

# Meeting highlights

## Rising concern on demand but relative safe haven; Buy

Our mgmt meeting revalidated our view that margin outlook is improving but we were surprised by mgmt's rather sombre outlook for demand. Our 2009 forecast of margin expansion of 150bp remains intact. However our sales forecast of 11% could be at risk should macro environment continue to deteriorate. Nonetheless overall, we believe HUVR is well placed to grow earnings in mid teens, way ahead of average Sensex growth. Hence we reiterate our Buy rating.

## Margin outlook is improving

We estimate lower input cost benefits will begin to flow in partly from March Q and fully from June Q. The benefits will differ category to category - Soaps will witness benefits being passed on, detergents will see benefits being retained.

## Key issue #1: Is there risk to volumes?

HUVR's volume growth has been slowing down from 10% in March Q to 7% in Sept Q in response to rising prices. Despite stabilizing retail prices, the macro environment is not favourable enough to suggest that volume acceleration is likely near term. Key concern is falling employment in 2nd tier cities and uncertain economic outlook. Yes, HUVR's products are non discretionary but down-trading is likely as was the case during the drought years of 2002/2003.

## Key issue #2: Will low price competition be rekindled?

Lower commodity prices invariably come in with the negative of reenergizing low price competitors. This is most likely the case in soaps as margins here will expand the maximum. We expect HUVR to withstand higher competitive activity through its diversified portfolio which gives it the flexibility to cut prices and retain margins more effectively versus competitors.

## Estimates (Dec)

(Rs)	2006A	2007A	2008E	2009E	2010E
Net Income (Adjusted - mn)	15,397	17,691	20,430	24,541	28,324
EPS	6.98	8.02	9.38	11.27	13.00
EPS Change (YoY)	17.2%	14.9%	17.0%	20.1%	15.4%
Dividend / Share	6.01	8.95	7.97	9.58	11.05
Free Cash Flow / Share	8.55	9.03	10.76	12.51	14.35

## Valuation (Dec)

	2006A	2007A	2008E	2009E	2010E
P/E	35.39x	30.80x	26.32x	21.91x	18.99x
Dividend Yield	2.43%	3.63%	3.23%	3.88%	4.48%
EV / EBITDA*	24.95x	22.02x	18.96x	15.68x	13.51x
Free Cash Flow Yield*	3.51%	3.71%	4.36%	5.07%	5.81%

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 4.



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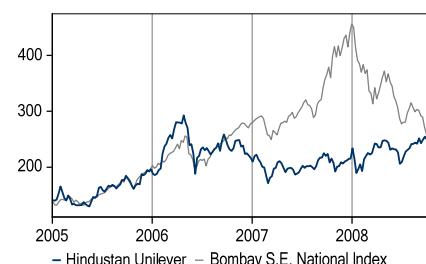
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## Stock Data

Price	Rs246.90
Price Objective	Rs265.00
Date Established	28-Oct-2008
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs169.00-Rs265.50
Mrkt Val / Shares Out (mn)	US\$11,347 / 2,178.0
Average Daily Volume	7,128,050
ML Symbol / Exchange	HINLF / BSE
Bloomberg / Reuters	HUVR IN / HLL.BO
ROE (2008E)	137.9%
Net Dbt to Eqty (Dec-2007A)	-7.8%
Est. 5-Yr EPS / DPS Growth	15.0% / 15.0%
Free Float	49.0%



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Refer to important disclosures on page 5 to 6. Analyst Certification on Page 3. Price Objective Basis/Risk on page 3.

# *iQprofile*<sup>SM</sup> Hindustan Unilever Ltd.

Key Income Statement Data (Dec)	2006A	2007A	2008E	2009E	2010E
<b>(Rs Millions)</b>					
Sales	122,580	138,982	166,372	184,811	207,355
Gross Profit	20,821	23,597	27,405	33,126	38,451
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	19,673	22,315	26,021	31,627	36,834
Net Interest & Other Income	(1,056)	(470)	(610)	(563)	(521)
Associates	NA	NA	NA	NA	NA
Pretax Income	18,617	21,845	25,411	31,064	36,313
Tax (expense) / Benefit	(3,220)	(4,155)	(4,980)	(6,523)	(7,989)
Net Income (Adjusted)	15,397	17,691	20,430	24,541	28,324
Average Fully Diluted Shares Outstanding	2,207	2,207	2,178	2,178	2,178

