



Hindustan Unilever

STOCK INFO.	BLOOMBERG
BSE Sensex: 19,838	HUVR IN
	REUTERS CODE
S&P CNX: 5,901	HLL.BO

31 October 2007

Neutral

Previous Recommendation: Neutral

Rs208

Equity Shares (m)	2,206.8
52-Week Range	255/166
1,6,12 Rel. Perf. (%)	-21/-35/-64
M.Cap. (Rs b)	458.1
M.Cap. (US\$ b)	11.6

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
12/06A	121,034	15,397	7.0	17.5	29.8	16.8	56.5	67.0	3.6	26.1
12/07E	136,539	17,579	8.0	14.2	26.1	21.7	83.4	99.7	3.2	22.8
12/08E	149,183	19,553	8.9	11.2	23.4	20.3	86.6	104.7	2.9	19.7

3QCY07 topline of Rs33.6b, a 9.7% YoY growth, was lower than our estimate of Rs34.3b; Adj PAT was Rs4.09b in comparison to estimated Rs4.4b. Gross margin declined 20bp while EBITDA margin increased 20bp due to 60bp decline in ad spend. EBITDA increased 11%, but 22% decline in operational other income and 250bp increase in tax rate resulted in PAT growth of just 6.9%.

Volume growth for HUL declined from 5% in 2QCY07 to 3% in 3QCY07. Soaps and detergents sales grew 12.8%; beverages grew 13% while continuing foods business recorded a 7% growth. High margin personal care business grew at just 4% YoY due to lockout in Doom Dooma facility for seven weeks. Soaps and detergents was the only segment which reported margin expansion of 440bp YoY and 60bp QoQ.

We expect the personal care segment to bounce back in the coming quarter due to resolution of lockout and low base effect (4QCY06 sales growth was 2.5%) in the peak season for skin creams. Margins in soaps and detergents will be a function of raw material costs and price increases due to rising input costs for crude oil, palm oil, soda ash and LAB. Initiatives to launch new products in foods portfolio and roll-out of water business will increase costs further.

We expect financial other income to decline in CY08 as special dividend (Rs3 per share) will absorb Rs7.8b from investments. In addition, HUL is undertaking buyback of shares which would reduce surplus cash by Rs6.6b (not factored in estimates). We are reducing CY07 and CY08 EPS estimates from Rs8.1 and Rs9.2 to Rs8 and Rs8.9. HUL trades at 26.1x CY07E and 23.4x CY08E earnings. Maintain **Neutral**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E DECEMBER	CY06				CY07				CY06	CY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales (incl service inc)	27,981	30,832	30,660	31,561	31,843	34,814	33,646	36,236	121,034	136,539
YoY Change (%)	11.6	8.7	12.2	6.1	13.8	12.9	9.7	14.8	9.4	12.8
Total Expenditure	24,675	26,686	26,631	26,561	28,224	29,695	29,170	30,452	104,553	117,541
EBITDA	3,306	4,146	4,029	5,000	3,620	5,120	4,476	5,783	16,481	18,999
YoY Change (%)	35.8	19.9	17.0	3.8	9.5	23.5	11.1	15.7	14.2	15.3
Margins (%)	11.8	13.4	13.1	15.8	11.4	14.7	13.3	16.0	13.6	13.9
Depreciation	339	301	320	342	329	333	353	337	1,302	1,352
Interest	21	34	34	18	51	110	68	-29	107	200
Other Income	694	814	968	1,070	908	1,063	1,059	1,067	3,545	4,096
PBT	3,640	4,625	4,643	5,709	4,147	5,739	5,114	6,542	18,617	21,543
Tax	700	833	812	875	809	1,020	1,021	1,114	3,220	3,964
Rate (%)	19.2	18.0	17.5	15.3	19.5	17.8	20.0	17.0	17.3	18.4
Adjusted PAT	2,940	3,793	3,830	4,834	3,339	4,719	4,093	5,428	15,397	17,579
YoY Change (%)	32.4	26.2	17.7	10.2	13.6	24.4	6.9	12.3	17.5	14.2
Extraordinary Inc/(Exp)	1,489	13	1,377	278	590	212	-12	0	3,157	802
Reported Profit	4,429	3,806	5,208	5,112	3,929	4,931	4,081	5,428	18,554	18,381
YoY Change (%)	77.0	35.1	59.8	-1.9	-11.3	29.6	-21.6	6.2	31.8	-0.9

