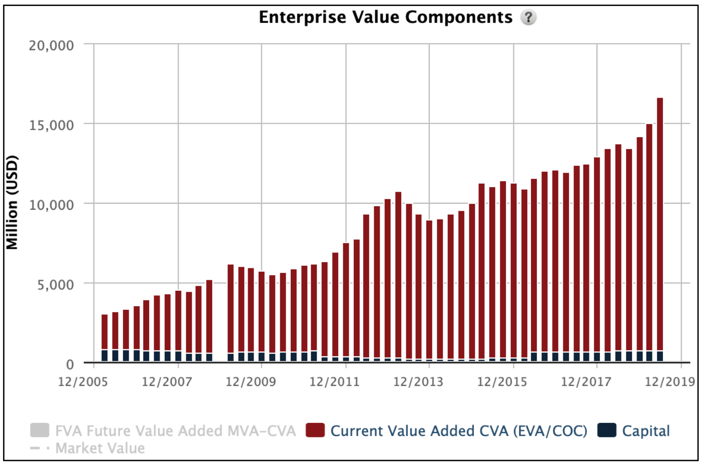
KIP CAPITAL

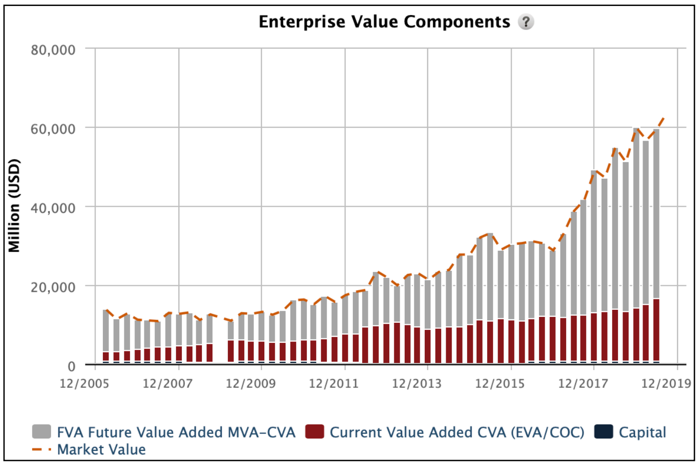
# Hindustan Unilever (HUVR IN)

