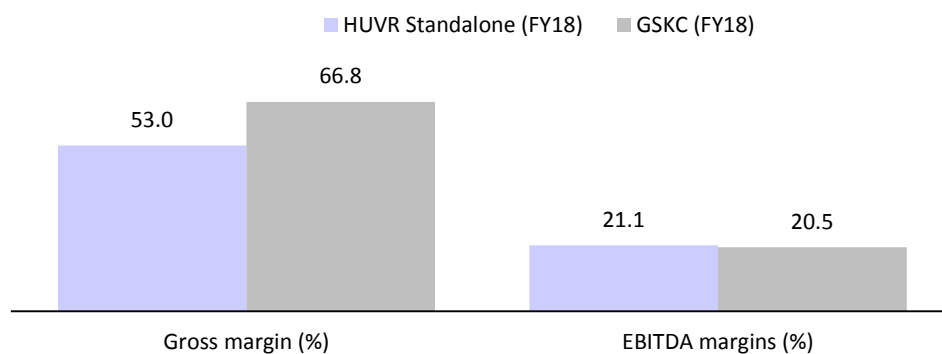
Source: Company, MOSL

- The transaction also includes a consignment selling contract to distribute GSKCH's Over-the-Counter and Oral Health products in India (mainly *Sensodyne, Eno, Crocin* and *Otrivin*) for a period of five years.
- The transaction is expected to be completed in a year's time subject to regulatory and shareholder approvals.
- Following the issue of new HUVR shares, Unilever's shareholding in HUVR will be diluted from 67.2% to 61.9%.
- As at 30 Sept'18, HUVR had total assets of INR176b and Net worth of INR70b. As at the same date, GSKCH had total assets of INR56b and Net worth of INR36b (GSK has historically had low levels of dividend payout).

What is in it for HUVR?

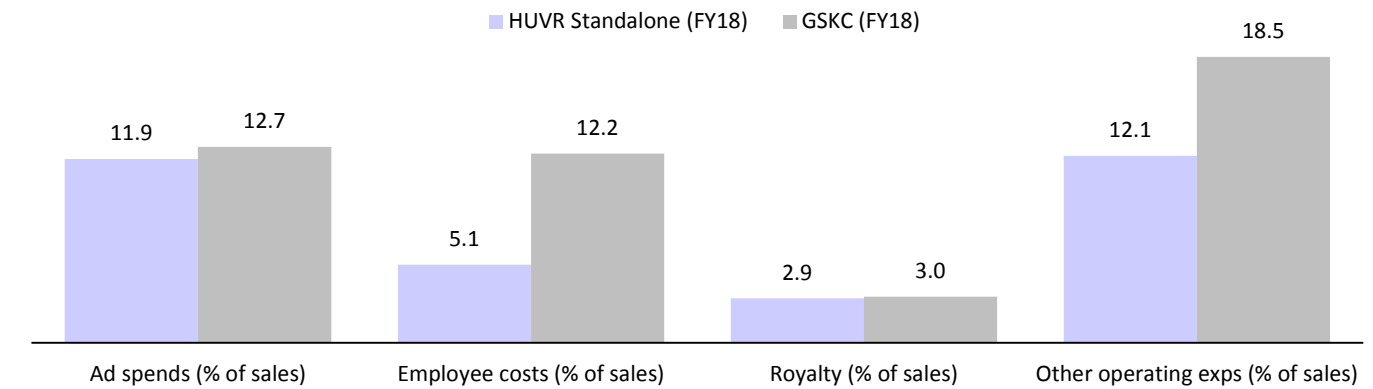
- The combined entity with sales of INR120b for FY19 will be the largest food and beverage business, much ahead of pure-play food and beverage businesses like Nestle and Britannia [both of which should have sales of around INR110b in FY19 (CY18 for Nestle)] and ITC's food business (likely to be around INR90b in FY19).
- HUVR's share of Food & Refreshments to total sales would increase from around 19% to around 31%.
- The value of the deal (effectively at INR7,530 per share) means that HUVR has acquired GSKCH at P/E multiples of 45.2x FY18, 36.6x FY19 and 32.9x FY20 EPS. On EV/ EBITDA the value is 31.8x, 25.4x and 21.8x, respectively. On EV/ Sales the value is 6.5x, 5.8x and 5.1x, respectively. The value of the transaction is at a substantial discount of around 25% to our FMCG peer universe (excluding alcohol, paints, adhesives and dairy companies) on P/E and EV/ EBITDA and at a premium of around 10% on EV/ Sales.
- Since HUVR is acquiring all assets it also gets access to the INR38.5b cash balance at GSKCH, which can either be put to productive use or paid to shareholders (effectively a DPS of INR16.4 on fully diluted shares).
- EPS accretion is around 5% with PAT addition of 14% and dilution of 8.5%. HUVR expects the topline of the business to grow in double-digits in the medium term.
- While overall EBITDA margins for HUVR and GSKCH are similar at around 21%, HUVR's F&R business EBIT margins is only around 15.6% v/s 19% for the GSKCH business. Hence, the profitability of the total F&R portfolio of HUVR improves meaningfully.

