

Competition and profitability are risks [EXTRACT]

■ Changing focus to a highly competitive category

Hindustan Unilever (HUL) is changing focus from its largest category, soaps and detergents (about 40% of revenue) to personal products. The change in focus is a result of HUL's high penetration in the soaps category and the increased profitability of the personal products segment. However, the personal products category is witnessing increased competition as other companies, including ITC, are also increasing their focus on the segment. HUL's cuts in advertising and promotion spending to maintain profitability could have an impact on volume growth, in our view.

■ ROE declines due to margin compression

ROE has declined from 123% in FY08 to 81.8% in FY11, as net profit margin has fallen. Net profit margin declined from 12.9% in FY08 to 11.1% in FY11. We believe margins will remain under pressure.

■ Negative catalysts to play out in ensuing quarters

We maintain our Sell rating as we think: 1) competitive intensity will remain high; 2) reduced advertising spend could result in single digit volume growth in the coming quarters; and 3) high volume growth expectations that might not materialise are built into the share price.

■ Valuation: maintain Sell rating , price target of Rs275.00

We maintain our Sell rating and price target of Rs275.00. We derive our price target from a DCF-based methodology and explicitly forecast long-term valuation drivers using UBS's VCAM tool. We assume a WACC of 10.8%.

Highlights (Rsm)	03/10	03/11	03/12E	03/13E	03/14E
Revenues	175,238	194,011	215,088	240,775	267,745
EBIT (UBS)	23,644	21,444	23,150	29,289	35,788
Net Income (UBS)	22,020	21,533	23,318	27,701	33,075
EPS (UBS, Rs)	10.09	9.88	10.70	12.70	15.17
Net DPS (UBS, Rs)	6.50	7.53	7.49	8.53	9.60

Profitability & Valuation	5-yr hist av.	03/11	03/12E	03/13E	03/14E
EBIT margin %	12.4	11.1	10.8	12.2	13.4
ROIC (EBIT) %	<-500	<-500	>500	482.0	365.3
EV/EBITDA (core) x	22.7	24.0	27.6	22.2	18.2
PE (UBS) x	26.6	27.7	31.3	26.3	22.0
Net dividend yield %	3.3	2.8	2.2	2.6	2.9

Source: Company accounts, Thomson Reuters, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Valuations: based on an average share price that year, (E): based on a share price of Rs334.45 on 03 Oct 2011 23:55 SGT

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Global Equity Research

India

Household Products, Non-Durable

12-month rating **Sell**
Unchanged

12m price target **Rs275.00/US\$5.59**
Unchanged

Price **Rs334.45/US\$6.79**

RIC: HLL.BO BBG: HUVR IB

4 October 2011

Trading data (local/US\$)

52-wk range	Rs352.60-265.90/US\$7.67-5.88
Market cap.	Rs730bn/US\$14.8bn
Shares o/s	2,182m (ORD)
Free float	49%
Avg. daily volume ('000)	2,745
Avg. daily value (m)	Rs901.3

Balance sheet data 03/12E

Shareholders' equity	Rs33.3bn
P/BV (UBS)	21.9x
Net Cash (debt)	Rs26.4bn

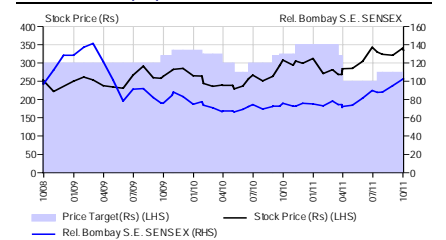
Forecast returns

Forecast price appreciation	-17.8%
Forecast dividend yield	2.2%
Forecast stock return	-15.6%
Market return assumption	13.3%
Forecast excess return	-28.9%

EPS (UBS, Rs)

	03/12E	03/11	Actual
	UBS	Cons.	
Q1E	2.85	2.79	2.36
Q2E	2.81	2.81	2.41
Q3E	2.84	2.84	2.63
Q4E	2.20	2.20	2.48
03/12E	10.70	10.70	
03/13E	12.70	12.71	

Performance (Rs)



Source: UBS

www.ubs.com/investmentresearch

This report has been prepared by UBS Securities India Private Ltd
ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 5.

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This is an extract from our India Consumer Sector report, published on 4 October 2011. For more detail, please refer to the full report.