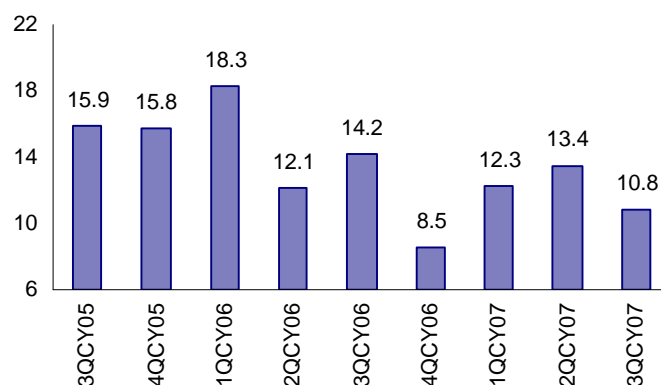
E: MOST Estimates

Deterioration in sales mix continues

HUL 3QCY07 results were below our estimates. Topline grew 9.4% at Rs33.6b (est of Rs34.3b) and Adj PAT grew just 6.9% to Rs4b (est. of Rs4.4b). Volume growth for HUL declined from 5% in 2QCY07 to 3% in 3QCY07. FMCG sales growth at 10.8% was lowest during the current year with HPC sales rising by just 9.5%. Sales mix of the company has been deteriorating with personal care business posting a single digit growth for the past four quarters. During 3QCY07, the personal care division grew by 4% YoY on account of closure of unit in Assam. Soaps and detergent business continued to post double digit sales growth during the quarter. Processed foods business reported just 7% increase in sales from continuing business, which is unexciting. Sales mix of the company is deteriorating as high margin personal care business is posting low single digit sales growth. The company is aggressively rolling out water purifier, which along with expected launch of new

food products will impact margins further. Maintaining margins could be a challenge in the coming quarters as raw materials like palm oil, soda ash; LAB etc are rising with increase in crude oil prices.

FMCG SALES GROWTH (%)



Source: Company/Motilal Oswal Securities

SEGMENTAL PERFORMANCE (RS M)

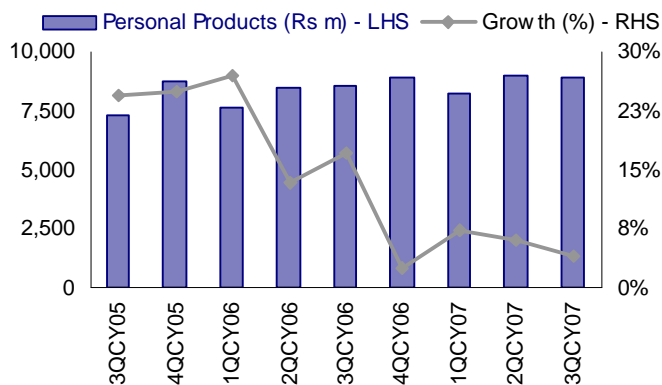
SEGMENTAL	3Q CY07	3Q CY06	CHG. (%)	9M CY07	9M CY06	CHG. (%)
Net Sales						
Soaps and Detergents	15,722	13,933	12.8	46,854	41,678	12.4
Personal Products	8,876	8,538	4.0	26,075	24,664	5.7
Beverages	3,905	3,455	13.0	11,243	9,637	16.7
Processed Foods	1,289	973	32.5	3,935	2,828	39.2
Ice Creams	371	338	9.7	1,315	1,108	18.7
Exports	3,136	3,274	-4.2	9,986	9,316	7.2
Others	642	480	33.8	1,912	1,199	59.4
EBIT						
Soaps and Detergents	2,626	1,720	52.7	7,054	5,029	40.3
Personal Products	2,147	2,284	-6.0	6,810	6,474	5.2
Beverages	562	477	17.8	1,687	1,349	25.1
Processed Foods	31	-4	-991.4	86	29	195.5
Ice Creams	5	43	-87.5	125	147	-14.9
Exports	63	205	-69.2	230	415	-44.6
Others	-329	-155	113.0	-783	-437	79.1
EBIT Margin (%)						
Soaps and Detergents	16.7	12.3		15.1	12.1	
Personal Products	24.2	26.7		26.1	26.2	
Beverages	14.4	13.8		15.0	14.0	
Processed Foods	2.4	-0.4		2.2	1.0	
Ice Creams	1.4	12.6		9.5	13.3	
Exports	2.0	6.3		2.3	4.5	
Others	-51.3	-32.2		-40.9	-36.5	