Exhibit 2: Margins for both the businesses in FY18



Source: Company, MOSL

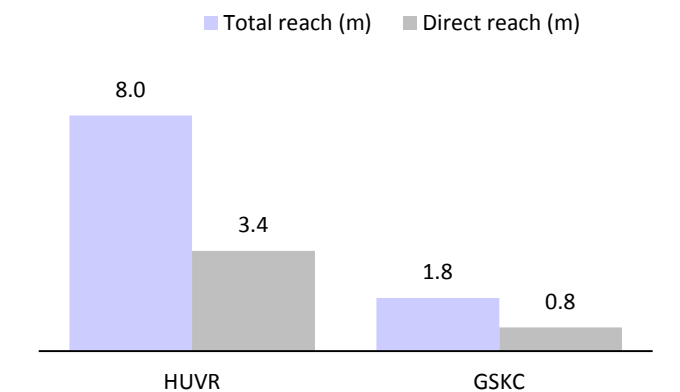
Exhibit 3: Full synergy benefits estimated at 800-1,000bp to margins led by supply chain, distribution, ad spends, etc.



Source: Company, MOSL

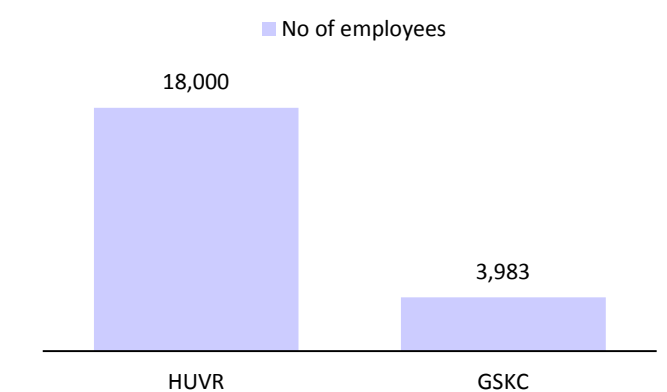
- In addition, synergies will be unlocked (management expects a staggering 800-1,000bp expansion in the existing GSKCH business margins over the medium term) on account of:
 - A. **Efforts to drive increased penetration of HFD**- Currently at 24% overall and 14% for rural.
 - B. **Increased distribution**- Particularly in the North and the West where distribution of *Horlicks* and *Boost* (GSKCH’s key HFD brands) are weaker than *Bournvita* (Mondelez). GSKCH has direct coverage of ~1m outlets whereas HUVR has direct coverage of over 3m outlets.

Exhibit 4: HUVR can drive penetration through its vast reach

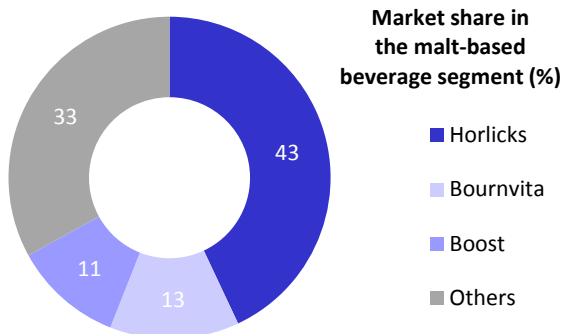


Source: Company, MOSL

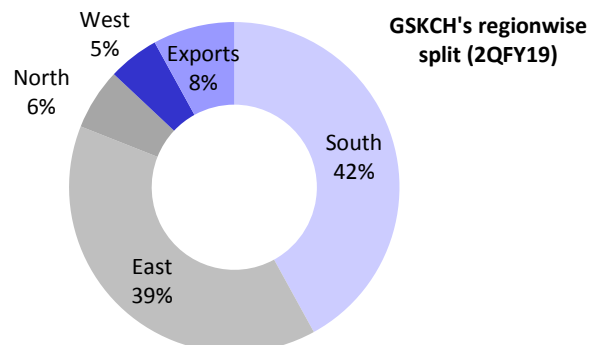
Exhibit 5: Post-merger, all GSKCH employees will become employees of HUVR