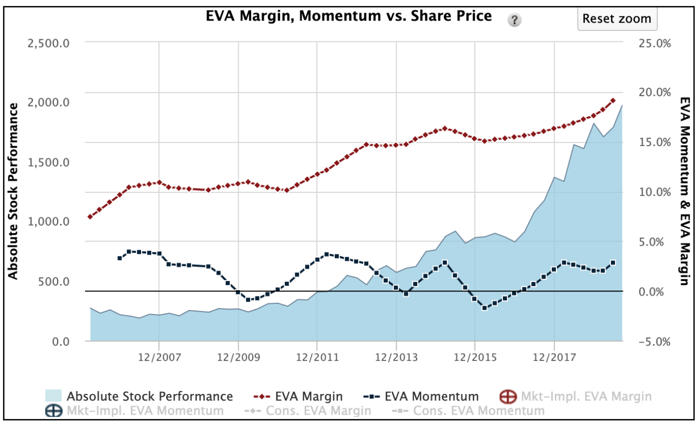
Oct 15th, 2019

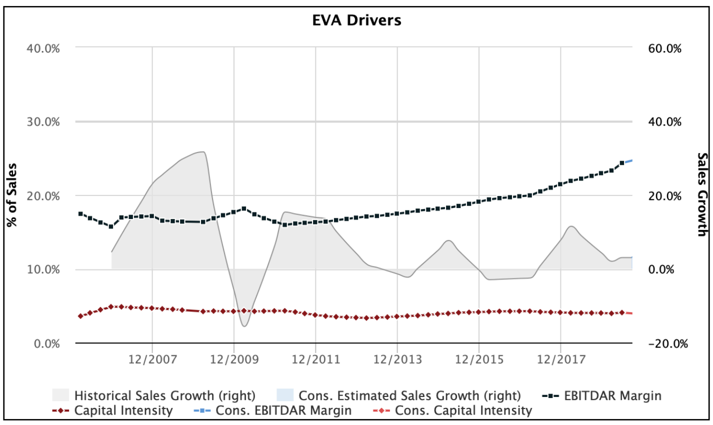
| Moat Category<br>Capital-Light Compounder | Fair Value Estimate<br>- | Price<br>$28.26 | Enterprise Value<br>$64.5bn |
|---|---|---|---|
| **Moat Type**<br>Ecos. of Scale + Distribution<br>Intangibles - Brand | **Economic Moat**<br>Wide | **Stewardship Rating**<br>Standard | **Market Cap**<br>$61.2bn |

**What does it do:** "Hindustan Unilever Ltd is an Indian consumer goods company. The firm's offering is diverse, as it includes over 35 brands from 20 distinct categories, from cosmetics and hygienic items (detergents, soaps, shampoos, skin care, toothpastes, and deodorants), to food and beverages (tea, coffee, packaged foods). Its product portfolio contains household brands such as Lux, Lifebuoy, Pepsodent, Closeup, Pureit, Axe, Brooke Bond, Bru, Knorr, Kissan, Pond's, Vaseline, Lakme, Dove, Clinic Plus, Sunsilk, Kwality Wall's, Surf Excel, Rin, Wheel, and Fair & Lovely." (Source: Morningstar)




*Source: www.evaexpress.com*

## Past 9-year EVA-Profitability numbers

**Profitability**

HUVR IN's exceptionally strong return on capital and its outstandin
rate, 99th percentile

| | | 011TFQ1 | 2012TFQ1 | 2013TFQ1 | 2014TFQ1 | 2015TFQ1 | 2016TFQ1 | 2017TFQ1 | 2018TFQ1 | 2019TFQ1 |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Sales | 4,472 | 4,924 | 4,940 | 4,948 | 5,188 | 5,040 | 5,087 | 5,541 | 5,709 |
| 2 | EBITDAR (EBITDA+Rent+R&D+Ad+Etc) | 721 | 816 | 847 | 884 | 960 | 986 | 1,042 | 1,230 | 1,389 |
| 3 | NOPAT (Net Operating Profit After Tax) | 529 | 657 | 740 | 769 | 849 | 790 | 847 | 981 | 1,143 |
| 4 | Capital (Net Operating Assets) | 303 | 260 | 156 | 194 | 251 | 652 | 614 | 682 | 680 |
| 5 | Return on Capital (ROC) (NOPAT/Capital) | 85.3% | 214.9% | 295.3% | 474.8% | 414.1% | 262.8% | 132.4% | 158.0% | 168.5% |
| 6 | Cost of Capital (COC) | 8.3% | 8.0% | 7.3% | 8.5% | 8.4% | 7.4% | 7.1% | 7.4% | 7.5% |
| 7 | EVA (ROC-COC) x Capital) | 477 | 633 | 721 | 755 | 832 | 768 | 802 | 935 | 1,092 |
| 9 | EVA Spread (EVA/Capital = ROC-COC) | 76.9% | 206.9% | 288.0% | 466.3% | 405.6% | 255.4% | 125.4% | 150.6% | 160.9% |
| 10 | EVA Margin (EVA/Sales) | 10.7% | 12.9% | 14.6% | 15.3% | 16.0% | 15.2% | 15.8% | 16.9% | 19.1% |
| 11 | EBITDAR Margin (EBITDAR/Sales) | 16.1% | 16.6% | 17.2% | 17.9% | 18.5% | 19.6% | 20.5% | 22.2% | 24.3% |
| 12 | Sales Growth | 14.9% | 10.1% | 0.3% | 0.2% | 4.9% | -2.9% | 0.9% | 8.9% | 3.0% |
| 13 | EVA Momentum (ΔEVA/Sales) | 1.6% | 3.5% | 1.8% | 0.7% | 1.6% | -1.2% | 0.7% | 2.6% | 2.8% |
| 14 | EVA Momentum (ΔEVA/Capital) | 10.5% | 25.1% | 29.0% | 13.5% | 47.3% | -31.3% | 11.3% | 20.9% | 25.3% |
| 15 | 3 Year Trend (ΔEVA/Capital) | 4.2% | 10.5% | 21.2% | 23.6% | 26.4% | 10.5% | 3.4% | 9.0% | 21.3% |
| 16 | Last Quarter (ΔEVA/Capital) | 25.4% | 30.1% | -13.1% | 75.4% | -49.0% | 7.8% | 26.3% | 14.5% | 41.7% |