Table 1: HUL's ROE decomposition

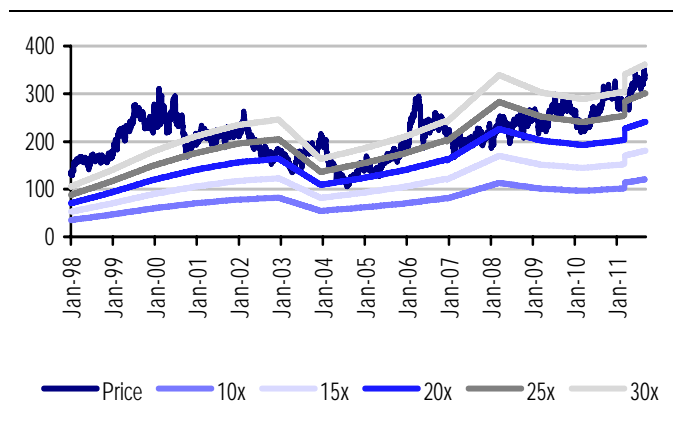
	2000	2001	2002	2003	2004	2005	2006	2007	2008	FY09	FY10	FY11	FY12E	FY13E
Net income margin	10.1%	12.4%	14.0%	17.3%	17.8%	12.1%	12.2%	12.7%	12.9%	12.3%	12.6%	11.1%	10.8%	11.5%
Asset turnover	197.7%	184.9%	148.5%	129.1%	139.3%	153.2%	170.7%	165.4%	206.6%	244.8%	188.1%	193.4%	202.2%	201.8%
Equity multiplier	242.7%	230.5%	217.8%	201.9%	360.7%	347.8%	281.1%	268.7%	461.3%	401.0%	360.6%	380.9%	319.1%	282.4%
Return on equity	48.4%	52.7%	45.4%	45.0%	89.4%	64.4%	58.7%	56.5%	122.9%	121.1%	85.2%	81.8%	70.0%	65.6%

Note: Prior to FY09, values are for December year end.

Source: Company data, UBS estimates

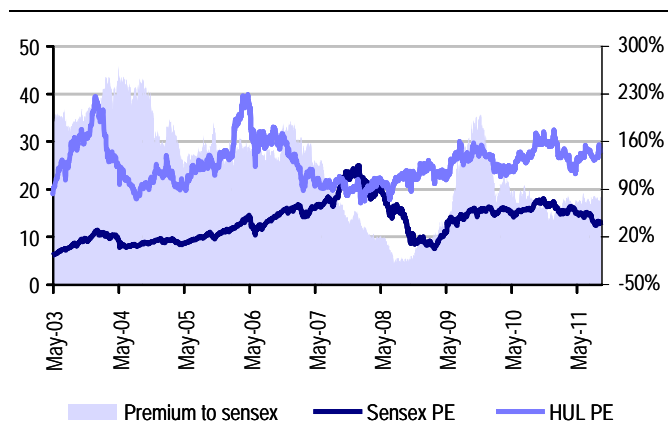
HUL's ROE increased to 123% in FY08 mainly due to improvement in the equity multiplier as shareholders' equity declined due to a Rs6.26bn buy back of approximately 30m shares, financed by reserves.

