



Hindustan Unilever

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,701	HUVR IN
	REUTERS CODE
S&P CNX: 2,584	HLL.BO

24 October 2008

Neutral

Previous Recommendation: Neutral

Rs225

Equity Shares (m)	2,177.5
52-Week Range	265/170
1,6,12 Rel. Perf. (%)	27/41/56
M.Cap. (Rs b)	489.7
M.Cap. (US\$ b)	9.8

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	32.2	18.2	56.5	67.0	3.9	28.4
12/07A	137,178	17,691	8.1	16.4	27.7	34.0	122.9	144.7	3.5	25.1
12/08E	164,279	19,920	9.2	12.6	24.6	26.1	106.1	127.4	2.8	21.9
12/09E	181,721	23,390	10.7	17.4	20.9	21.5	102.5	123.6	2.5	18.1

- HUL's 3QCY08 results are below estimates. Sales at Rs40.2b (est Rs40.5b) have grown 19.7%, while adj PAT at Rs4.4b (est of Rs4.7b) has grown 7%. Reported PAT grew 34% to Rs5.5b, which includes Rs1.3b profit on sales of properties. Excluding gains from forward contracts and forex, PAT growth would be just 2.5%.
- FMCG Volume growth is 6.8% (QoQ decline of 150bp) and 360bp lower than 1QCY08 volume growth of 10.4%. Gross margins declined 112bp despite selective price increases. EBIDTA margin declined 148bp YoY due to 90bp increase in other expenses despite 50bp lower advertising spend. EBIDTA grew only 6.4% v/s est of 16.1% growth.
- Soaps and detergents (48% of revenues) reported 26% increase in sales but only 4.5% increase in PBIT as margins declined 279bp. Detergents reported mid single digit volume growth, while toilet soap volumes have been flat. Personal care has reported 18% increase in sales and 20.8% increase in PBIT as margins expanded 57bp.
- Prices of key inputs like palmoil and LAB (Linear Alkyl Benzene) have declined 55% and 9% from the peak. HUL has also hinted at prices cuts in key categories if the raw material prices remain low. We believe that high competitive intensity in soaps and detergents will prevent any significant margin expansion on sustained basis.
- We are increasing sales growth estimates for CY08 to 19.8% from 18.7%. Sales growth for CY09 is estimated at 10.6% (12.6% earlier), which factors in lower volume growth of 4.9% (7.2% earlier). We are now factoring in 80bp EBIDTA margin decline in CY08 and 100bp expansion in CY09 to 12.9% (13.3% earlier) and 13.9% (14% earlier). We are reducing CY08 and CY09 PAT growth estimates by 1.7% and 2%. We now arrive at an EPS of Rs9.2 for CY08 and Rs10.7 for CY09. The stock trades at 24.6x CY08E and 20.9x CY09E earnings. Maintain **Neutral**.

QUARTERLY PERFORMANCE

(Rs Million)

