

Initiation of Coverage

Hindustan Unilever Limited

Fair & lovely

Hindustan Unilever Limited (HUL) is the largest player in the home & personal care (HPC) segments of the Indian consumer space, with dominant market shares in key categories, such as soaps & detergents, skin care and shampoos. We initiate coverage with a 1-Overweight rating and a 12-month target price of INR293 based on a P/E of 29x FY09E EPS of INR10.1, which represents 22% potential upside from current levels.

Stock Rating: 1-OVERWEIGHT
Sector View: 1-POSITIVE
Ticker: HLL.BO
Price (16-Apr-2008): INR 241.05
Price Target: INR 293.00

INDIA BSE 30 SENSITIVE: 16153.66

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Analyst Certification

We, Manish Jain and Jamil Ansari, hereby certify (1) that the views expressed in this research Company Report accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Company Report and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Company Report.

April 17, 2008

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- Industry dynamics in key categories have improved significantly over the past couple of years, with the easing of competitive pressures and the return of pricing power.
- The company was successful in improving its margins in segments such as soaps & detergents in CY07, in spite of the steep rise in key raw material costs. We believe that margins, which are substantially lower than historical levels, will expand by 210 bp during CY07-CY09E, which will likely surprise the street.
- HUL is currently trading at a significant discount to its three-year average P/E multiple. We believe this provides a good entry point, given the strong visibility of earnings.

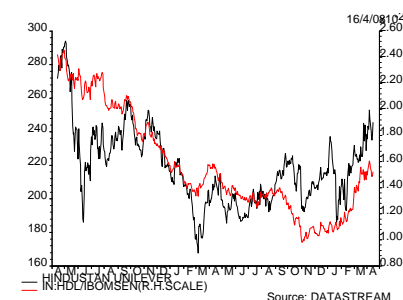
FY Dec (INR)	2007A	2008E	2009E
Revenue (m)	139134.0	158944.0	179528.0
Net Profit (m)	17637.0	20802.0	25103.0
EPS	8.10	9.60	11.50
EPS growth (%)	17.60	17.90	20.70
P/E	29.76	25.11	20.96
EV/EBITDA	21.6	18.4	15.1

Market Data

Market Cap (mn)	525003
Market Cap (US\$ mn)	13140
Shares Outstanding (mn)	2178.0
6mth Daily T/O (US\$ mn)	3.01
Free float (%)	49.0
Share per ADR	N/A

Financial Summary

Proj 3-Yr EPS Grth(%)	17.6
ROE (%)	85.6
Debt / Capital (%)	6.0
Dividend Yield (%)	N/A



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Investment arguments

Focus shifted to profitable growth; margins expected to expand in core categories

Over the past couple of years, the focus of the company has shifted from just growth to profitable growth. In the core categories of soaps & detergents and personal products, the company is now looking at steady margin expansion. During this period, aggressive pricing actions in its core categories have been targeted towards not only countering the commodity inflation, but enabling the company to expand margins. Consequently, the operating margins of the company in the soaps and detergents segment have expanded by 250 bp in CY07, despite palm oil prices almost doubling during the year.

Figure 1: Profitability of key segments

PBDIT margins (%)	CY02	CY03	CY04	CY05	CY06	CY07
Soaps & detergents	25.7	24.8	17.3	13.7	13.1	15.6
– % revenue contribution	41.2	40.4	42.2	42.9	45.1	45.8
Personal products	33.7	35.1	31.5	28.7	27.8	28.4
– % revenue contribution	21.1	23.8	24.6	26.0	27.1	26.4
HUL PBDIT margins (%)	20.4	20.7	16.7	15.3	15.1	16.0

Source: Company data, Lehman Brothers research

We believe that despite strong commodity inflation faced by the company, the headroom for further margin expansion seems to be there. The table below analyzes the dynamics of a mass fabric wash detergents brand (e.g. Wheel).

Figure 2: Detergents – sample profitability calculations

(INR)	2006	2007	2008E	2009E
Retail price (per 1,000 gram)	24	27	30	33
Retailer margins (%)	10	10	10	10
Invoice price to retailer	21.8	24.5	27.3	29.5
Stockist margins (%)	5	5	5	5
Invoice price to stockist	20.8	23.4	26	28.1
Sales tax (%)	4	4	3	3
Gross sales price	20	22.5	25.2	27.3
Excise duty (%)	12	12	12	12
Net sales price	17.1	19.2	21.6	23.4
Cost of goods				
Linear alkyl benzene sulphonic acid (LABSA) (gram per 1,000 gram of detergents)	110	110	110	110
Cost (per gram)	0.07	0.08	0.09	0.095
Total cost of LABSA	7.7	8.8	9.9	10.45
Salt/dolomite	890	890	890	890
Cost (per gram)	0.005	0.005	0.006	0.006
Total cost of salt/dolomite	4.45	4.67	4.91	5.15
Cost of perfumes	0.7	0.7	0.8	0.9
Total raw material costs (per 1,000 gram)	12.8	14.2	15.6	16.5
Non raw material costs	2.6	2.68	2.82	2.96
Operating profits	1.71	2.34	3.2	4
OPM (%)	10.0	12.2	14.8	17.10

Source: Lehman Brothers research

The table above shows the strong operating leverage that the company enjoys in the detergents category. In CY08 for instance, even if prices are increased by 10% (from December 2007 levels) and Linear alkyl benzene sulphonic acid (LABSA) prices move up by as much as 13%, margins are expected to improve by 260 bp.

The company's pricing power in recent times is evidenced by the following:

- The per kg realization of the company's flagship mass fabric detergent has increased substantially in the past couple of years (the quantity in an INR10 pack of Wheel which used to be 500 grams during the peak of the price war has now come down to 350 grams, thereby resulting in an improvement in the per kg realization by more than 40%).
- Similarly the price of 100 gram premium toilet soap (e.g. Lux) has been increased from an average of INR12 in CY06 to INR17 currently (an increase of around 42% over a two-year period).

We believe such improvements in realization should continue in the near future, partly due to higher raw material costs and partly due to some easing in the competitive scenario in this segment. This increase in realization should help the company improve its margins in this segment further, in our view.

Sustained market shares in key categories

One of the key strengths of HUL has been its market share leadership in all of its key categories. However, it was also viewed as a threat some years ago, as the street expected HUL to lose market share significantly in the face of the increasing competitive intensity. However, analysis of the company's market share movements indicates that HUL has done rather well in the past two years, even in the face of very aggressive moves by its competitors. The fact that the company was able to not only defend but actually slightly increase its market share in categories such as detergents, which saw massive price wars by the global major Procter & Gamble (PG IN, not rated), speaks volumes about the company's ability to defend its market share leadership, in our view.

Figure 3: Market share in key categories

(%)	1Q of CY06	4Q of CY07	Difference
Toilet soaps	55.84	54.30	-1.54
Washing powders/liquids	34.74	38.29	3.55
Skin creams	53.02	53.77	0.75
Detergent cakes/bars	39.42	40.62	1.20
Shampoos	47.67	47.78	0.11

Source: ACNielsen data, Lehman Brothers research

We believe that competitive intensity will be much lower in future compared to the past five years and HUL should be able to maintain and slightly increase its market share in most of its key categories.

New initiatives

Over the years, HUL has been consistently criticized for its inability to expand into newer fast-growing categories. However, things are changing and HUL is making some progress towards expanding its categories.

The first of such moves was the launch of the water purifier business, Pureit, through which the company aims to tap the fast-growing segment of providing domestic water-purification systems. Given the scarcity of clean, drinkable water in India, we believe this business has good long-term prospects. The fact that this system requires neither continuous running water nor electricity, should mean that it finds good usage in rural and semi-urban India, which have severe water supply problems. In addition, the business model seems interesting as the purifier requires a cartridge, which has to be replaced every six months, thus providing a continuous revenue stream for the company.

In February 2008, the company launched the Amaze range of nutritional foods from the parent Unilever's portfolio. HUL had earlier missed out on the tremendous growth seen in categories such as biscuits and snack foods, due to its philosophy of being present only in segments which are healthy for end consumers. Hence, it is now looking to enter the fast-growing food segment in India through its Amaze range of nutritional products. The company has already launched nutritional snack foods, malt-based drinks, etc. under this brand and we expect it to grow its portfolio gradually. We believe this is a positive move by the company. However, it is too early to be classified as a success, in our view.

We believe the company is trying to get its act right in the foods segment with the launch of Amaze which is a positive indicator, in our view; however, it is too early for any of these initiatives to have a significant impact on the company's financials.

Price war – an unlikely scenario

The sector in general and HUL in particular was impacted significantly in 2004 on account of a price war in the detergent and shampoo category between the company and P&G.

Price war – a historical perspective

The pricing action was initiated by P&G in early 2004; the strategy was to correct the premium positioning of its key brands, Tide and Ariel, and was aimed at moving consumers up the value chain. The company slashed the prices of Tide and Ariel by 47% and 29%, respectively, for their 500 gram packs. The strategy was to take a temporary knock on margins in order to expand the detergents market.

However, HUL was quick to react and announced a 24% and 29% price reduction for its Surf Excel and Surf Excel Blue brands, respectively. The situation had by then escalated into a full-scale price war. What followed was an increased thrust on advertising and promotion (A&P) spend, which HUL increased by almost 19% in CY05.

The end result of the price war was quite contrary to the competitors' expectations. Volumes did not quite expand by as much as they were expected to and margins took a significant knock. For instance, revenue from soaps and detergents increased only 2% but operating profits declined by almost 29% in CY04, resulting in a margin dip of almost 750 bp in CY04.