Chart 1: HUL 1-year forward PE band



Source: Reuters, UBS estimates

Chart 2: HUL prem/(disc) to Sensex



Source: Reuters, UBS estimates

Hindustan Unilever

Income statement (Rsm)	12/06	12/07	03/09	03/10	03/11	03/12E	% ch	03/13E	% ch	03/14E	% ch
Revenues	121,034	137,178	202,393	175,238	194,011	215,088	10.9	240,775	11.9	267,745	11.2
Operating expenses (ex depn)	(104,553)	(118,321)	(175,614)	(149,754)	(170,359)	(189,708)	11.4	(209,234)	10.3	(229,592)	9.7
EBITDA (UBS)	16,480	18,857	26,780	25,484	23,652	25,380	7.3	31,542	24.3	38,154	21.0
Depreciation	(1,302)	(1,384)	(1,953)	(1,840)	(2,208)	(2,230)	1.0	(2,253)	1.0	(2,365)	5.0
Operating income (EBIT, UBS)	15,179	17,473	24,827	23,644	21,444	23,150	8.0	29,289	26.5	35,788	22.2
Other income & associates	2,736	4,627	4,648	3,861	5,860	6,003	2.4	5,562	-7.3	5,840	5.0
Net interest	702	(255)	734	559	(2)	(5)	108.3	663	-	775	17.0
Abnormal items (pre-tax)	0	0	0	0	1,527	0	-	0	-	0	-
Profit before tax	18,617	21,845	30,209	28,064	28,829	29,148	1.1	35,513	21.8	42,404	19.4
Tax	(3,220)	(4,155)	(5,244)	(6,044)	(5,769)	(5,830)	1.0	(7,813)	34.0	(9,329)	19.4
Profit after tax	15,397	17,690	24,965	22,020	23,060	23,318	1.1	27,701	18.8	33,075	19.4
Abnormal items (post-tax)	0	1,565	0	0	0	0	-	0	-	0	-
Minorities / pref dividends	0	0	0	0	0	0	-	0	-	0	-
Net income (local GAAP)	15,397	19,255	24,965	22,020	23,060	23,318	1.1	27,701	18.8	33,075	19.4
Net Income (UBS)	15,397	17,690	24,965	22,020	21,533	23,318	8.3	27,701	18.8	33,075	19.4
Tax rate (%)	17	19	17	22	20	20	-0.1	22	10.0	22	0.0
Pre-abnormal tax rate (%)	20	24	21	25	27	25	-6.4	26	3.6	26	-2.2
Per share (Rs)	12/06	12/07	03/09	03/10	03/11	03/12E	% ch	03/13E	% ch	03/14E	% ch
EPS (local GAAP)	6.99	8.73	11.31	10.09	10.58	10.70	1.1	12.70	18.8	15.17	19.4
EPS (UBS)	6.99	8.02	11.31	10.09	9.88	10.70	8.3	12.70	18.8	15.17	19.4
Net DPS	5.50	9.00	10.50	6.50	7.53	7.49	-0.5	8.53	13.9	9.60	12.5
Cash EPS	7.59	8.64	12.20	10.94	10.89	11.72	7.6	13.74	17.2	16.25	18.3
BVPS	12.37	6.52	9.47	11.86	12.07	15.28	26.5	19.36	26.8	24.84	28.3
Balance sheet (Rsm)	12/06	12/07	03/09	03/10	03/11	03/12E	% ch	03/13E	% ch	03/14E	% ch
Net tangible fixed assets	15,110	17,081	20,789	24,361	24,682	27,961	13.3	31,709	13.4	35,643	12.4
Net intangible fixed assets	0	0	0	0	0	0	-	0	-	0	-
Net working capital (incl. other assets)	(16,305)	(17,457)	(15,812)	(28,797)	(26,033)	(23,609)	-9.3	(23,906)	1.3	(23,849)	-0.2
Other liabilities	0	0	0	0	0	0	-	0	-	0	-
Operating invested capital	(1,195)	(375)	4,977	(4,436)	(1,351)	4,352	-	7,802	79.3	11,794	51.2
Investments	5,396	2,385	2,521	2,322	2,571	2,571	0.0	2,571	0.0	2,571	0.0
Total capital employed	4,201	2,009	7,497	(2,114)	1,220	6,923	467.2	10,373	49.8	14,365	38.5
Shareholders' equity	27,235	14,392	20,615	25,835	26,339	33,326	26.5	42,246	26.8	54,192	28.3
Minority interests	0	0	0	0	0	0	-	0	-	0	-
Total equity	27,235	14,392	20,615	25,835	26,339	33,326	26.5	42,246	26.8	54,192	28.3
Net debt / (cash)	(23,034)	(12,383)	(13,118)	(27,949)	(25,119)	(26,403)	5.1	(31,873)	20.7	(39,827)	25.0
Other debt-deemed items	0	0	0	0	0	0	-	0	-	0	-
Total capital employed	4,201	2,009	7,497	(2,114)	1,220	6,923	467.2	10,373	49.8	14,365	38.5
Cash flow (Rsm)	12/06	12/07	03/09	03/10	03/11	03/12E	% ch	03/13E	% ch	03/14E	% ch
Operating income (EBIT, UBS)	15,179	17,473	24,827	23,644	21,444	23,150	8.0	29,289	26.5	35,788	22.2
Depreciation	1,302	1,384	1,953	1,840	2,208	2,230	1.0	2,253	1.0	2,365	5.0
Net change in working capital	(525)	2,737	(2,929)	12,975	(2,631)	(2,074)	-21.2	1,406	-	540	-61.6
Other (operating)	0	0	0	0	0	0	-	0	-	0	-
Operating cash flow (pre tax/interest)	15,955	21,594	23,850	38,459	21,021	23,306	10.9	32,947	41.4	38,694	17.4
Net interest received / (paid)	(107)	(255)	(253)	(70)	(2)	(5)	108.3	(25)	400.0	(50)	100.0
Dividends paid	(12,129)	(23,412)	(19,436)	(16,560)	(17,503)	(16,331)	-6.70	(18,859)	15.48	(21,129)	12.04
Tax paid	(3,220)	(4,032)	(5,244)	(6,044)	(5,184)	(5,830)	12.5	(8,398)	44.1	(9,329)	11.1
Capital expenditure	(1,576)	(3,355)	(5,660)	(5,412)	(2,530)	(5,509)	117.8	(6,000)	8.9	(6,300)	5.0
Net (acquisitions) / disposals	0	0	0	0	0	0	-	0	-	0	-
Other	2,201	888	(561)	259	143	0	-	0	-	0	-
Share issues	2,037	(6,957)	0	0	0	0	-	0	-	0	-
Cash flow (inc)/dec in net debt	3,160	(15,531)	(7,304)	10,632	(4,057)	(4,369)	7.7	(334)	-92.3	1,887	-
FX / non cash items	3,328	4,879	8,039	4,199	1,226	5,654	361.0	5,804	2.7	6,068	4.6
Balance sheet (inc)/dec in net debt	6,489	(10,651)	735	14,831	(2,830)	1,285	-	5,469	325.7	7,955	45.4
Core EBITDA	16,480	18,857	26,780	25,484	23,652	25,380	7.3	31,542	24.3	38,154	21.0
Maintenance capital expenditure	(1,302)	(1,384)	(1,953)	(1,840)	(2,208)	(2,230)	1.0	(2,253)	1.0	(2,365)	5.0
Maintenance net working capital	0	0	0	0	0	0	-	0	-	0	-
Operating free cash flow, pre-tax	15,179	17,473	24,827	23,644	21,444	23,150	8.0	29,289	26.5	35,788	22.2