Source: Company/Motilal Oswal Securities

Personal care growth – one of the lowest in the past nine quarters

HUL's personal care portfolio grew 4% YoY, on account of a seven week lock-out in the Assam factory. Shampoos grew in double digits while skin and toothpaste were the key categories impacted due to this lock-out. The division has been disappointing repeatedly with single digit growth over the last four quarters. HUL's market share in the key personal care categories like oral care and skin care has declined compared to 2QCY07. Personal care has traditionally been a high margin and a high growth business for the company. Innovations during the quarter included relaunch of Fair & Lovely, Clinic All Clear and Lakme 9to5 range. However, management expects to report improved growth numbers in the current quarter as the lock out has been lifted. HUL has been emphasizing on the top end segment of skin creams with anti aging and high end cosmetics, which would benefit the company over the longer term only. We expect double digit growth rate from personal care segment in the coming quarter due to the low base effect (4QCY06 sales growth of just 2.5%).

TREND IN PERSONAL PRODUCTS

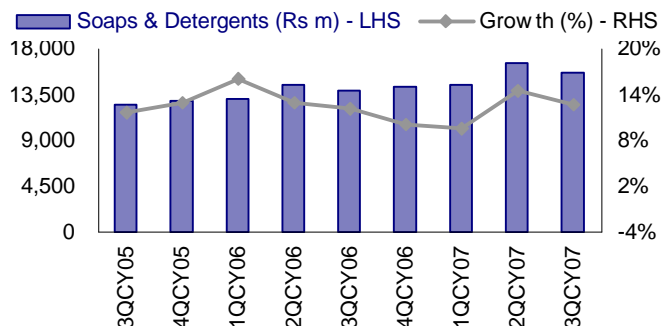


Source: Company/Motilal Oswal Securities

Strong growth in soaps and detergent support margin

Soaps and detergents business grew 12.8% in 3QCY07 at Rs15.7b. The growth was witnessed across all fabric wash brands. Personal wash growth was steady with Lifebuoy and Breeze brands registering good growth. Judicious price increases and steady volume growth in fabric wash was the key positive. Soaps and detergents posted a 440bp increase in PBIT margin YoY and 60bp QoQ. Such increase in margin has been shown after a long gap indicating improving economies in fabric wash. Management is of the view that the current margins despite improvement are significantly lower than the margins before the price wars. However, prices of key inputs like palm oil, soda ash and LAB continue to rise due to strong crude prices. We expect HUL to undertake further price increases in the coming quarters to ward off adverse impact of input cost increases. We expect steady volumes for both fabric and personal wash categories.