However, we believe that in the near to medium term, another price war is unlikely on account of

- The focus of the industry in general has shifted towards more sustainable and profitable growth. Hence, challengers are looking at market-share gains but on a more sustained basis and do not want to sacrifice profitability. For instance, in the soap category, the management of Godrej Consumer has indicated that they are targeting to increase their share in the soaps segment by 100 bp per year over the medium term and are not looking at a quantum jump immediately. Hence this focus on profitability would prevent existing challengers from entering a price war;
- In terms of new players mounting a serious challenge to the company, we do not anticipate many potential candidates in the near term. The only new entrant in the consumer space who can present a challenge to the company, in our view, is ITC in the soap and shampoo segments. However, ITC is still relatively new and is likely to focus on establishing its network and brands over the next few years; and,
- The consumer market in general is focusing more on the emerging categories, such as post-wash hair care, skin care, male grooming products and services. Hence to that extent, the threat in HUL's core categories is likely to be minimal.

Financials

We expect HUL to register 12.8% revenue CAGR over CY07-10E on the back sustained growth momentum in the key categories, such as soaps, detergents and personal care products. We expect earnings to register a 17% CAGR over CY07-10E. We forecast EPS to increase from INR8.1 in CY07 to INR12.9 in CY10E.

Valuations

At the current market price of INR241, the company trades at a P/E of 25.1x our CY08E EPS of INR9.6. We believe that the company is likely to register steady revenue growth largely in line with expectations, however, we expect margins in core categories to surprise the market.

We have valued the stock on a P/E of 29x our four rolling quarters' forward estimated EPS of INR10.1. Our target price of INR293 implies potential upside of 22% from current levels. We initiate coverage on the stock with a 1-Overweight rating.

Investment risks

Spiraling raw material costs

One of the biggest risks that the company faces is spiraling raw material prices, courtesy of commodity prices, which are at record highs currently. Key raw materials, such as palm oil and LABSA, are at record highs.

Palm oil prices witnessed a jump of 74% to US\$722 per MT in CY07 and have increased by around 95% in the first quarter of CY08E. While this has been putting pressure on margins, the company has so far managed the situation in a fairly commendable manner, in our view. Margins in the soap and detergent segment have increased by 250 bp YoY in CY07, despite the spiraling raw material costs. We believe that the company will be able to expand margins in the core category by judicious price increases and mix improvements. Also, the government's recent announcement of cutting import duties on palm oil is expected to go a long way in helping the company.

Tax incentives may be withdrawn

In the past, the company has benefitted from tax incentives offered by various state governments in lieu of setting up a manufacturing plant in some specified locations. Hence, the excise duty rate is lower at 7.5% and income tax rate is at 19%.

In the long term, there is a threat of some or all of these incentives being withdrawn by the government. In fact, there was a recent notification by the union government which withdrew tax incentives for manufacturing plants located in the north-east region.

Any such announcements in future are likely to result in the tax rate going up substantially, in our view, and thus are expected to depress the core earnings of the company.

Another price war may depress margins

One of the biggest hits that the company took on its operating margins was in CY03-CY05, primarily on account of the price war between the company and P&G. Similar price wars by existing challengers or new entrants could pose a threat to the company's margins in future. However, we believe that the threat of a price war is relatively remote at the moment, given the industry-wide focus being steady on sustained market-share gains and profitable growth. Furthermore, the threat of strong existing players entering the categories with a big bang seems a little unlikely, in our view.

Financials

Revenue

Over the medium to long term, we expect HUL to register growth largely in line with the industry. Our assumptions do not build in additional revenue from the newer initiatives such as Pureit water filters. However, we believe that these initiatives are still in a fairly nascent stage and are unlikely to add meaningfully over the course of the next two to three years.

We expect growth to be driven by a mix of both volume and value over the next couple of years. We expect the company to increase prices at a pace higher than the increase in raw material costs, thereby resulting in an expansion in operating margins over the next few years.

We expect HUL to register a 12.8% revenue CAGR over CY07-10E on the back of sustained growth momentum in key categories, such as soaps, detergents and personal care products. We expect a volume CAGR of 4% in soaps, 5% in detergents and 8% in personal care products. Realizations are expected to increase by a steady 5-9% across key categories.

Figure 4: Segmental revenue

Category (INR mn)	CY07	CY08E	CY09E	CY10E
Soaps	30,408	33,826	37,648	41,112
– growth (%)	8.3	11.2	11.3	9.2
Synthetic detergents	29,552	33,822	37,644	41,107
– growth (%)	17.8	14.5	11.3	9.2
Personal care	38,608	44,615	51,076	57,920
– growth (%)	11.7	15.6	14.5	13.4
Beverages	20,298	22,581	24,949	26,779
– growth (%)	11	11.2	10.5	7.3
Others	20,268	24,100	28,212	32,605
– growth (%)	12.1	18.9	17.1	15.6
Total net revenue	139,134	158,944	179,528	199,522
– growth (%)	12.1	14.2	13	11.1

Source: Company data, Lehman Brothers estimates

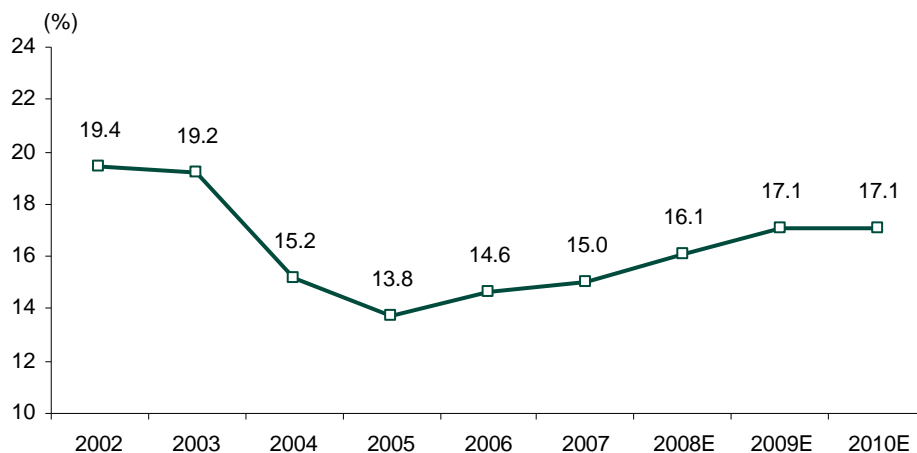
Margins

The company's strategy of sustained and profitable growth is likely to yield results over the next three years. We expect the consolidated operating margin to expand by 210 bp from 15% in CY07 to 17.1% in CY10E. We believe the key drivers for margin expansion will be: 1) judicious price increases in key categories, 2) product-mix improvements, and 3) savings on account of cost-cutting measures implemented by the company (such as merging the separate profit centers for foods & home & personal care [HPC] into a single profit center).

We believe that consensus is building in a very conservative margin scenario with just a 90 bp improvement over CY07-10E. Rapid and sustained improvement in the dynamics of the core categories, such as soaps and detergents, is likely to drive the improvement in consolidated margins. We expect that over the course of the next two years, the company will surprise the street in general on the margins front.

What needs to be kept in mind is that even after the 210 bp expansion in margins until CY10E, these are still lower than their historical highs. Margins in CY04-05 were adversely impacted due to the price war with P&G in some of the key categories. However, they have been recovering at a steady pace ever since.

Figure 5: Operating margins – steadily gaining lost ground



Source: Lehman Brothers estimates

The company is facing pressure on the raw material front due to record prices in most of the key input commodities. However, over the course of past couple of years, the company has managed the situation in a good manner, in our view. This is especially visible in the soap and detergent category, where operating margins have improved 250 bp in CY07 to 15.6% despite the significant spurt in Malaysian palm oil prices. Even in the personal products category, margins have witnessed an improvement of 60 bp to 28.4%.

We think that further improvement in the operating margins in these two core categories should be possible through price increases coupled with the mix improvement. We are expecting a 150 bp improvement in operating margins for soap and detergent margins in CY08 and a 100 bp improvement in the personal products category.

A&P

We expect the advertising and promotions (A&P) budget of the company to increase at a 12% CAGR over CY07-10E. However, A&P as a percentage of sales is expected to remain steady at 10.3%.

The company's strategy of focusing on mass-media campaigns for the power brands and trade promotions for the other brands seems to have yielded benefits in the past couple of years and we believe that the trend is likely to continue.

Taxation

HUL has derived significant benefits from the fiscal benefits available in tax-free zones, such as Daman, Uttaranchal, Himachal Pradesh and the North East. This has resulted in substantial savings in income tax as well as in excise duty. HUL had an income tax rate of around 19% and excise duty of 7.5% in CY07. We have assumed a marginal increase in the tax rate of 20% in CY10E. However, we believe that the excise duty rate is likely to witness a reduction from 7.5% in CY07 to 6.8% in CY10E; this is primarily on the back of the excise duty cut announced by the union government in the recent budget.

Capex and dividend

The asset intensity of the consumer goods business is extremely low, which results in very low capex requirements for the companies in this sector. We have assumed capital expenditure of INR5 billion over the next three years. This should be funded comfortably through the cash generated by the company, according to our estimates.

We expect the company to maintain around a 90% payout ratio over the next three years and expect the yield to be around 3.7% in CY08.

Earnings

We expect the earnings of the company to register a 17% CAGR over CY07-10E. EPS is expected to increase from INR8.1 in CY07 to INR12.9 in CY10E.

Our earnings estimates are 7% and 10% higher in CY09 and CY10, respectively, compared to consensus estimates. This is primarily on account of higher operating margin assumptions as compared to the street.

Valuation

At the current market price of INR241, the company trades at a P/E of 25.1x our CY08 earnings estimate of INR9.6. We believe that the company is likely to register steady revenue growth largely in line with our expectations; however, margins in the core categories are likely to surprise the market, in our view.

The performance of the company in core categories, such as soaps and detergents, has been impressive in past year, despite enormous pressure faced on account of raw material prices. Margins in the soap and detergent category have expanded by 250 bp in CY07 even on the back of a 74% jump in palm oil prices over CY06. We believe that the company will be able to expand margins in these core categories, which we estimate will drive EPS growth of nearly 18% in the next three years.