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items. Note: For some companies, the data represents an extract of the full company accounts.

12-month rating

Sell

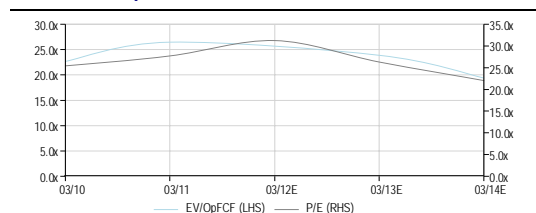
12m price target

Rs275.00

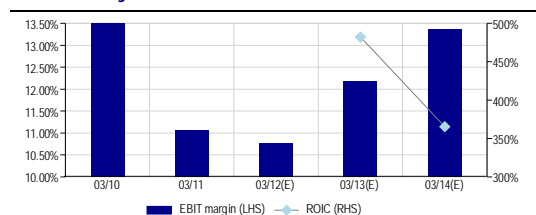
Company profile

Hindustan Lever is the leading household goods and food products company in the country. It has a dominant share in each of its key businesses: personal care, laundry, tea and branded staple foods. An unmatched distribution reach covering directly over a million retailers and a wide product portfolio with price-competitive products underpin its market leadership. Management is focusing on rationalising its brand portfolio to drive a sales growth rebound and has identified 30 core brands to which it will commit maximum resources for growth.