## Key Cash Flow Statement Data

Net Income (Reported)	15,397	17,691	20,430	24,541	28,324
Depreciation & Amortization	1,149	1,282	1,385	1,498	1,617
Change in Working Capital	600	2,641	3,613	3,210	3,314
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	3,157	1,564	0	0	0
Cash Flow from Operations	20,302	23,178	25,428	29,249	33,255
Capital Expenditure	(1,423)	(3,253)	(2,000)	(2,000)	(2,000)
(Acquisition) / Disposal of Investments	(3,997)	9,731	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(5,421)	6,478	(2,000)	(2,000)	(2,000)
Shares Issue / (Repurchase)	6	(29)	0	0	0
Cost of Dividends Paid	(15,114)	(22,291)	(19,588)	(23,530)	(27,157)
Cash Flow from Financing	(14,951)	(34,974)	(19,588)	(23,530)	(27,157)
Free Cash Flow	18,879	19,924	23,428	27,249	31,255
Net Debt	(3,443)	(1,123)	(4,963)	(8,682)	(12,780)
Change in Net Debt	227	5,477	(3,840)	(3,719)	(4,098)

## Key Balance Sheet Data

Property, Plant & Equipment	15,110	17,081	17,697	18,198	18,581
Other Non-Current Assets	26,385	16,532	16,532	16,532	16,532
Trade Receivables	4,404	4,434	5,823	6,468	7,257
Cash & Equivalents	4,169	2,009	5,849	9,567	13,665
Other Current Assets	23,123	26,332	31,943	34,929	39,190
Total Assets	73,191	66,387	77,844	85,695	95,226
Long-Term Debt	726	885	885	885	885
Other Non-Current Liabilities	0	0	0	0	0
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	45,230	51,110	61,724	68,565	76,929
Total Liabilities	45,956	51,995	62,609	69,450	77,814
Total Equity	27,235	14,392	15,234	16,245	17,412
Total Equity & Liabilities	73,191	66,388	77,843	85,696	95,226

## iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	68.3%	92.4%	133.3%	150.3%	162.2%
Return On Equity	61.2%	85.0%	137.9%	155.9%	168.3%
Operating Margin	16.0%	16.1%	15.6%	17.1%	17.8%
EBITDA Margin	17.0%	17.0%	16.5%	17.9%	18.5%

## iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	1.3x	1.3x	1.2x	1.2x	1.2x
Asset Replacement Ratio	1.2x	2.5x	1.4x	1.3x	1.2x
Tax Rate (Reported)	17.3%	19.0%	19.6%	21.0%	22.0%
Net Debt-to-Equity Ratio	-12.6%	-7.8%	-32.6%	-53.4%	-73.4%
Interest Cover	NM	NM	NM	NM	NM

## Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Description

HLL, 51% owned by Unilever, is India's largest consumer products company. It offers more than 9 types of everyday household products - soaps, detergents, shampoos, skin care, oral care, beverages, and foods. Key strengths: extensive distribution network (its products are available in 6mn outlets), powerful brand equity (most of its brands are market leaders and straddle price segments), strong balance sheet, and high-quality management.

## Investment Thesis

Our positive view is based on stable earnings outlook and attractive valuations. We believe in the current tough macro environment HUV's defensive qualities will stand out. Demand risk is minimal given the staple nature of its products. Cash flows are strong given minimal capex requirements. Additional positive is weakening commodity prices and hence potential for earnings upgrade. We believe valuations are attractive and in our view more than price in the competitive pressures.

## Stock Data

Price to Book Value 35.3x

## Price objective basis & risk

### Hindustan Unilever (HINLF)

Our preferred valuation methodology is a target P/E multiple on one year forward EPS. Our target multiple for HUVR is 24x which on CY09E EPS of Rs11.3 gives us our price objective of Rs265. Our target multiple is what HUVR is currently trading at but is at 10% discount to its last five year average trading multiple. We believe the discount is justified given the slightly tougher competitive environment versus the past. We expect the current multiple to sustain given our expectation of earnings upside from falling commodity prices that include crude oil, vegetable oil and packaging costs. Moreover, inherent strengths of HUVR stand out in the current tough economic environment. Its business of staple consumer products is relatively recession proof which ensures continuing strong cash flows. Downside risks are slower than expected demand and stiffer competition.