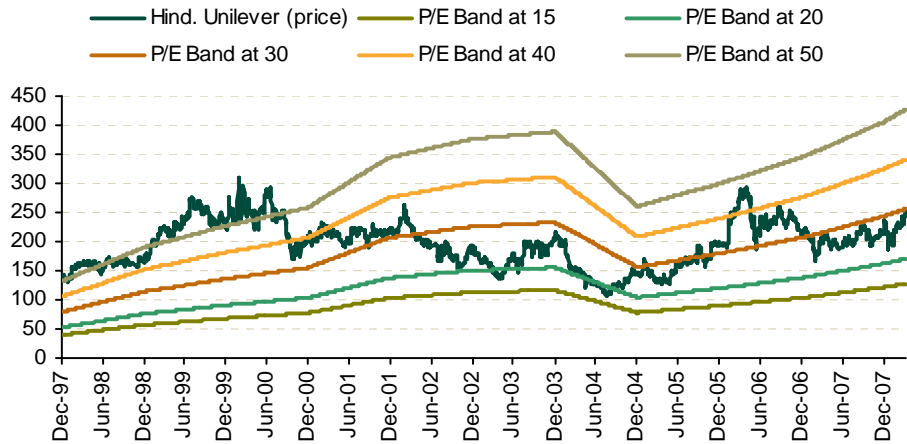
Our March 2009 target price is based on multiple of 29x on our FY09E EPS of INR10.1. We believe that the multiple of 29x FY09 earnings estimates is reasonable, considering the fact that the stock has traded at an average P/E multiple of 31.5x current year earnings in the past three years (please refer to Figure 6). Furthermore, the P/E premium of HUL compared to the Sensex has shrunk to a historical low (refer to Figure 7).

At a multiple of 29x our FY09 earnings estimates, the stock would be trading at a 24% premium as compared to other companies in our coverage universe (refer to Figure 8). We think that this premium is justified given that:

- HUL is among the largest companies in the consumer space in terms of both revenue and market capitalization and is among the most liquid consumer stocks trading in India;
- It has one of the strongest brand portfolios in India. The competitive advantages that the company enjoys in some of the core categories in terms of strong brands, enormous wallet size and a very strong distribution network, are difficult to replicate;
- HUL has one of the highest ROE and ROCE in the Indian consumer space and offers a high dividend yield; and
- Over the next couple of years, the company is likely to witness the fastest operating margin expansion in our coverage universe, according to our estimates.

Our target price of INR293 implies potential upside of 22% from current levels, based on a P/E of 29x FY09 estimated EPS of INR10.1. We initiate coverage on the stock with a 1-Overweight rating.

Figure 6: HUL – historical P/E band



Source: Lehman Brothers research

Figure 7: HUL – premium to Sensex



Source: Lehman Brothers research

Figure 8: Local peer valuation

Company	Lehman rating	Bloomberg code	CMP (INR)	Market cap (INR mn)	Revenue CAGR (%)	Margins expansion (bp)	Earnings CAGR (%)	P/E (x)			ROE (%)
								FY08	FY09E	FY10E	
ITC Limited	3-UW	ITC IN	204	767,448	13.1	210	16.3	23.2	20	17.1	28.8
Asian Paint	1-OW	APNT IN	1,200	115,080	18.4	30	23.1	28.9	22.7	19.1	41.1
Dabur	3-UW	DABUR IN	105	90,615	16.3	-80	13.2	26.9	23.9	21	56.0
Tata Tea	1-OW	TT IN	888	54,520	4.5	-70	20	16.1	12.5	11.2	13.4
Marico	1-OW	MRCO IN	69	42,204	16.7	40	24.7	25.7	20.4	16.5	48.9
Godrej Consumer	1-OWt	GCPL IN	126	28,408	14	90	18.4	19.3	16.4	13.8	124.5
United Spirits	Not Rated	UNSP IN	1,707	170,064	15.7	134	45	44.6	28.5	21.2	44.2
Nestle	Not Rated	NEST IN	1,514	145,988	17.2	59	20.6	34.4	28.4	23.6	102.5
Colgate	Not Rated	CLGT IN	420	57,165	12.9	247	17.8	23.7	20	17.1	57.1
Weighted average					14.3	73.3	19.6	27	21.4	17.8	57.4
HUL	1-OW	HUVR IN	241	525,003	13.6	210	19.6	29.8	25.1	20.8	85.6

Source: Company data, Bloomberg for not rated companies, Lehman Brothers estimates

Figure 9: Global peer comparison

Company	Bloomberg code	Lehman rating	Market cap (USD mn)	Price (local currency)	Earnings CAGR (%)	P/E (x)		
						FY07	FY08E	FY09E
China								
Belle International Holdings Limited	1880 HK	1-OW	9046	8.3	25	33.4	29.8	21.4
China Resources Enterprise	291 HK	1-OW	7626	25.0	-23	11.8	23.3	19.8
Yue Yuen	551 HK	2-EW	5124	24.1	14	13.0	11.5	10.0
Hengan International	1044 HK	3-UW	3623	24.7	17	30.6	25.6	22.5
Li Ning	2331 HK	1-OW	2626	19.7	42	42.8	29.0	21.2
Prime Success	210 HK	1-OW	901	4.3	26	18.1	14.2	11.3
US								
Colgate-Palmolive	CL US	1-OW	42475	78.3	13	23.2	20.3	18.0
Procter & Gamble	PG US	2-EW	235551	70.2	13	23.1	20.2	18.1
Kimberly-Clark Corp	KMB US	1-OW	27843	63.9	9	15.0	13.8	12.7
Avon Products	AVP US	1-OW	17626	40.5	47	33.2	18.0	15.4
Wrigley	WWY US	2-EW	17330	62.5	10	27.9	25.0	22.9
Sara Lee	SLE US	2-EW	10265	14.1	24	19.6	16.6	12.7
Kellogg	K US	1-OW	21195	53.1	9	19.2	17.7	16.2
Heinz	HNZ US	2-EW	15356	47.2	10	19.8	17.8	16.3
Kraft Food	KFT US	2-EW	47957	30.9	7	17.0	15.5	14.9
Coca-Cola Co	KO US	1-OW	143026	60.9	11	22.6	19.9	18.4
Pepsi Co	PEP US	1-OW	117157	71.2	11	21.1	18.7	17.0
Europe								
Henkel (Euro)	HEN3 GR	2-EW	7595	27.7	11	12.9	12.6	10.6
Unilever NV (Euro)	UNA NA	2-EW	38386	21.0	8	16.0	15.0	13.7
Cadbury Schweppes (Pound)	CBRY LN	2-EW	5955	5.6	14	18.6	15.5	14.3
Danone (Euro)	BN FP	2-EW	18946	57.2	15	22.0	19.5	16.8
Nestle R (CHF)	NESN VX	1-OW	207.763	518.5	10	19.2	17.9	15.9
Average					15	21.8	19.0	16.4
Hindustan Unilever Limited	HUVR IN	1-OW	525,003	241	18	29.8	25.1	20.8

Source: Bloomberg, Lehman Brothers estimates

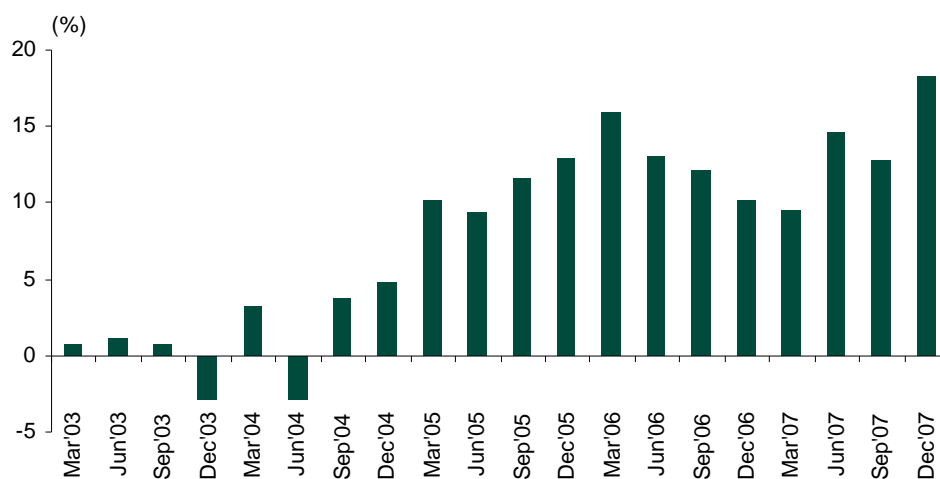
Business overview

Soaps & detergents

The soap and detergent segment continues to be the mainstay of HUL's portfolio, contributing roughly 45% of its annual sales. The company is the leader in both sub-segments with market shares of around 54% in soaps and 40% in detergents and continues to grow in line with the category growth rates.

Growth in these segments has been driven by sustaining its market share in key brands in both segments. In the soap category, brands such as Lux at the higher end and Breeze at the lower end have been able to ward-off any market-share threats from the competition.