TREND IN SOAPS AND DETERGENTS



Source: Company/Motilal Oswal Securities

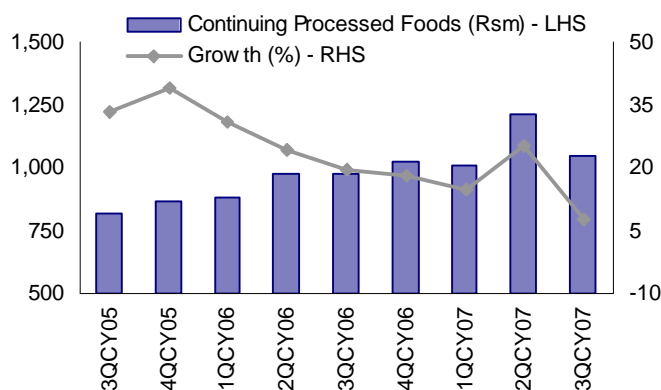
Beverages record a robust growth

Beverages reported 13% increase in sales at Rs3.9b in sales backed by steady growth in both tea and coffee. Higher growth was backed by improvement in EBIT margin from 13.8% in 3QCY06 to 14.4% in 3QCY07 although sequentially there was a 130bp decline. Bru Coffee, Lipton Yellow label and Brooke Bond Red label grew steadily. HUL lost volume market leadership to Tata Tea in the packet tea segment during the quarter. Raw coffee prices continue to remain strong, which is expected to keep the margin expansion under check.

Processed foods minus Modern Foods see growth decline

Process foods business grew 32.5% on the back of merger of Modern Foods business with the company. Excluding the merger of Modern Foods, the division grew just 7%. Knorr and Kissan continue to do well contributing to the growth in processed food segment. The company launched new flavors in Knorr soups range and some cooking aids. Ice creams sales grew 9.7% to Rs371m, however, PBIT margin declined from 12.6% to 1.4% due to stabilization period of new unit. The plan to launch new food products is progressing and the management expects to launch new products in the beginning of next calendar year. Success of new food products holds key to the future growth potential of HUL, as processed food is a low penetration category that offers huge potential over the coming few years.

TREND IN PROCESSED FOODS



Source: Company/Motilal Oswal Securities

Entry of ITC in HPC to increase competition

ITC has entered the HPC market with the launch of Fiama Di Wills shampoos and body washes in the premium segment and Superia soaps and shampoos in the popular segment. This is the maiden entry of the company in mass market for HPC products. Fiama Di Wills will compete with Dove range of shampoos and body washes. Superia will compete with Breeze in the popular segment of soaps and Lux in shampoos. As such, none of these brands directly compete with a power brand of HUL, but we expect ITC to launch more products in the HPC segment. ITC has deep pockets and marketing strength which can put pressure on the specific categories for some time, although HUL has its brand and distribution strengths. Success of ITC in these segment and launch of products which directly compete with HUL can have impact on the medium term performance of HUL.

Valuation and view

We expect the personal care segment to bounce back in 4QCY07 due to resolution of lockout and low base effect (4QCY06 sales growth was 2.5%) in the peak season for skin creams. Margins in soaps and detergents will be a function of raw material costs and price increases due to rising input costs for crude oil, palm oil, soda ash and LAB. Initiatives to launch new products in foods portfolio and roll-out of water business will increase costs further. We expect financial other income to decline in CY08 as special dividend (Rs3 per share) will absorb Rs7.8b from investments. In addition, HUL is undertaking buyback of shares which would reduce surplus cash by Rs6.6b (not factored in estimates). We are reducing CY07 and CY08 EPS estimates from Rs8.1 and Rs9.2 to Rs8 and Rs8.9. HUL trades at 26.1x CY07E and 23.4x CY08E earnings. **Maintain Neutral.**

Hindustan Lever: an investment profile

Company description

HLL is the largest company in the FMCG industry, with market leadership in soaps, detergents and personal care categories.

It has a wide distribution network with direct reach of over 1m retail outlets. The company is a subsidiary of Unilever, the Anglo Dutch FMCG giant.

Key investment arguments

- Sales growth in Personal Care has been lagging industry growth from last nine quarters.
- Food products led by Ice Cream, Beverages and *Knorr* range are growing in high double digits.