*Source: www.evaexpress.com* *Figures in $$ millions*

## Wide Moat Checklists

| Competitive Strengths | Does HUVR have it? | Evidence |
|---|---|---|
| Product or service is needed or desired (and will continue to do so) | ☑ | HUVR's brands are desired by Indian consumers and have become a staple in almost every household in the nation. This is likely to remain the same. |
| Product is perceived by its customers to have no close substitute | ☐ | Inherent to the FMCG industry, competition is fierce, and in India it is no different. HUVR's brands face high competition amongst other local and international consumer goods brands. |
| Product is not subject to price regulation | ☑ | Industry is not regulated on the basis of price. |

| Competitive Strengths | Does HUVR have it? | Evidence |
|---|---|---|
| Strong barriers to entry | ☑ | A potential entrant would face three types of barriers to entry.<br>First, regulatory approvals for selling FMCG products. These are difficult and costly to achieve in time and resources.<br>Second, the continuous investment in Ad&Promo in order to capture consumer mindshare. HUVR spent $600m last year in Ad&Promo (14% of total expenses). A new entrant would need deep pockets in order to compete with the likes of HUVR.<br>Lastly, Economies of Scale. In order to keep their price points low, a new player would need economies of scale. Given HUVR's massive scale in production and distribution, this is a significant barrier to entry that must be considered. |
| Loyal customers | ☑ | HUVR has done an exceptional job in capturing mindshare of Indian consumers for all its brands across differing price points. The company has achieved this in two ways: 1. Consistently marketing its products using several media channels; 2. Having their products widely available using its extensive distribution channels (the largest of its kind in the country).<br>Consumers face close to zero switch cost in the FMCG market, specifically when price points are low. However, HUVR's products cater to high, mid and low income households. If economic conditions turn sour and disposable incomes shrink, consumers are likely to switch to cheaper, but still familiar household, personal care and food products. These are essentials to running a household.<br>HUVR boasts a portfolio of 40 brands, and 95% of products hold the two leading spots in their respective categories in terms of market share. HUVR estimates 90% of households in India use one of their products. |
| Low risk of technological obsolescence | ☑ | The industry is unlikely to experience major changes in production methods that would render current practices obsolete. Changes are likely to be incremental. |
| Abundant growth possibilities | ☑ | The FMCG sector has grown from $31.6 billion in 2011 to $52.8 billion in 2017-18. The sector is further expected to grow at a CAGR of 27.9% to reach $103.7 billion by 2020. This is due to the fast growing Indian economy, expanding middle-class, and rising disposable incomes within rural India. HUVR is highly likely to capture a large part of this expansion, leveraging its wide and growing distribution network and entrenched brands in the Indian culture. |
| Limited capital requirements | ☑ | Given HUVR's large scale, its capital requirements are limited, as illustrated by EVA graphs above. |
| Significant and growing free cash flows (and EVAs) | ☑ | HUVR is likely to continuing growing EVA in the future. It is possible the rate of growth may slow. More research is required. |