Figure 10: Soaps & detergents sales growth YoY

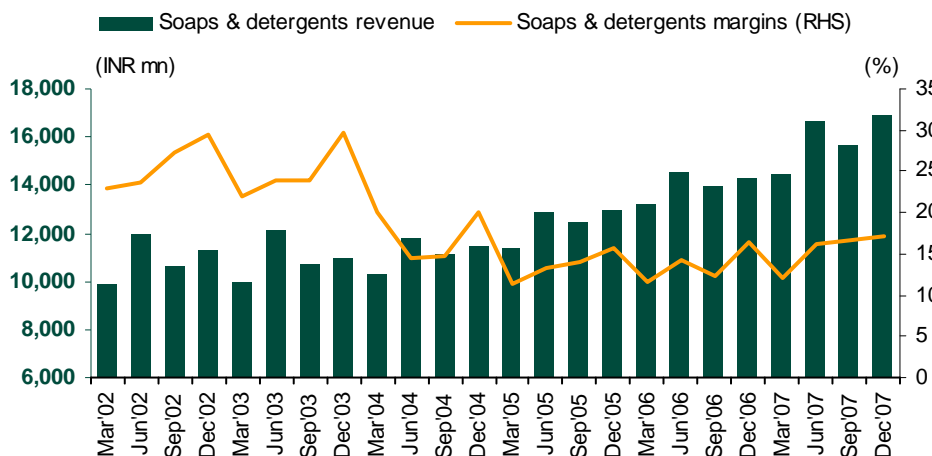


Source: Company data, Lehman Brothers research

Profitability to improve from current levels

The soaps and detergents segment was badly hit both in terms of growth and profitability due to the entry of P&G in CY02. Although we believe that HUL has done a commendable job in retaining its grip on its market shares in these categories and growth has come back to the normal trend line growth, the severe price war inflicted by P&G has had a permanent impact on the profitability in this segment, in our view. Margins in this segment are far lower than they used to be prior to CY02.

Figure 11: Soaps and detergents – improving dynamics



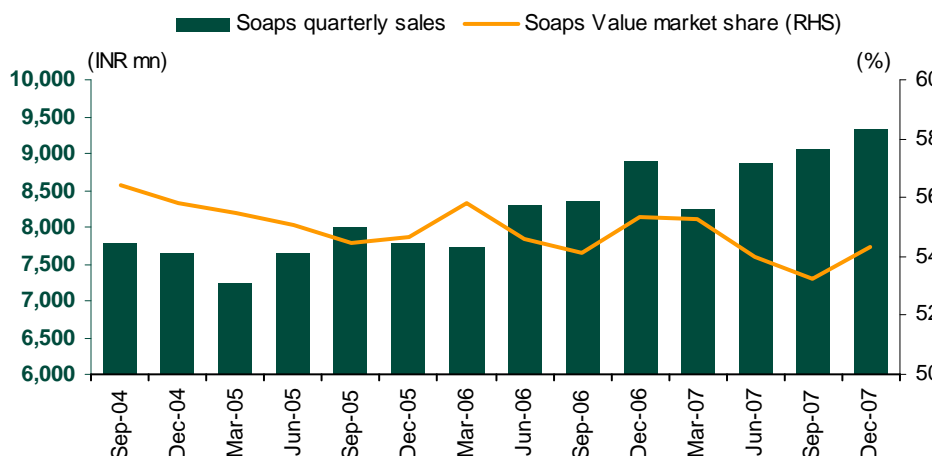
Source: Company data, Lehman Brothers research

Soaps

HUL is the undisputed leader in the toilet soaps category with products at each and every price point. The company boasts as many as seven key soap brands in the country, including Lux, Lifebuoy, Breeze, Liril, Hamam, Pears & Dove. Its market share in the soap segment has been steady at 50%-plus over the past few years.

Though a few of the competitors (earlier Godrej Consumers & now ITC) at various points have threatened to pose a challenge to HUL's position in this category, any severe impact of the same is yet to be seen as the company continues to grow in line with the industry growth rate of around 6-7% p.a.

Figure 12: Soaps – holding on strongly



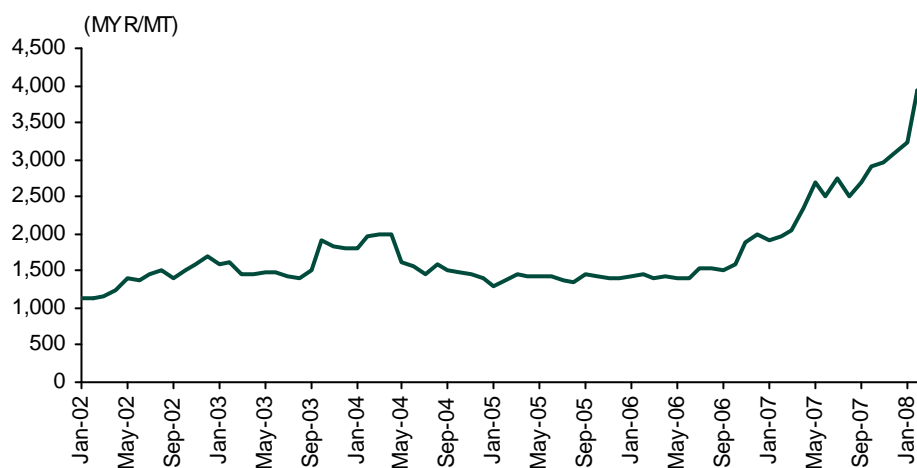
Source: ACNielsen data, Lehman Brothers research

However profitability in this segment has been under pressure lately, due to the enormous rise in various vegetable oil prices which are a key ingredient for this product. The industry has countered this adverse move in raw material prices by a slew of price hikes in the past few months, which have now started impacting volume growth in this segment.

Raw material prices on a strong uptrend ...

Base oils such as palm oil, which are the key ingredients in toilet soaps, have been witnessing significant increases in prices over the past two years. Prices of palm oil (which is one of the most commonly used base oils in toilet soaps) have almost doubled during this period. This has resulted in substantial pressure on input prices for the soap category.

Figure 13: Palm oil – going through the roof



Source: Company data, Lehman Brothers research

... but pricing power is expected to spur margins

However, the improved pricing power and mix changes in this segment have helped the company mitigate this pressure quite efficiently. We believe that margins in this segment should continue their upward trajectory, partly due to judicious price hikes and partly due to some softening in raw material costs due to regulatory actions, such as the reduction in the import duty on palm oil, etc.

Our workings indicate that if average palm oil prices were to rise by 30% in CY08 compared to the average prices in CY07, HUL will be required to take moderate price hikes (in the range of 6-7%) to not just offset this increase but also to increase its margins in the soap segment marginally.

Our confidence comes from the fact that during the past couple of years HUL has consistently passed on any input price increases in its key brands, such as Lux, to the end consumer. I.e., when palm oil prices more than doubled during the past two to three years, the maximum retail price (MRP) of Lux (100 gram bar) was increased from INR12 in 2006 to INR17 now. Our estimates indicate that cost of palm oil should be close to 17% of the net sales of a premium soap (e.g. Lux), which implies that the price hike was much more than the corresponding increase in key raw material costs.

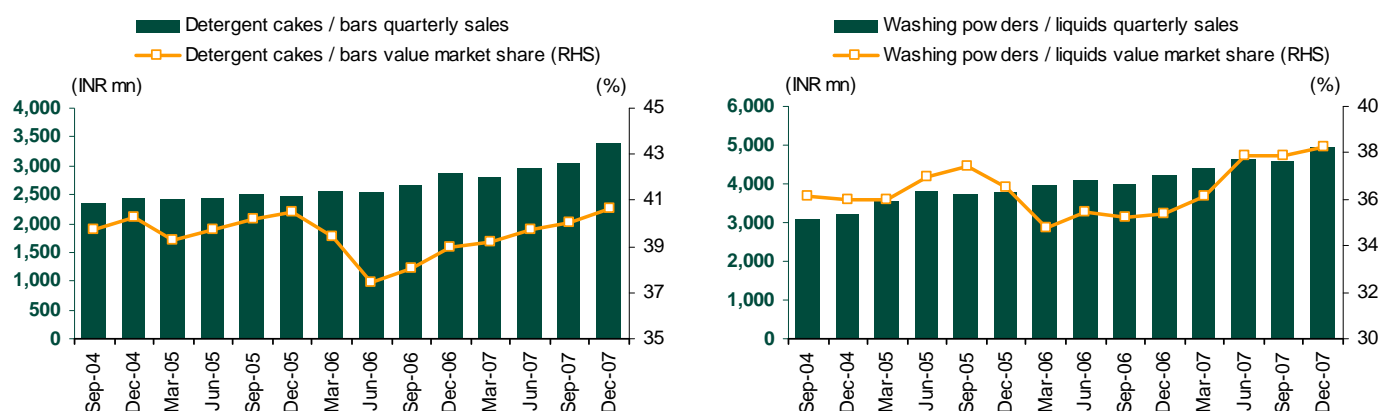
Given the size of the soaps category we believe that any improvement in the profitability of this segment should positively affect overall operating margins for the company.

Detergents

HUL is the leader even in the detergent category, with a share of around 40%. This segment has time and again witnessed aggressive moves both from local and global players; however, they have been unable to replace HUL from its pre-eminent position in this category.

The latest of the attacks in this category came from P&G in 2004, when the global major launched its brands Tide & Ariel in the local markets and subsequently lowered prices substantially. This move has proven to be a destructive one for the segment, as it took away the healthy profitability of the category without compensating enough in terms of volume growth.

Figure 14: Fabric care – steady gains



Source: ACNielsen data, Lehman Brothers research

Growth

Growth in the detergents category, which was hit severely due to the price wars of 2004-05, has recovered to a large extent in the past couple of years. However, most of the growth has come due to price hikes, as volume growth remains modest. Growth has been all-round with both the premium and mass fabric care brands being successful in defending their market shares.