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### India - Consumer Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY	Bombay Rayon Fashions Ltd	BORYF	BRFL IN	Manish Sarawagi
	Hindustan Unilever	HINLF	HUVR IN	Vandana Luthra
	ITC Limited	ITCTF	ITC IN	Vandana Luthra
	McLeod Russel India Ltd.	XCVFF	MCLR IN	Manish Sarawagi
	Nestle India	XNTEF	NEST IN	Vandana Luthra
	Titan Inds Ltd	TTNIF	TTAN IN	Manish Sarawagi
	United Spirits	UDSRF	UNSP IN	Vandana Luthra
	Welspun India	WPNIF	WLSI IN	Manish Sarawagi

11 November 2008

**India - Consumer Coverage Cluster**

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
<b>NEUTRAL</b>				
	Asian Paints	XAPNF	APNT IN	Vandana Luthra
	Colgate India	CPIYF	CLGT IN	Vandana Luthra
	Dabur India	DBUIF	DABUR IN	Vandana Luthra
	Himatsingka Seid	HMKFF	HSS IN	Manish Sarawagi
	Pantaloon	PFI AF	PF IN	Vandana Luthra
<b>UNDERPERFORM</b>				
	Arvind Ltd	ARVZF	ARVND IN	Manish Sarawagi
	Gokaldas Exports	GKLDF	GEXP IN	Manish Sarawagi
	Radico Khaitan	RKHAF	RDCK IN	Vandana Luthra
	Raymond Ltd	XRAMF	RW IN	Manish Sarawagi
	Shoppers' Stop	SHPSF	SHOP IN	Manish Sarawagi
	Vishal Retail Ltd	XVHLF	VISH IN	Manish Sarawagi

**iQmethod<sup>SM</sup> Measures Definitions**

<b>Business Performance</b>		<b>Numerator</b>	<b>Denominator</b>
Return On Capital Employed		NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity		Net Income	Shareholders' Equity
Operating Margin		Operating Profit	Sales
Earnings Growth		Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow		Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>			
Cash Realization Ratio		Cash Flow From Operations	Net Income
Asset Replacement Ratio		Capex	Depreciation
Tax Rate		Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio		Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover		EBIT	Interest Expense
<b>Valuation Toolkit</b>			
Price / Earnings Ratio		Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value		Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield		Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield		Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales		EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	
EV / EBITDA		Enterprise Value	Basic EBIT + Depreciation + Amortization

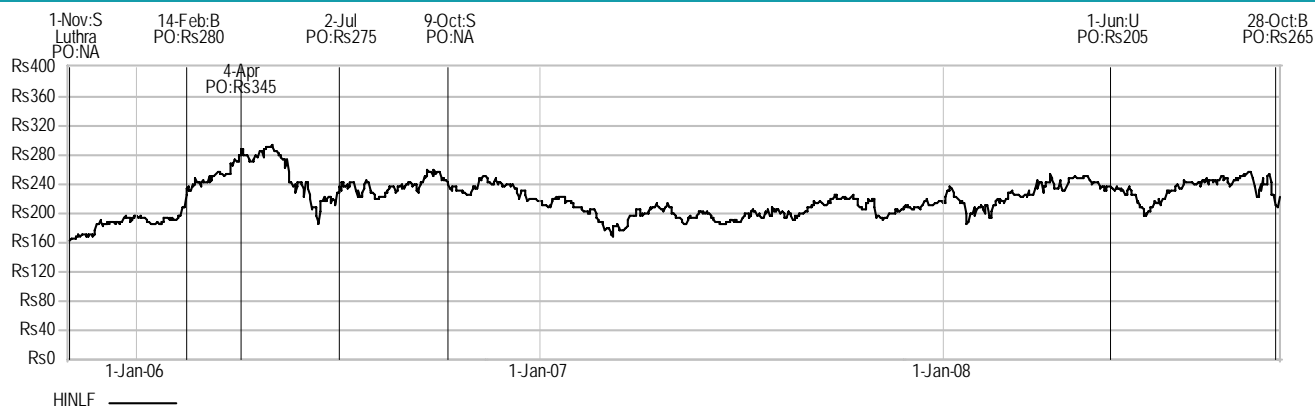
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### HINLF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

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### Investment Rating Distribution: Consumer Products Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	28	40.58%	Buy	5	20.00%
Neutral	17	24.64%	Neutral	2	12.50%
Sell	24	34.78%	Sell	5	23.81%

### Investment Rating Distribution: Global Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1647	45.31%	Buy	429	28.83%
Neutral	858	23.60%	Neutral	240	31.41%
Sell	1130	31.09%	Sell	227	22.02%

\* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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