Source: Company, MOSL

Exhibit 6: GSKCH has ~54% value share in the HFD category in India

Source: Company, MOSL

Exhibit 7: HUVR's reach will help unlock the North & the West regions for the merged entity

Source: Company, MOSL

- C. **Upgrade and premiumization-** HUVR could sharply expand recent innovations of *Horlicks Growth Plus* (competing with the rapidly growing *Pediasure* of Abbot) and *Horlicks Protein Plus* (which competes against *Protinex*) as well as forays into ready to drink (RTD) market where *Boost* has already made an entry.
- a) HUVR can drive savings on the cost front (a) by saving on costs for the GSKCH brands as it is the largest advertiser (b) via overhead and administrative cost efficiencies, (c) as a result of operational improvement and supply chain opportunities, and (d) through the 'Go to market' and its distribution network optimization.

Conference call highlights - HUVR merger with GSKCH

Overall context

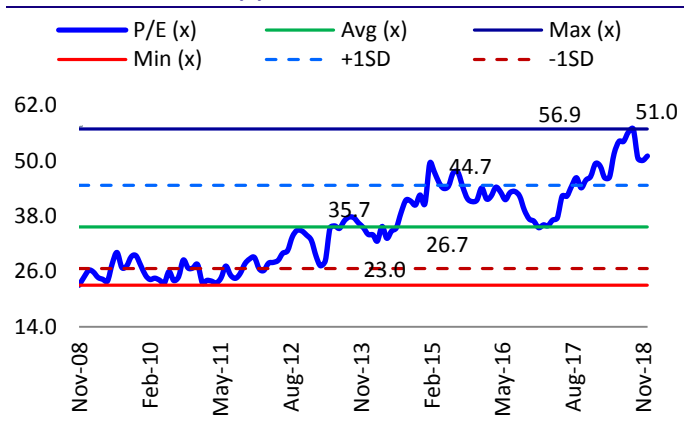
- HUVR has grown its F&R portfolio in double-digits over the past 10 years despite penetration being very high in some of these categories.
- Penetration of HFD category is 24% with 14% penetration in the rural market. Increase in distribution and low units packs will enable increased penetration levels.
- HUVR is already the largest player in Beauty & Personal care as well as Home Care. With GSKCH, it will rank among the largest in foods with sales of INR106b (FY18).
- Glaxo has good R&D capabilities and a healthy pipeline, which will be married to HUVR's marketing capabilities.
- Once the merger concludes, all employees of GSKCH will be employees of HUVR. Strategy will be decided later, according to management.

What are the growth prospects/ benefits/ margin expansion?

- Unilever has acquired rights to the *Horlicks'* brand from GSK providing unfettered access to the brand in India, Bangladesh and 20 other markets.
- Post-merger, India will have only one-listed entity (likely before Dec'19), which is HUVR.
- **Growth-** Management expects growth to range from high single-digits to even double-digits for the GSKCH portfolio.
- **Premiumization-** It will also be a big driver. HUVR's overall share in the premium end across categories is higher than its overall market share.