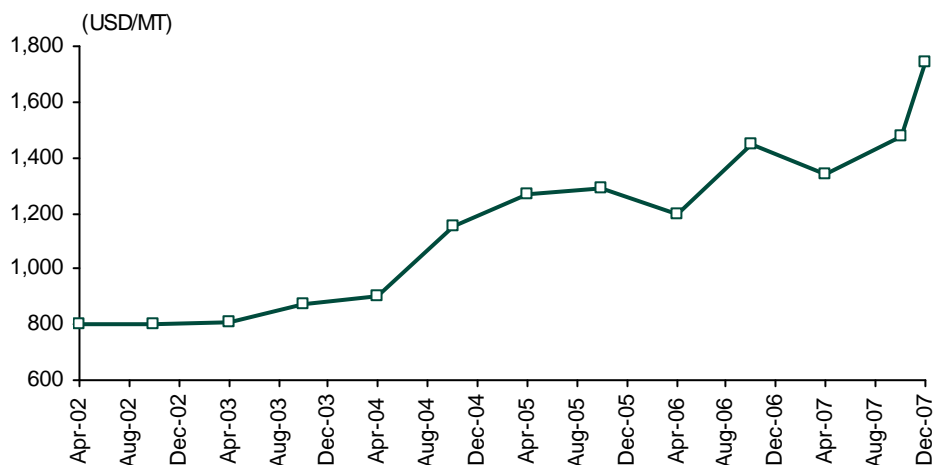
Profitability coming back with ease in competitive pressure

The profitability of the detergent segment was badly hit due to the intense price war initiated by P&G. In March 2004, P&G dropped the prices of its key brands, such as Tide and Ariel, in the range of 28-45% overnight. HUL quickly followed suit with similar price cuts on its flagship brands, Surf Excel & Rin, in order to preserve its market share in the detergent category. Though this move helped HUL retain its grip over the detergent category, it dented the profitability of this segment to a great extent.

However, the competitive scenario which has resulted in an increase in the per unit realizations, seems to be easing now. While the company has left the price-points unchanged, it has reduced the quantity significantly. For example, a pack of Wheel at the price point of INR10 in CY06 which used to have 500 grams, now contains just 350 grams.

In addition, input price pressure has been comparatively muted in this category in the past few years, with the exception of some price increases in LABSA in the past few months.

Figure 15: Linear Alkyl Benzene (LAB) prices – now inching upwards



Source: Company data, Lehman Brothers research

We believe that price action in this category will continue to be positive, which should more than offset any pressure from input prices, thereby resulting in significant margin improvements in this category.

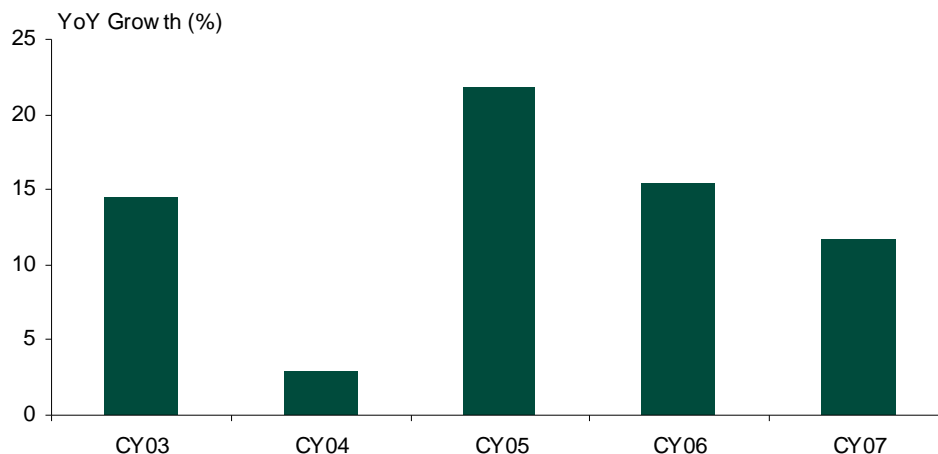
Personal products

The personal product category is the other key segment for HUL. It includes categories such as oral care, skin care, shampoos and cosmetics, etc. and contributed around 28% of the company's revenue in CY07. However, given the high profitability in this segment, its importance increases as it accounts for almost 46% of the company's operating profits.

Growth is steady

Growth in the personal products segment has been relatively steady over the past few years, with the exception of CY03, which witnessed heightened competitive activity both in the shampoo and skin care markets from domestic players and P&G, respectively.

Figure 16: Steady growth in personal products

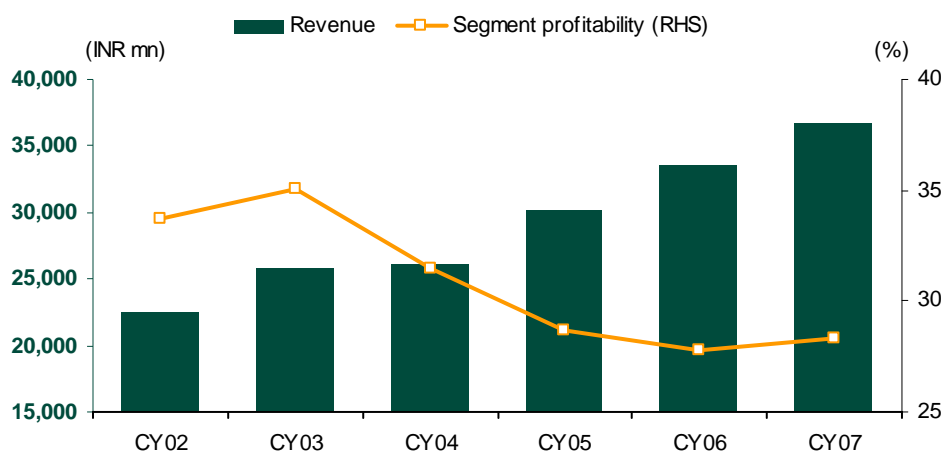


Source: Company data, Lehman Brothers research

High margins

Operating margins in the personal product segment tends to be higher, given the low raw material intensity and high brand premium charged in these segments. The profitability in this segment took a hit in CY04 and CY05, with the aggressive launch by P&G in the shampoo segment and a host of domestic players attacking the skin care segment, thereby resulting in an increase in A&P spending for HUL and negatively impacting margins. The situation has stabilized since then and operating margins for HUL in this segment have been steady at around the 30% mark over the past couple of years. Now that most of the competitive action has settled down, we believe that margins in this segment should continue their upward trend and improve by 100 bp each in the next two years, according to our estimates.

Figure 17: Personal products – revenue & profitability



Source: Company data, Lehman Brothers research

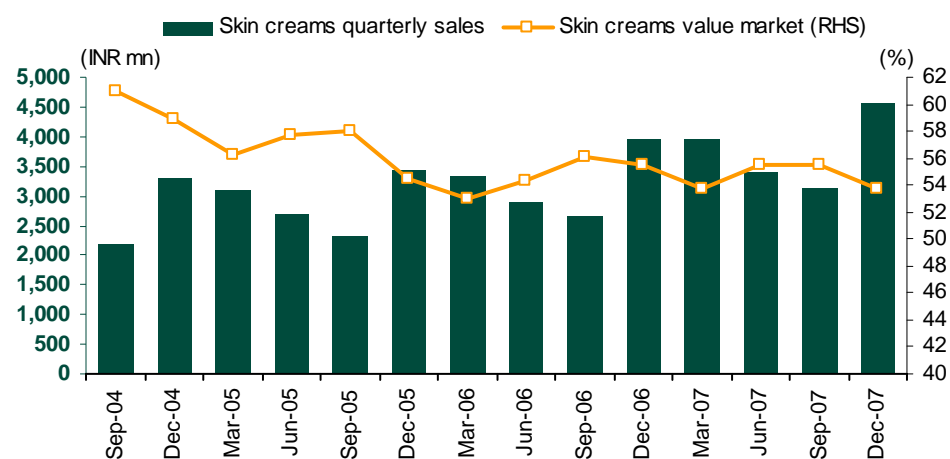
We believe that robust growth in some of the key categories and mix changes should enable the company's margins to expand in this segment in the near future.

Skin

Skin care is another stronghold for HUL with its flagship brand Fair & Lovely continuing its dominance, even in the face of the increased competition from local players such as Emami, Cavin Care & Dabur.

However, none of the attempts from the competition to grab market share in this category have met with success. We believe the high level of brand loyalty in this segment will prove to be a major hindrance for any competitor looking to challenge HUL's dominance in this segment.

Figure 18: Steady growth & steady market shares



Source: ACNielsen data, Lehman Brothers research

Host of new players entering – could put some pressure on market shares ...

Over the past few years there have been a slew of new entrants in the skin care market. Some of the prominent names include P&G with its Olay range of products and the latest being ITC with its Fiama Di Willis range of beauty products.

Although personal product categories have not seen price wars similar to those in other price-sensitive segments, such as soaps & detergents, the challenge here for HUL is to maintain its market share against the onslaught from the competition. The high levels of profitability in this segment give enough cushion for the competition to launch aggressive marketing campaigns, thereby resulting in loss of market share for HUL.

Although HUL has been successful so far in defending its market share in this segment, we believe it is highly possible that the competitive intensity will increase in this segment, which may pose a big challenge to HUL.

Figure 19: New entrants in the skin care market

Competitor	Status of competition	Brands
P&G	Global	Olay range
ITC	National	Fiama Di Willis
Dabur	National	Gulabari
Emami	National	Fairever
Godrej Consumers	National	Fair-one

Source: Lehman Brothers research

...however, the response from HUL has been swift

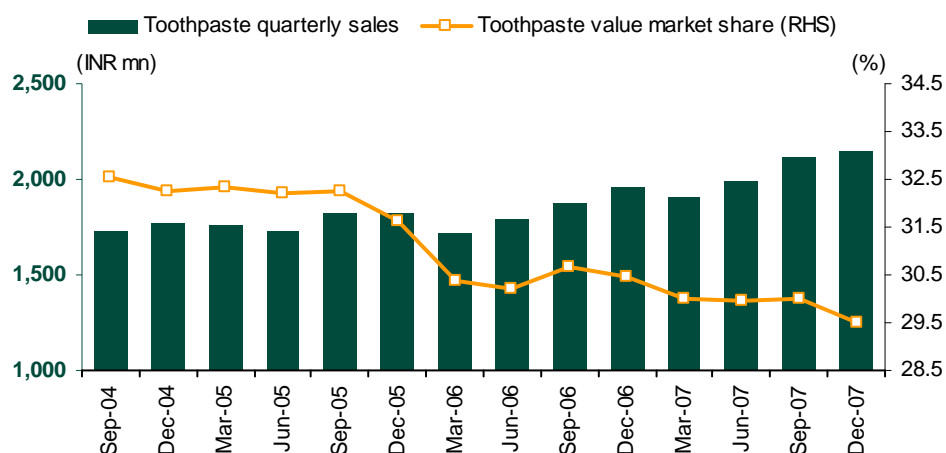
Unlike in the past, this time the response from HUL to competition has been fairly swift. The company launched the Ponds range of skin creams in response to the Olay launch by P&G. While the response to the initial Ponds Age Miracle range has been fairly good, the company has now extended the range to skin-lightening creams.