Key investment risks

- Competitive pressure could intensify with more companies entering personal care and toilet soaps which account for more than 50% of HLL sales.
- Failure of monsoons could dampen rural demand pickup.
- High crude prices would increase material costs.

Recent developments

- Announced national roll out of water project in CY07.
- The company launched new flavors in Knorr soups range and some cooking aids.
- Launched new products like Clinic All Clear Scalp Control, Ponds Age Miracle and variants of Fair & Lovely.

Valuation and view

- We expect an earnings CAGR of 12.7% over CY06-08E.
- The stock quotes at 26.1x CY07E and 23.4x CY08E earnings. We maintain **Neutral**.

Sector view

- We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- Companies with low competitive pressures and brought product portfolios will be able to better withstand any slowdown in a particular segment.
- Longer term prospects bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		HLL	ITC	NESTLE
P/E (x)	CY07E	26.1	21.9	33.4
	CY08E	23.4	18.9	26.6
EV/EBITDA (x)	CY07E	22.8	14.1	20.3
	CY08E	19.7	11.8	16.2
EV/Sales (x)	CY07E	3.2	4.5	4.2
	CY08E	2.9	3.6	3.5
P/BV (x)	CY07E	21.7	5.6	21.6
	CY08E	20.3	5.0	19.3

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	51.4	51.4	51.4
Domestic Inst	16.8	16.9	15.4
Foreign	13.5	12.6	14.3
Others	18.3	19.1	18.9

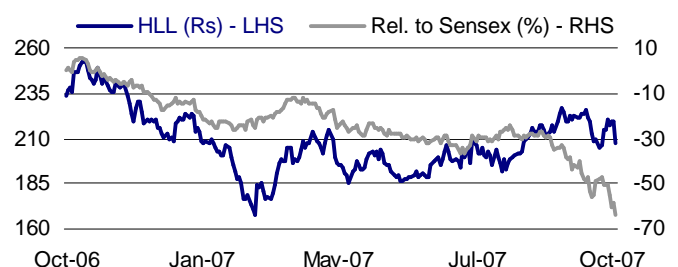
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY07	8.0	9.4	-15.3
CY08	8.9	10.5	-15.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
208	-	-	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Net Sales	99,269	110,605	121,034	136,539	149,183
Change (%)	-2.1	11.4	9.4	12.8	9.3
Total Expenditure	-84,896	-96,172	-104,553	-117,541	-127,408
EBITDA	14,374	14,433	16,481	18,999	21,775
Change (%)	-27.3	0.4	14.2	15.3	14.6
Margin (%)	14.5	13.0	13.6	13.9	14.6
Depreciation	-1,209	-1,245	-1,302	-1,352	-1,402
Int. and Fin. Charges	-1,300	-192	-107	-200	-150
Other Income - Recurring	3,188	3,048	3,545	4,096	4,020
Profit before Taxes	15,053	16,045	18,617	21,543	24,243
Change (%)	-32.9	6.6	16.0	15.7	12.5
Margin (%)	15.2	14.5	15.4	15.8	16.3
Tax	-2,660	-2,530	-2,952	-3,641	-4,326
Deferred Tax	-547	-410	-268	-323	-364
Tax Rate (%)	-21.3	-18.3	-17.3	-18.4	-19.3
Profit after Taxes	11,846	13,105	15,397	17,579	19,553
Change (%)	-32.6	10.6	17.5	14.2	11.2
Margin (%)	11.9	11.8	12.7	12.9	13.1
Non-rec. (Exp)/Income	128	976	3,157	802	0
Reported PAT	11,973	14,081	18,554	18,381	19,553