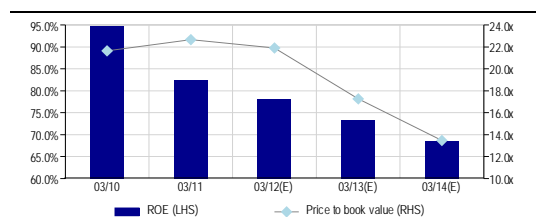
Value (EV/OpFCF & P/E)



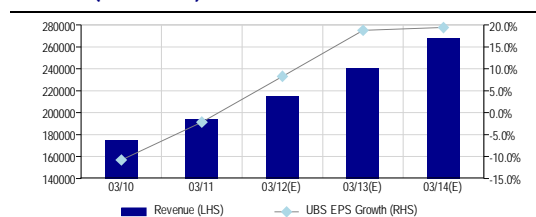
Profitability



ROE v Price to book value



Growth (UBS EPS)



Valuation (x)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
P/E (local GAAP)	25.8	25.4	25.9	31.3	26.3	22.0
P/E (UBS)	26.6	25.4	27.7	31.3	26.3	22.0
P/CEPS	24.5	23.5	25.1	28.5	24.3	20.6
Net dividend yield (%)	3.3	2.5	2.8	2.2	2.6	2.9
P/BV	23.9	21.6	22.7	21.9	17.3	13.5
EV/revenue (core)	3.0	3.1	2.9	3.3	2.9	2.6
EV/EBITDA (core)	22.7	21.0	24.0	27.6	22.2	18.2
EV/EBIT (core)	24.6	22.7	26.5	NM	23.9	19.4
EV/OpFCF (core)	24.6	22.7	26.5	NM	23.9	19.4
EV/op. invested capital	NM	NM	NM	NM	NM	NM

Enterprise value (Rsm)	03/10	03/11	03/12E	03/13E	03/14E
Average market cap	559,052	596,757	729,665	729,665	729,665
+ minority interests	0	0	0	0	0
+ average net debt (cash)	(20,533)	(26,534)	(25,761)	(29,138)	(35,850)
+ pension obligations and other	0	0	0	0	0
- non-core asset value	(2,322)	(2,571)	(2,571)	(8)	(8)
Core enterprise value	536,196	567,652	701,333	700,519	693,807

Growth (%)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
Revenue	12.5	-13.4	10.7	10.9	11.9	11.2
EBITDA (UBS)	9.5	-4.8	-7.2	7.3	24.3	21.0
EBIT (UBS)	9.0	-4.8	-9.3	8.0	26.5	22.2
EPS (UBS)	9.0	-10.8	-2.2	8.3	18.8	19.4
Cash EPS	9.5	-10.3	-0.4	7.6	17.2	18.3
Net DPS	8.2	-38.1	15.9	-0.5	13.9	12.5
BVPS	-0.6	25.3	1.8	26.5	26.8	28.3

Margins (%)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
EBITDA / revenue	13.5	14.5	12.2	11.8	13.1	14.3
EBIT / revenue	12.4	13.5	11.1	10.8	12.2	13.4
Net profit (UBS) / revenue	12.3	12.6	11.1	10.8	11.5	12.4

Return on capital (%)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
EBIT ROIC (UBS)	NM	NM	NM	NM	NM	NM
ROIC post tax	-	NM	NM	NM	NM	NM
Net ROE	87.5	94.8	82.5	78.2	73.3	68.6

Coverage ratios (x)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
EBIT / net interest	-	-	NM	NM	-	-
Dividend cover (UBS EPS)	1.2	1.6	1.3	1.4	1.5	1.6
Div. payout ratio (% , UBS EPS)	84.9	64.4	76.3	70.0	67.2	63.3
Net debt / EBITDA	NM	NM	NM	NM	NM	NM

Efficiency ratios (x)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
Revenue / op. invested capital	NM	NM	NM	NM	NM	27.3
Revenue / fixed assets	8.5	7.8	7.9	8.2	8.1	8.0
Revenue / net working capital	NM	NM	NM	NM	NM	NM

Investment ratios (x)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
OpFCF / EBIT	1.0	1.0	1.0	1.0	1.0	1.0
Capex / revenue (%)	2.2	3.1	1.3	2.6	2.5	2.4
Capex / depreciation	2.1	2.9	1.1	2.5	2.7	2.7

Capital structure (%)	5Yr Avg	03/10	03/11	03/12E	03/13E	03/14E
Net debt / total equity	(88.8)	NM	(95.4)	(79.2)	(75.4)	(73.5)
Net debt / (net debt + equity)	NM	NM	NM	NM	NM	NM
Net debt (core) / EV	(3.9)	(3.8)	(4.7)	(3.7)	(4.2)	(5.2)

Source: Company accounts, UBS estimates. (UBS) valuations are stated before goodwill, exceptionals and other special items.