Oral

Among the various major categories, HUL's performance in the oral care category has been disappointing in the past few years. The company has underperformed the category growth, posting a 7% CAGR during CY05-07 compared to the category growth of 11% during the same period. HUL, which is present in this segment through brands such as Pepsodent and Close Up has been steadily losing market share to competitors.

Colgate Palmolive continues to be the leader in this segment with around a 50% market share; however, most of HUL's market-share losses in this segment have gone to smaller players such as Dabur and other regional players such as Anchor and Ajanta, etc. We believe one of the key reasons for this underperformance is the lack of focus globally by Unilever on this segment which has percolated down to HUL as well defocusing this category.

Figure 20: Oral care – disappointing performance



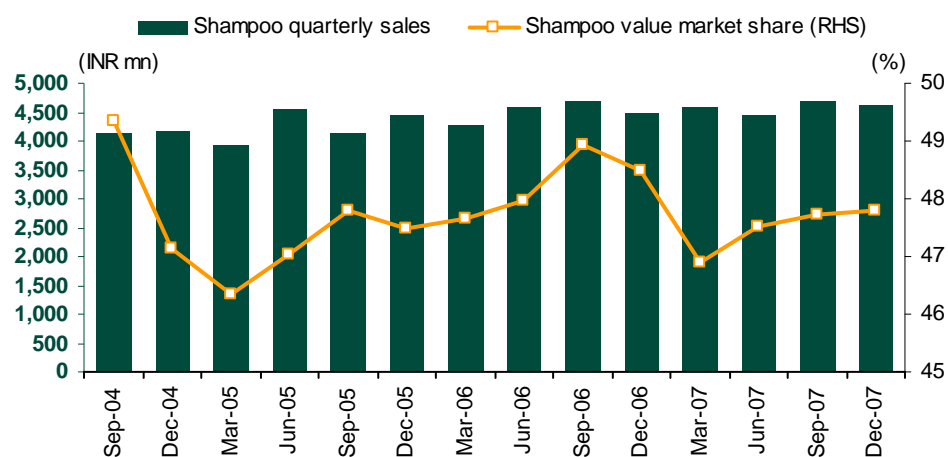
Source: ACNielsen data, Lehman Brothers research

So far, the growth and market share for the company have been a cause of concern and things seem unlikely to change in the medium term, in our view. The company has stated that it is looking at the re-launch of Pepsodent as the brand's performance has been disappointing. We expect that any action from the company's side will boost growth in this segment.

Shampoos

HUL has brands such as Clinic All Clear, Clinic Plus & Sunsilk range in this segment and continues to be the market leader. However, competition in this segment is intensifying with the entry of global players such as P&G and Garnier, etc. and with the latest entry of ITC's Fima Di Willis range of shampoos; although at the moment, HUL continues to reign supreme over this category with a market share of close to 50%.

Figure 21: Shampoos – steady performance



Source: ACNielsen data, Lehman Brothers research

Dove – pre-empting the competition

The company launched the Dove range of hair care products in CY07 from its global portfolio. The higher-end skin and hair care segment has been growing at a rapid pace and Dove has enabled the company to cash in on the growth.

Positioned in the high-end hair care segment, the company has been able to pre-empt competitors such as ITC and has also been able to take advantage of Dove being an extension of its well established soap brand.

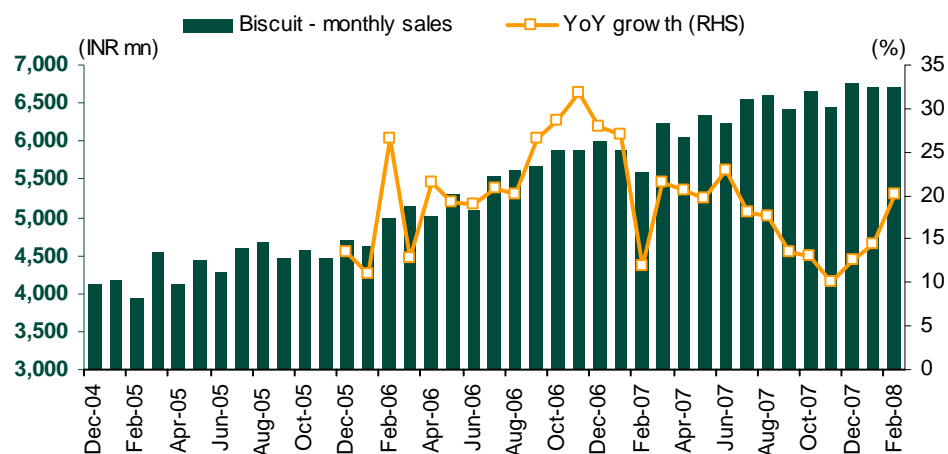
Foods & beverages

Foods – missed the bus

One of the biggest disappointments for HUL in the past few years has been that the company has missed the opportunity in the processed foods business. While other competitors, such as Britannia and Pepsico foods made aggressive moves in the biscuits and salty snacks market, HUL adopted a completely different strategy.

HUL's expansion in the foods segment is driven by the Unilever philosophy of vitality for consumers, which discourages it from entering segments such as biscuits & snacks food which are perceived to be unhealthy for consumers. This philosophy has hindered HUL's entry into these fast-growing categories, thereby restricting growth of its foods segment as compared to its competitors. HUL has now turned its attention to the healthy foods segment with its Knorr range of products.

Figure 22: Biscuits – very strong growth



Source: Company data, Lehman Brothers research

Some moves that went wrong

Entry into staples

In a bid to utilize its vast distribution network and capitalize on the fast growth of the packaged foods market, HUL entered the staple foods market with its Annapurna range of products which included atta (wheat flour) and salt. However, the business turned out to be extremely supply-chain intensive, with very low operating margins. Also, profitability in this segment depended to a large extent on an efficient commodity sourcing model. HUL is now defocusing from this segment.

Exiting the vanaspati business

As part of the philosophy to be present only in segments which are healthy for the end consumers, HUL exited one of its oldest businesses in India of selling vanaspati (Indian name for a fully or partially hydrogenated vegetable cooking oil) through the sale of the Dalda brand to Bunge India (not rated) in CY03. Dalda which was struggling under HUL's control has done well under the aegis of Bunge India Ltd. Though we do not believe in the long-term sustainability of the Dalda brand, we believe HUL could have entered the fast-growing refined edible oil market through this route.

Sangam

With the view of having a play in the fast-growing front end of the Indian consumer goods space, HUL launched its own direct-to-home retailing venture by the name Sangam in CY03. The business model included delivery of more than 5,000 stock keeping units (SKUs) of FMCG products, including those of its competitors, direct to consumers.

The business model was test-launched in the city of Mumbai and was to be rolled out to other parts of the country if found successful. Even though the venture was reasonably successful in Mumbai, the company abruptly walked out of this venture in late CY06, by selling it to the Wadhavan group. HUL cited reasons such as direct confrontation with its traditional channel partners, such as distributors and retailers, as the main reason for this volte-face. We believe such a half-hearted attempt at tapping the fast-growing organized retailing market in India did no good for the company, rather it only soured its existing relationships with its channel partners.

But new initiatives look promising

Focus on Knorr

HUL is focusing on the healthy foods market and is playing it through its Knorr range of products, which at this point of time include largely ready to prepare soups. The company is planning to introduce a host of other products under the Knorr umbrella brand in the coming years. We believe that although this segment is promising and has good growth prospects in the long term, it is very small at this point of time to have any significant impact on HUL's category mix.

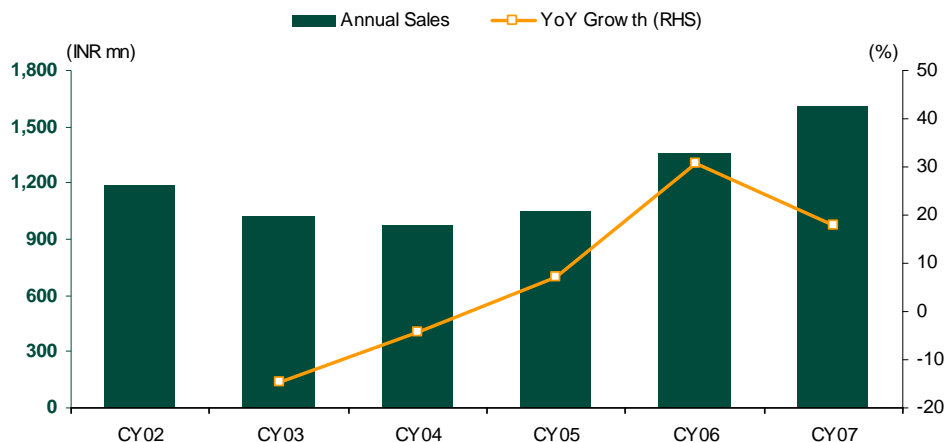
Ice creams doing well

HUL increased its focus on the ice creams segment when it brought the Walls brand from its parent's portfolio to India and also acquired one of the local ice cream manufacturers Kwality in the mid 1990s. However, the company has gone through a rough patch in the ice cream business in the past few years. The business was earlier hit by a host of supply-chain issues, which resulted in sales decline in CY03 & CY04. The issues have been sorted out now and the business is on a steady growth trajectory.