BALANCE SHEET					
(RS MILLION)					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Share Capital	2,201	2,201	2,207	2,207	2,207
Reserves	18,726	20,855	25,028	18,881	20,360
Net Worth	20,927	23,056	27,235	21,088	22,567
Loans	14,711	569	726	726	726
Capital Employed	35,638	23,626	27,961	21,814	23,293
Gross Block	23,142	23,751	24,627	25,627	26,627
Less: Accum. Depn.	-8,911	-9,896	-10,619	-11,971	-13,373
Net Fixed Assets	14,231	13,855	14,007	13,656	13,254
Capital WIP	944	980	1,103	1,103	1,103
Investments	22,296	20,142	24,139	21,189	23,722
Deferred Charges	2,260	2,201	2,245	2,392	2,549
Curr. Assets, L&A	33,050	27,630	31,697	33,483	36,173
Inventory	14,704	13,218	15,477	16,550	17,551
Account Receivables	4,893	5,228	4,404	4,863	5,313
Cash and Bank Balance	6,980	3,550	4,169	4,814	5,928
Others	6,472	5,634	7,646	7,256	7,381
Curr. Liab. and Prov.	37,143	41,183	45,231	50,009	53,508
Account Payables	20,292	23,450	24,637	27,622	29,941
Other Liabilities	10,773	11,572	13,369	13,870	14,905
Provisions	6,077	6,162	7,224	8,517	8,662
Net Current Assets	-4,093	-13,553	-13,534	-16,526	-17,335
Application of Funds	35,638	23,626	27,961	21,814	23,293

E: MOST Estimates

RATIOS					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	5.4	6.0	7.0	8.0	8.9
Cash EPS	5.9	6.5	7.6	8.6	9.5
BV/Share	9.5	10.5	12.3	9.6	10.2
DPS	5.0	5.0	6.0	9.5	7.0
Payout %	92.9	84.0	86.0	119.3	79.0
Valuation (x)					
P/E		34.9	29.8	26.1	23.4
Cash P/E		31.8	27.4	24.2	21.9
EV/Sales		3.9	3.6	3.2	2.9
EV/EBITDA		30.1	26.1	22.8	19.7
P/BV		19.8	16.8	21.7	20.3
Dividend Yield (%)		2.4	2.9	4.6	3.4
Return Ratios (%)					
RoE	56.6	56.8	56.5	83.4	86.6
RoCE	45.9	68.7	67.0	99.7	104.7
Working Capital Ratios					
Debtor (Days)	18	17	13	13	13
Asset Turnover (x)	2.8	4.7	4.3	6.3	6.4
Leverage Ratio					
Debt/Equity (x)	0.7	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
OP/(loss) before Tax	13,165	13,189	15,179	17,647	20,373
Int./Div. Received	3,188	3,048	3,545	4,096	4,020
Depreciation and Amort.	1,209	1,245	1,302	1,352	1,402
Interest Paid	-1,300	-192	-107	-200	-150
Direct Taxes Paid	-2,660	-2,530	-2,952	-3,641	-4,326
(Incr)/Decr in WC	-679	6,030	600	3,636	1,924
CF from Operations	12,923	20,789	17,566	22,890	23,242
Extraordinary Items	128	976	3,157	802	0
(Incr)/Decr in FA	-1,931	-645	-998	-1,000	-1,000
(Pur)/Sale of Investments	3,454	2,154	-3,997	2,951	-2,534
CF from Invest.	1,650	2,485	-1,838	2,753	-3,534
Issue of Shares	0	0	0	0	0
(Incr)/Decr in Debt	-2,332	-14,141	157	0	0
Dividend Paid	-11,006	-11,006	-15,100	-24,528	-18,073
Others	-2,320	-1,557	-166	-470	-520
CF from Fin. Activity	-15,659	-26,704	-15,109	-24,998	-18,593
Incr/Decr of Cash	-1,085	-3,430	619	644	1,115
Add: Opening Balance	8,065	6,980	3,550	4,169	4,814
Closing Balance	6,980	3,550	4,169	4,813	5,928

N O T E S



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Disclosure of Interest Statement

Hindustan Unilever

- | | |
|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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