Valuations: based on an average share price that year, (E): based on a share price of Rs334.45 on 03 Oct 2011 23:55 SGT Market cap(E) may include forecast share issues/buybacks.

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■ Hindustan Unilever

Hindustan Lever is the leading household goods and food products company in the country. It has a dominant share in each of its key businesses: personal care, laundry, tea and branded staple foods. An unmatched distribution reach covering directly over a million retailers and a wide product portfolio with price-competitive products underpin its market leadership. Management is focusing on rationalising its brand portfolio to drive a sales growth rebound and has identified 30 core brands to which it will commit maximum resources for growth.

■ Statement of Risk

We think the key risks that could affect the sector include continued upward movement of downstream petrochemical products and higher agri-commodity based raw material costs, and the inability of branded consumer companies to pass on price increases in an increasingly competitive market. The sector has low corporate tax rates because factories are located in areas that are designated as tax benefit zones; any change in this law could affect earnings, in our view.

■ Analyst Certification

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UBS Investment Research: Global Equity Rating Allocations

UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	59%	35%
Neutral	Hold/Neutral	35%	33%
Sell	Sell	6%	14%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	0%
Sell	Sell	less than 1%	20%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 30 September 2011.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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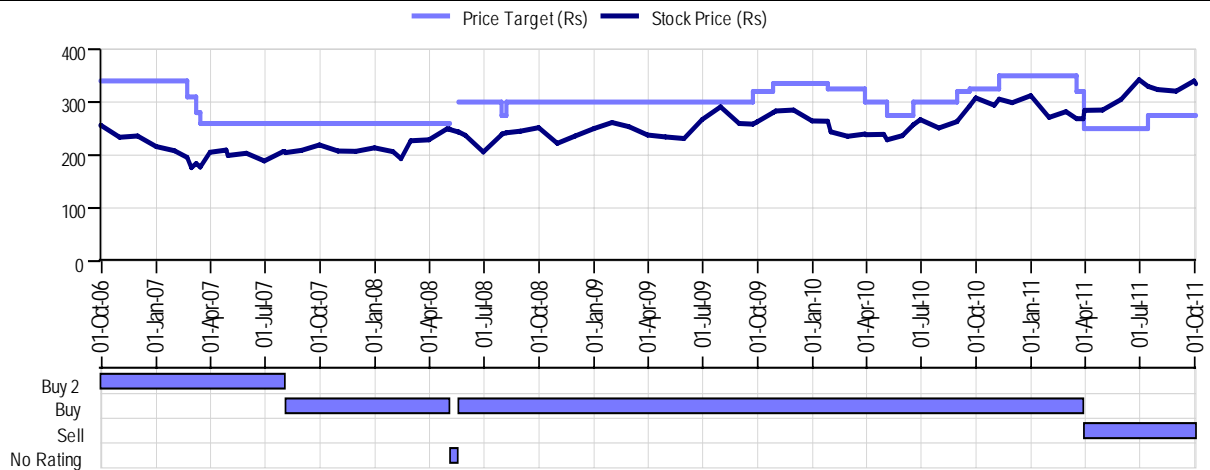
Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Hindustan Unilever	HLL.BO	Sell	N/A	Rs334.45	03 Oct 2011

Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Hindustan Unilever (Rs)



Source: UBS; as of 03 Oct 2011

Note: On August 4, 2007 UBS revised its rating system. (See 'UBS Investment Research: Global Equity Rating Definitions' table for details). From September 9, 2006 through August 3, 2007 the UBS ratings and their definitions were: Buy 1 = FSR is > 6% above the MRA, higher degree of predictability; Buy 2 = FSR is > 6% above the MRA, lower degree of predictability; Neutral 1 = FSR is between -6% and 6% of the MRA, higher degree of predictability; Neutral 2 = FSR is between -6% and 6% of the MRA, lower degree of predictability; Reduce 1 = FSR is > 6% below the MRA, higher degree of predictability; Reduce 2 = FSR is > 6% below the MRA, lower degree of predictability. The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities. From October 13, 2003 through September 8, 2006 the percentage band criteria used in the rating system was 10%.

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