Another key concern for the company is the intense competitive landscape of this segment. Amul which is a milk co-operative association operating in the state of Gujarat is the leader in this segment. One of the key reasons for its leadership is its efficient sourcing of milk which enables it to price its product at a steep discount to HUL. In fact the discount is so significant that HUL had to reposition its products as frozen desserts and not just ice creams to justify the premium that its products were charging. The past few years have also seen the entry of other players such as Mother Dairy, which is pricing its products equally competitively.

Such an intense competitive landscape and a lack of efficient sourcing have resulted in wafer-thin margins in this segment, which have remained at lower than 10% at the operating level.

Figure 23: Ice creams – recovering lost ground



Source: Company data, Lehman Brothers research

Amaze launched

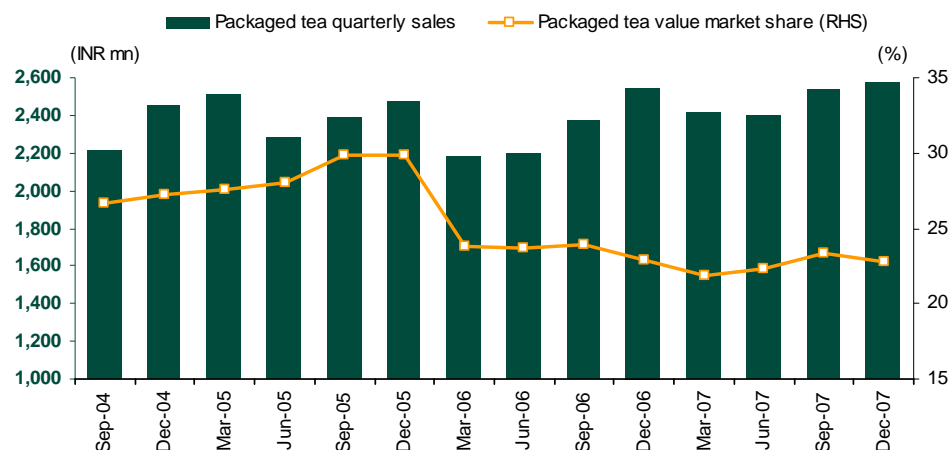
Earlier this year, HUL launched another brand in India from Unilever's food portfolio, Amaze. The company has launched various products on the health platform, such as health snacks food, malt-based health drinks and nutritional biscuits through the Kissan-Amaze brand. We believe that these are the first steps in the company's long-term strategy of focusing aggressively on the healthy foods platform; however, these are early days to take a call on the success of this move.

Tea

Like oral care, tea has been another category in which HUL's performance has been questionable. Once an undisputed leader in this segment; the company has recently lost its volume share leadership to Tata Tea.

Although the company's product portfolio in this segment is strong, with brands such as Brooke Bond, Taj Mahal and Lipton, it has failed to tap the lower end of the tea market as effectively as some of its competitors. The company has also transformed itself from an integrated tea company to a pure tea marketing company, with the hive-off of its plantation business.

Figure 24: Tea – still the value leader



Source: ACNielsen data, Lehman Brothers research

Missing growth at the lower end of the market

One of the key reasons for HUL's loss of market share in volume terms is its lack of focus at the lower end of the tea market (economy segment – tea priced at less than INR130 per kg). HUL has always concentrated on the premium end of the market which has led to some decline in volume market share, as the growth in the lower end has been faster in the past few years due to consumer migration from unbranded to branded tea consumption. On the other hand one of its key competitors, Tata Tea, has focused on this segment in the past few years with launch of brands such as Agni which has enabled it to take away volume market share from HUL.

Restructuring the tea business

HUL which was an integrated tea producer-cum-marketer a few years ago, has now turned to the non-integrated model with the hiving off of its tea estates in the north-eastern states. Though this move takes away the administrative hassles associated with tea plantations, it does expose the company to any increase in the auction tea market.

Tea prices are expected to rise in the near future due to the demand-supply imbalance in the domestic market and supply-side disruptions in the export markets. This might put some pressure on the profitability of this segment, in our view. However, we believe that given the benign pricing regime that tea has gone through in the past decade, the company should not have a problem in passing on any increase in input prices to end consumers.

Water – Pureit sounds good, but too small to have an impact

Late last year, HUL entered the home water purification system business through its product Pureit. The product was initially test-launched in the southern states of India, and has now been rolled out to as many as 66 towns across the country. One of the distinct selling points for the product is that unlike other water purification systems available in the market, Pureit does not require electricity for its operations. Given the poor situation of electricity supply in non-urban Indian cities, we believe Pureit has a potentially large market to tap.

The product has been priced at INR1,800 for the filter system, and it will require the cartridge to be replaced every six months. This cartridge is expected to cost around INR300. While we expect HUL to barely recover its costs on the filter system, it should make decent profits on the sale of cartridges. We believe this is an interesting business model which might result in significant repeat sales through the sale of cartridges, once the installed base of the Pureit system rises.

Figure 25: Water filters – expected to break even in CY09E

(mn units)	CY07E	CY08E	CY09E	CY10E	CY11E	CY12E	CY13E	CY14E	CY15E
Opening base of installed Pureit filters	0.15	0.80	2.00	3.40	5.10	6.38	7.65	8.80	10.12
Additions during the year	0.65	1.20	1.40	1.70	1.28	1.28	1.15	1.32	1.52
Closing base of installed Pureit filters	0.80	2.00	3.40	5.10	6.38	7.65	8.80	10.12	11.63
Growth in additions	433	150	70	50	25	20	15	15	15
% of installed base going for full recharge	60	60	60	60	60	60	60	60	60
No. of recharges sold	0.29	0.84	1.62	2.55	3.44	4.21	4.93	5.67	6.53
Cost per filter (INR)	1,800	1,800	1,890	1,985	2,084	2,188	2,297	2,412	2,533
Increase (%)			5	5	5	5	5	5	5
Cost per recharge (INR)	300	300	315	331	347	365	383	402	422
Increase (%)			5	5	5	5	5	5	5
Sales from filters (INR mn)	1,170	2,160	2,646	3,374	2,657	2,790	2,636	3,183	3,844
Sales from Recharge (INR mn)	86	252	510	843	1,196	1,534	1,889	2,281	2,755
Total	1,256	2,412	3,156	4,217	3,852	4,324	4,525	5,464	6,598

Source: Lehman Brothers estimates

Company profile

Background

Formed in 1933 as Lever Brothers India Pvt. Ltd., HUL is one of the oldest multinational corporations (MNC) operating in India today. The company has evolved from an oil and soaps company to a marketing behemoth. Today the company's products reach every two out of three Indians through its vast and unmatched distribution network. The company has a wide product portfolio spanning categories such as soaps & detergents, personal products and food & beverages. In fact, the company was faced with a problem of plenty in the late 1990s in terms of the number of brands in its portfolio, when it decided to narrow down its focus and concentrate on just 30 brands known as the "Power Brands". The strategy has achieved moderate success over the years.

HUL holds special importance for its parent Unilever, as it acts as a major source of management talent for the parent's global businesses. The trend started by the appointment of Keki Dadiseth as a Director and member of the executive committee of Unilever Plc and Unilever NV in the year 2000, continues today with two Indians from HUL (Manvinder Banga & Harish Manwani) being part of the high profile nine-member executive committee of Unilever NV.

Figure 26: Management profile

Name	Designation
Harish Manwani	Non Executive Chairman
D Sundaram	Vice Chairman
Nitin Paranjpe	CEO & MD
Sanjiv Kakkar	ED, Sales & Customer Development
Deepak Parekh	Independent Director
S Ramodorai	Independent Director
C K Prahlad	Independent Director
V Narayanan	Independent Director
Dhawal Buch	Independent Director

Source: Company data, Lehman Brothers research

Recent changes

Last month, HUL reshuffled its top management team in India whereby Mr Nitin Paranjpe, who was until now heading the HPC division of the company was elevated to the role of CEO & Managing Director of HUL effective April 2008.

Mr Doug Baillie the outgoing CEO & Managing Director of the company has taken over a significant position with the parent Unilever NV in Western Europe.

We believe this a positive move by the company, as even though Mr Baillie was successful in bringing back some growth to the company and making some sweeping changes in the organizational structure over the last two years, the appointment of Mr Paranjpe will bring back local leadership at the helm of HUL, which has been a hallmark for this MNC for many decades.