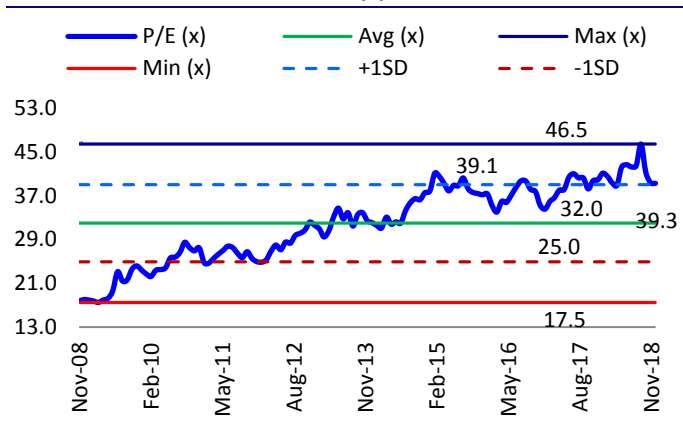
- **North and West-** HUVR will also provide the right offerings for this region apart from distribution reach.
- **Cost savings-** Common overall infrastructure and IT infrastructure will lead to savings. Large-scale raw material and packaging purchases should also lead to savings. Advertising is also an area where HUVR’s expertise as well as bulk buying can make a significant difference to costs.
- Management expects 800-1,000bp savings over the longer term in GSKCH after the deal is complete.
- **Chemist channel advantage-** HUVR is under-indexed in the chemist channel relative to other channels. For categories like Beauty and Personal Care, the chemist channel is becoming extremely relevant where having OTC brands should help HUVR.
- **Royalty** is currently between 1.5-4% on various brands of *Horlicks*. Royalty on *Horlicks* will be decided later with Unilever. *Boost* is owned by the Indian entity and has been acquired as part of the deal. Hence, there will be no royalty on *Boost*.
- **Intangible assets** will be created. Management will work out the final amount to be amortized.
- **Broadly the same net margins will accrue on distribution** of the GSK Asia brands (*Sensodyne, Crocin, Eno & Otrivin*).
- **Tax deductibility of goodwill** – Management said it is likely but they need to verify.

Exhibit 8: HUVR P/E (x)



Source: Bloomberg, Company, MOSL

Exhibit 9: Consumer sector P/E (x)



Source: Bloomberg, Company, MOSL

Financials and valuations

Income Statement							(INR M)
Y/E March	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Total Revenue	308,056	310,609	318,900	345,250	383,564	437,253	498,916
Change (%)	9.9	0.8	2.7	8.3	11.1	14.0	14.1
COGS	156,236	153,053	156,850	162,320	178,307	201,614	228,187
Gross Profit	151,821	157,556	162,050	182,930	205,257	235,640	270,728
Gros Margin (%)	49.3	50.7	50.8	53.0	53.5	53.9	54.3
Operating Exp	99,738	100,070	101,580	110,170	118,621	130,923	147,304
% of sales	32.4	32.2	31.9	31.9	30.9	29.9	29.5
EBIDTA	52,082	57,486	60,470	72,760	86,636	104,717	123,425
Change (%)	16.4	10.4	5.2	20.3	19.1	20.9	17.9
Margin (%)	16.9	18.5	19.0	21.1	22.6	23.9	24.7
Depreciation	2,867	3,208	3,960	4,780	5,022	5,160	5,145
Int. and Fin. Charges	168	150	220	200	220	242	266
Other Income - Recurring	6,184	5,640	5,260	5,690	7,537	8,363	9,501
Profit before Taxes	55,231	59,769	61,550	73,470	88,931	107,678	127,515
Change (%)	15.1	8.2	3.0	19.4	21.0	21.1	18.4
Margin (%)	18.3	19.6	19.7	21.7	23.6	25.0	26.0
Tax	19,060	18,160	18,650	21,480	26,057	31,550	37,362
Deferred Tax	-338	-70	410	-1,000	623	754	893
Tax Rate (%)	33.9	30.3	31.0	27.9	30.0	30.0	30.0
Profit after Taxes	36,510	41,679	42,490	52,990	62,251	75,374	89,260
Change (%)	2.7	14.2	1.9	24.7	17.5	21.1	18.4
Margin (%)	12.1	13.7	13.6	15.6	16.5	17.5	18.2
Non-rec. (Exp)/Income	6,643	-310	2,410	-620	0	0	0
Reported PAT	43,153	41,369	44,900	52,370	62,251	75,374	89,260

