Morgan Stanley

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Stock Rating
Overweight

Industry View
Attractive

Hindustan Unilever

Structural Growth Story, Not Just a Defensive Play

Quick Comment: Reiterate Overweight rating on HUL: We recently met up with HUL's top management. Our conviction on the company has increased as we believe that the company is not only well geared to manage in this tough economic environment but management is building pillars for future growth. We continue to believe that FMCG sector is at an inflection point in its growth trajectory and a sharp reduction in input costs is likely to be beneficial to consumers as well as companies. We reiterate our Overweight rating on HUL as we believe that investors are likely to be positively surprised by its structural growth story and turnaround in the company's business fundamentals. Here are the key takeaways from the meeting:

On immediate issues and concerns: 1. FMCG sector growth has been holding up pretty well as there seems to be no slowdown in consumer spending. 2. It is not witnessing any exceptional up trading or down trading across its product portfolio. 3. Industry volume growth in soaps and laundry is flat as price hikes have been quite sharp. Volume and price growth in personal products is quite balanced. 4. Despite sharp price increases, consumers have been pretty resilient. Revenue growth in F2010 is likely to be lower as it will be largely volume led. Volume growth is likely to recover in H2F2010. 5. The company has geared up to respond to volatility in input costs and has shortened its response time and planning cycle. It believes that fall in input costs will benefit the consumer and the companies. 6. Slowdown similar to one witnessed in 2000-04 is unlikely to be repeated as a) FMCG sector is likely to gain share of wallet, and b) Rural economy is more robust.

Positive mindset – using economic downturn as an opportunity: In our view, top management's thought process appears to be extremely positive. They are considering using the downturn as an opportunity to exit the period as a much stronger company. This may be possible as few of their competitors don't enjoy similar position of strength and resources as HUL do.

Key Ratios and Statistics

Reuters: HLL.BO Bloomberg: HUVR IN
India Consumer

Price target	Rs300.00
Upside to price target (%)	29
Shr price, close (Dec 3, 2008)	Rs232.20
52-Week Range	Rs265.00-170.00
Sh out, dil, curr (mn)	2,192
Mkt cap, curr (mn)	Rs508,932
EV, curr (mn)	Rs494,466
Avg daily trading volume (mn)	Rs122

Fiscal Year ending	12/07	03/09e	03/10e	03/11e
ModelWare EPS (Rs)	8.07	11.38	11.28	13.25
Prior ModelWare EPS (Rs)	-	-	-	-
Consensus EPS (Rs)§	8.13	9.48	10.87	12.95
Revenue, net (Rs mn)	137,178	207,672	192,429	218,612
EBITDA (Rs mn)	21,105	30,471	29,789	34,870
ModelWare net inc (Rs mn)	17,691	24,776	24,565	28,850
P/E	26.5	20.4	20.6	17.5
P/BV	32.6	27.6	23.0	19.2
RNOA (%)	990.5	(25,702.4)	(201.5)	(347.2)
ROE (%)	65.0	172.1	134.2	131.2
EV/EBITDA	21.5	15.8	16.1	13.6
Div yld (%)	4.2	3.7	3.7	4.3
FCF yld ratio (%)	2.4	6.7	4.3	6.4
Leverage (EOP) (%)	(100.5)	(150.2)	(128.5)	(136.7)

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).
§ = Consensus data is provided by FactSet Estimates.
e = Morgan Stanley Research estimates

Discussion regarding long-term pillars for HUL: The current management's key objective is to build a unique and differentiated competitive advantage for HUL that will give the company an edge similar to the head start it had with its distribution network between 1975 and 2000. The company is currently working on 2-3 such long-term building blocks, details of which will be released at an opportune time.

Simultaneously, the key immediate priority for the company is to put in place a matrix that will be able to develop and build capabilities required in the future. Hence, the key focus area for the company is: 1) To have a dominant share in tomorrow's consumers i.e. affluent and young, 2) To have a dominant share in tomorrow's markets i.e. Modern Trade, and 3) Have a dominant share in product categories of the future.

Further, during the last nine months, the company has been able to gear itself up to manage the volatility in the business environment. It no longer works on a point forecast but works on a range forecast which allows them flexibility to manage in volatile market environments. In our view, this has been the biggest achievement of the management at HUL which should go a long way in helping the company outperform peers over the next two years.

The company has also moved from more dynamic planning cycles and does not rely entirely on annual targets. The management committee is working on four quarters rolling targets reviewed periodically.

The new CEO of Unilever already visited HUL last week and is very excited about the growth opportunity in India. HUL continues to be a priority growth market for Unilever.

Discussion regarding loss of HUL's market share: Assuming that AC Nielsen data accurately reflects market share, the company's overall market share in the FMCG sector is flat. However, in Skin care, Hair care and Soaps, it has lost market share. Bulk of HUL's market share loss in these categories can be explained by the rapid growth in the premium segment in which HUL traditionally had lower market share. HUL has held/improved market share in most of its key operating segments within a category. For example, Clinic Plus shampoos seemed to have lost market share in shampoos, however, in the discount price segment of shampoos Clinic Plus share has grown from 78% to 79%, however, the growth in the discount segment has been significantly lower than the premium segment which impacted the company's overall market share in shampoos.

HUL has already begun focusing on the premium segment in these categories with brands such as Dove, Pears, Pond's and Lakme and importantly the company has been steadily gaining market share in these segments during the last 2-3 years.

Key challenge for F2010 is the uncertainty in consumer demand.

Company Description

Hindustan Lever, a 51%-owned subsidiary of Anglo Dutch giant Unilever, is the largest consumer company in India, with an annual turnover of US$2.2 billion. Its business portfolio includes detergents, soaps, personal and oral care products and processed foods and beverages. The company is the market leader in most of its product categories.

India Consumer

Industry View: Attractive

MSCI Country: India

Asia Strategist's Recommended Weight: 3.0%
MSCI Asia/Pac All Country Ex Jp Weight: 6.8%

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of November 30, 2008)

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Stock Rating Category	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	**838**	**36%**	**254**	**40%**	**30%**
Equal-weight/Hold	**1037**	**44%**	**282**	**45%**	**27%**
Not-Rated/Hold	**31**	**1.3%**	**7**	**1.1%**	**22.5%**
Underweight/Sell	**427**	**18%**	**90**	**14%**	**21%**
Total	**2,333**		**633**		

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Industry Coverage:India Consumer

Company (Ticker)	Rating (as of)	Price (12/03/2008)
Hozefa Topiwalla		
Colgate-Palmolive India (COLG.BO)	O (01/10/2005)	Rs395
Dabur India (DABU.BO)	O (10/18/2006)	Rs82.45
Godrej Consumer Products Limited (GOCP.BO)	E (08/12/2008)	Rs121
Hindustan Unilever (HLL.BO)	O (01/07/2008)	Rs232.2
ITC Ltd. (ITC.BO)	U (03/03/2008)	Rs168.5
Marico Limited (MRCO.BO)	O (07/06/2007)	Rs50
Nestle India (NEST.BO)	O (05/02/2002)	Rs1,404.45
Tata Tea (TTTE.BO)	O (01/23/2008)	Rs531.75

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