Figure 27: Strong product portfolio

Category	Brands	Market position	Key competition
Toilet Soaps	Lux, Lifebuoy, Pears, Dove, Breeze, Hamam, Liril	First	Godrej Consumers Wipro Consumers
Detergents	Surf, Rin, Wheel, Vim, OK	First	P&G Nirma
Shampoos	Clinic range, Sunsilk, Dove range	First	P&G Dabur Cavin Care
Oral care	Pepsodent, Close Up	Second	Colgate Palmolive Dabur
Skin care	Fair & Lovely, Ponds range	First	L'oreal P&G Emami
Tea	Brooke Bond, Taj Mahal, Lipton, 3Roses	First	Tata Tea Goodricke
Ice creams	Walls	NA	Amul Mother Dairy
Soups	Knorr	NA	Nestle
Cosmetics	Lakme, Elle18	NA	L'oreal P&G

Source: Company data, Lehman Brothers research

Key financials

Figure 28: Income statement

Year-end 31 Dec (INR mn)	CY06	CY07	CY08E	CY09E	CY10E
Net sales	124,110	139,134	158,944	179,528	199,522
Growth (%)	7.3	12.1	14.2	13.0	11.1
Operating expenses	-107,989	-120,092	-135,292	-151,054	-168,158
Operating profit	16,121	19,042	23,652	28,474	31,364
Other income	3,929	4,531	3,722	4,419	5,614
EBITDA	20,050	23,574	27,374	32,893	36,978
Depreciation	-1,357	-1,419	-1,438	-1,548	-1,662
EBIT	18,693	22,155	25,936	31,345	35,316
Interest paid	-140	-265	-101	-95	-85
Non-recurring items (net of taxes)	3,705	1,512	0	0	0
Pre-tax profit	22,258	23,402	25,835	31,250	35,231
Tax (current + deferred)	-3,322	4,213	-4,986	-6,125	-7,046
Profit after tax	18,936	19,189	20,849	25,125	28,185
Minority interests	-36	-40	-44	-48	-53
Net profit	18,900	19,149	20,805	25,077	28,132
Adjusted net profit	15,195	17,637	20,805	25,077	28,132
Growth (%)	14.8	17.6	18.0	20.5	12.2

Source: Company data, Lehman Brothers estimates

Figure 29: Balance sheet

Year-end 31 Dec (INR mn)	CY06	CY07	CY08E	CY09E	CY10E
Current assets	31,897	34,196	44,246	54,608	63,994
Investments	23,523	14,292	14,292	14,292	14,292
Net fixed assets	15,852	17,477	17,162	17,642	18,189
Other non-current assets	3,914	4,095	4,095	4,095	4,095
Total assets	75,186	70,060	79,794	90,637	100,569
Current liabilities	46,338	51,950	59,626	68,058	76,683
Total debt	925	1,021	1,000	900	800
Other liabilities	1,641	1,951	1,951	1,951	1,951
Total liabilities	48,904	54,923	62,577	70,910	79,434
Share capital	2,207	2,177	2,177	2,177	2,177
Reserves & surplus	24,028	12,904	14,984	17,495	18,903
Shareholders' funds	26,235	15,082	17,162	19,672	21,080
Minorities	47	55	55	55	55
Total equity & liabilities	75,186	70,060	79,794	90,637	100,569

Source: Company data, Lehman Brothers estimates

Figure 30: Cash flow statement

Year-end 31 Dec (INR mn)	CY06	CY07	CY08E	CY09E	CY10E
Pre-tax profit	22,258	23,402	25,831	31,283	35,267
Depreciation	1,357	1,419	1,438	1,548	1,662
Tax paid	-3,094	-3,817	-4,985	-6,131	-7,053
Chg in working capital	1,255	1,329	3,740	3,518	4,299
Cash flow from operations (a)	21,777	22,333	26,024	30,218	34,175
Capital expenditure	-13	-1,025	-1,122	-2,029	-2,209
Chg in investments	-5,307	9,231	0	0	0
Cash flow from investing (b)	-5,320	8,207	-1,122	-2,029	-2,209
Free cash flow (a+b)	16,457	30,540	24,902	28,189	31,966
Equity raised/(repaid)	6	-29	0	0	0
Chg in minorities	-29	-32	-44	-48	-53
Debt raised/(repaid)	-262	97	-21	-100	-100
Dividend (incl. tax)	-13,241	-19,597	-18,722	-22,593	-26,753
Cash flow from financing (c)	-13,526	-19,562	-18,787	-22,741	-26,906
Net chg in cash (a+b+c)	2,931	10,978	6,115	5,448	5,060

Source: Company data, Lehman Brothers estimates

Figure 31: Key ratios

Year-end 31 Dec (INR mn)	CY06	CY07	CY08E	CY09E	CY10E
Adjusted EPS (INR)	6.9	8.1	9.6	11.5	12.9
Adjusted EPS growth (%)	14.8	17.6	17.9	20.7	12.2
EBITDA growth (%)	14.6	17.6	16.1	20.3	12.4
Operating margins (%)	14.6	15.0	16.1	17.1	17.1
Pre-tax margins (%)	17.9	16.8	16.3	17.4	17.7
ROE (%)	63.3	85.2	128.6	135.9	137.8
ROCE (%)	70.5	94.4	135.5	146.8	152.2
Net debt/Equity (%)	-14.0	-10.6	-45.0	-67.4	-87.3

Source: Company data, Lehman Brothers estimates

Figure 32: Valuations

Year-end 31 Dec (INR mn)	CY05	CY06	CY07	CY08E	CY09E	CY10E
PER (x)	40.2	35.0	29.8	25.2	20.9	18.6
PCE (x)	36.4	32.1	27.5	23.6	19.7	17.6
Price/book (x)	24.4	20.2	34.7	30.5	26.6	24.8
Yield (%)	2.1	2.6	3.8	3.7	4.4	5.2
EV/net sales (x)	4.6	4.3	3.8	3.3	2.8	2.5
EV/EBITDA (x)	33.2	29.1	25.1	20.2	16.7	14.9

Source: Company data, Lehman Brothers estimates

Appendix I: HUL vs Unilever

We have tried to analyze the current portfolio of Unilever with that of HUL, so as to determine what would be the company's strategy in future in terms of portfolio expansion. The table below summarizes the portfolio comparison.

Figure 33: Unilever vs HUL portfolio

Brand	Product type	Presence – India
Personal care		
AXE	Deodorants and shower gels	Yes
Lifebuoy	Hygiene and health products	Yes
Ponds	Skin care	Yes
Signal/Pepsodent	Toothpaste	Yes
Close Up	Toothpaste	Yes
Vaseline	Skin care	Yes
Dove	Soap, hair care and body wash	Yes
Lux	Soap and hair care	Yes
Rexona	Deodorants	Yes
Sunsilk	Shampoos	Yes
Home care		
Cif/Vim	Cleaner	Yes
Domestos/Domex	Toilet bleach	Yes
Radiant/Rin	Detergent	Yes
Surf	Detergent	Yes
Omo	Detergent	No
Sunlight	Dish washing	Yes
Comfort	Fabric softener	No
Foods		
Knorr	Nutrition food	Yes
Becel/Flora	Nutrition food	No
Rama	Nutrition food	No
Hellman/Wish bone/Calve	Nutrition food	No
Heartbrand	Ice creams	Yes
Amaze	Nutritional foods	Yes

Source: Company data, Lehman Brothers research

The table above clearly signifies that global and local portfolios are largely aligned in the HPC segments and there is very little scope of bringing any new global brands into the country.

In the foods category, there are a host of global brands which are not present in India. The company has recently launched the Amaze brand from the global portfolio in India and it might launch a few more foods brand in the near future. However, we believe that the growth strategy of the company in this vertical would be India-centric and for quantum growth in the foods segment, the company will have to develop some strong local brands.

Appendix II: Recent successful innovations

Ponds Age Miracle

Over the past couple of years, the company has been successful in transforming Ponds from a mid-range of skin creams to a high-end skin care range of products. The company recently introduced Ponds Age Miracle cream, which has been developed specially for the Indian skin tone in the technology centre in India. The anti-aging cream has been fairly successful in the country largely on account of the company's effort to invest heavily in consumer education and front end.

When initially launched, HUL ran a seven-day challenge for the product wherein consumer could use it for seven days and if unsatisfied, could return it and claim the full money back. On the front end the company has more recently started the skin analyzer tests on machines developed by the company especially for the purpose. These help the consumers to identify the key characteristics of their skin and hence choose the treatment accordingly.

Now the company has embarked on an effort to expand the Ponds range into the skin lightening area with the launch of Pond's flawless white range of creams which helps lighten the skin tone and reduce the blemishes and dark spots.

The key thing to note is that the Ponds Age Miracle range was launched in response to P&G's Olay launch. Unlike in the past, this time the response to competition was swift and hence has been reasonably successful in countering it.

Dove hair care range

In CY07, HUL introduced its high-end Dove hair care range (shampoos and conditioners) from the global portfolio. Despite stiff competition from the recently introduced Fiama Di Wills shampoos, Dove has done well in terms of creating a niche for itself.

The biggest credit for the success of the shampoo must go to the distinct advertising campaign that the company backed the brand with. Instead of signing a celebrity to endorse the brand, which is the usual norm, the company went ahead and used actual users for the campaign. This has had a very favourable impact on the brand sales.

Positioned in the higher end, priced at INR99 for a 100ml bottle, the brand has good prospects, in our view. The higher-end skin care and hair care market in India is growing at a rapid pace and also the usage of hair conditioners is relatively low as compared to the global average.

Dove has been an introduction in the hair care segment by the company after a long time. The growth so far has been driven largely by the lower and medium priced brand. This is not only a departure from the company's usual strategy but with Dove, the company has successfully preempted the competition.

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INR 241.05 (16-Apr-2008)

1-Overweight / 1-Positive

Rating and Price Target Chart:

CHART IS NOT APPLICABLE

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Valuation Methodology: We have used a P/E multiple based valuation methodology. We have valued HUL at 29x current year's earnings, which is at a 24% premium to the average multiple of our coverage universe. We believe that the premium is justified due to: a) strong brand portfolio of the company,

b) the large size and enhanced liquidity in the stock, c) the historically high multiples that the company has traded in the past and d) the strong ROE and high dividend yield that the stock offers.

Risks Which May Impede the Achievement of the Price Target: Some of the key risks to our call include: 1) a greater-than-expected increase in prices of key raw materials, such as palm oil,

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Avon Products	AVP	US\$ 40.53	1-Overweight / 1-Positive
Belle International Holdings Limited	1880.HK	HKD 8.34	1-Overweight / 1-Positive
Cadbury Schweppes	CBRY.L	556.5p	2-Equal weight / 3-Negative
China Resources Enterprise	0291.HK	HKD 24.75	1-Overweight / 1-Positive
Coca-Cola Co	KO	US\$ 60.94	1-Overweight / 1-Positive
Colgate-Palmolive	CL	US\$ 78.31	1-Overweight / 1-Positive
Dabur India	DABU.NS	INR 106.65	3-Underweight / 1-Positive
Danone	DANO.PA	EUR 57.20	2-Equal weight / 3-Negative
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