Balance Sheet							(INR M)
Y/E March	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Share Capital	2,164	2,164	2,164	2,164	2,164	2,164	2,164
Reserves	35,084	60,630	62,740	68,590	71,647	71,867	67,852
Capital Employed	37,248	62,794	64,904	70,754	73,812	74,031	70,017
Gross Block	44,306	50,774	65,827	71,787	73,787	75,787	77,787
Less: Accum. Depn.	-19,731	-21,627	-25,587	-30,367	-35,389	-40,549	-45,694
Net Fixed Assets	24,575	29,147	40,240	41,420	38,398	35,237	32,093
Capital WIP	4,790	3,860	2,030	4,300	4,300	4,300	4,300
Investment in Subsidiaries	6,541	3,130	2,540	2,540	2,540	2,540	2,540
Current Investments	26,238	24,670	35,250	28,570	28,570	28,570	28,570
Deferred Charges	1,960	1,680	1,600	2,550	2,550	2,550	2,550
Curr. Assets, L&A	72,236	76,509	65,850	92,110	108,409	131,364	147,580
Inventory	26,027	25,284	23,620	23,590	27,561	29,342	35,893
Account Receivables	7,829	10,645	9,280	11,470	10,571	14,470	15,144
Cash and Bank Balance	25,376	27,590	16,710	33,730	40,210	54,710	60,896
Others	13,005	12,990	16,240	23,320	30,067	32,842	35,647
Curr. Liab. and Prov.	99,093	76,202	82,606	100,736	110,955	130,530	147,616
Account Payables	48,515	54,980	60,060	70,130	75,711	90,485	102,589
Other Liabilities	29,828	12,382	13,826	16,376	18,014	19,815	21,796
Provisions	20,749	8,840	8,720	14,230	17,230	20,230	23,230
Net Current Assets	-26,857	307	-16,756	-8,626	-2,546	834	-36
Application of Funds	37,248	62,794	64,904	70,754	73,812	74,031	70,017

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
Basic (INR)							
EPS	16.9	19.3	19.6	24.5	28.8	34.8	41.2
Cash EPS	18.2	20.7	21.5	26.7	31.1	37.2	43.6
BV/Share	17.2	29.0	30.0	32.7	34.1	34.2	32.4
DPS	15.0	15.5	17.0	20.0	24.0	30.0	37.0
Payout %	89.9	96.9	97.9	98.9	99.8	103.0	107.3
Valuation (x)							
P/E	108.2	94.8	93.0	74.6	63.5	52.4	44.3
Cash P/E	100.3	88.0	85.1	68.4	58.7	49.1	41.9
EV/Sales	13.0	12.9	12.6	11.5	10.4	9.1	7.9
EV/EBITDA	75.2	68.2	65.0	53.8	45.1	37.2	31.5
P/BV	106.1	62.9	60.9	55.9	53.5	53.4	56.4
Dividend Yield (%)	0.8	0.8	0.9	1.1	1.3	1.6	2.0
Return Ratios (%)							
RoE	104.3	83.3	66.5	78.1	86.1	102.0	123.9
RoCE	140.6	108.5	88.5	100.2	112.9	134.7	164.2
RoIC	4,018.2	263.3	108.6	132.9	200.6	355.2	1,121.8
Working Capital Ratios							
Debtor (Days)	9	13	11	12	10	12	11
Asset Turnover (x)	8.1	4.9	4.8	4.8	5.1	5.8	7.0
Leverage Ratio							
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Cash Flow Statement

(INR M)

Y/E March	FY15	FY16	FY17	FY18	FY19E	FY20E	FY21E
OP/(loss) before Tax	55,231	59,770	61,550	73,470	88,931	107,678	127,515
Financial other income	-3,559	-1,910	-920	-2,720	-7,537	-8,363	-9,501
Depreciation	2,867	3,210	3,960	4,780	5,022	5,160	5,145
Net Interest Paid	-1,890	-3,160	-2,400	-2,460	220	242	266
Direct Taxes Paid	-17,775	-17,040	-18,040	-22,100	-26,057	-31,550	-37,362
(Incr)/Decr in WC	-2,156	-1,130	5,380	8,190	400	11,120	7,056
CF from Operations	32,719	39,740	49,530	59,160	60,979	84,287	93,119
Other Items	3,506	6,004	450	4,790	9,022	9,686	10,814
(Incr)/Decr in FA	263	-6,740	-8,520	-8,210	-2,000	-2,000	-2,000
Free Cash Flow	32,982	33,000	41,010	50,950	58,979	82,287	91,119
(Pur)/Sale of Investments	1,182	3,290	-9,700	7,790	0	0	0
CF from Invest.	4,951	2,554	-17,770	4,370	7,022	7,686	8,814
Dividend Paid	-29,123	-33,420	-35,610	-38,720	-62,124	-77,655	-95,775
Others	-5,403	-6,660	-7,030	-7,790	603	181	29
CF from Fin. Activity	-34,504	-40,080	-42,640	-46,510	-61,521	-77,474	-95,746
Incr/Decr of Cash	3,166	2,214	-10,880	17,020	6,480	14,499	6,187
Add: Opening Balance	22,210	25,376	27,590	16,710	33,730	40,210	54,709
Closing Balance	25,376	27,590	16,710	33,730	40,210	54,709	60,897

E: MOSL Estimates

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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