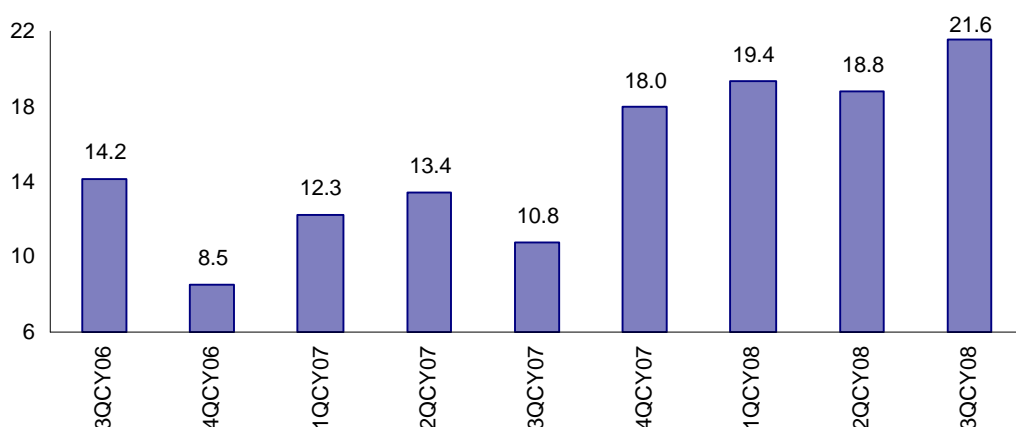
Y/E DECEMBER	CY07				CY08				CY07	CY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales (incl service inc)	31,843	34,814	33,646	36,874	37,939	42,157	40,279	43,904	137,178	164,279
YoY Change (%)	13.8	12.9	9.7	16.8	19.1	21.1	19.7	19.1	13.3	19.8
Total Expenditure	28,224	29,801	29,170	31,232	33,861	36,642	35,516	37,118	118,321	143,136
EBITDA	3,620	5,013	4,476	5,642	4,078	5,515	4,763	6,786	18,857	21,143
YoY Change (%)	9.5	20.9	11.1	12.8	12.7	10.0	6.4	20.3	14.4	12.1
Margins (%)	11.4	14.4	13.3	15.3	10.7	13.1	11.8	15.5	13.7	12.9
Depreciation	329	333	353	369	363	379	393	388	1,384	1,523
Interest	51	110	68	26	35	87	0	128	255	250
Other Income	908	1,058	1,059	1,597	1,009	1,647	1,239	1,320	4,627	5,215
PBT	4,147	5,628	5,114	6,844	4,689	6,695	5,610	7,590	21,845	24,584
Tax	809	1,111	1,021	1,305	905	1,294	1,231	1,234	4,155	4,664
Rate (%)	19.5	19.7	20.0	19.1	19.0	18.0	19.0	16.3	19.0	19.0
Adjusted PAT	3,339	4,517	4,093	5,540	3,784	5,401	4,379	6,356	17,691	19,920
YoY Change (%)	13.6	19.1	6.9	14.6	13.3	19.6	7.0	14.7	14.9	12.6
Extraordinary Inc/(Exp)	590	414	-12	775	25	180	1,087	0	1,564	1,293
Reported Profit	3,929	4,931	4,081	6,314	3,810	5,582	5,466	6,356	19,255	21,213
YoY Change (%)	-11.3	29.6	-21.6	23.5	-3.0	13.2	34.0	0.7	3.8	10.2

E: MOST Estimates

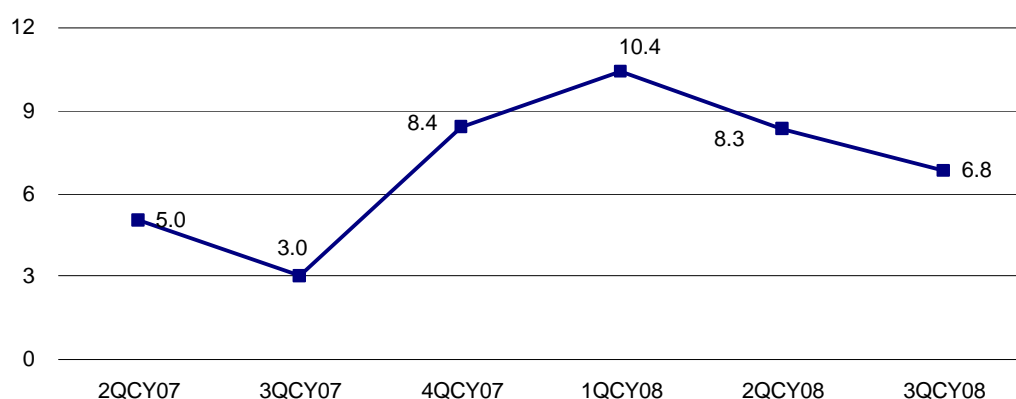
Sales volume declines 210bp QoQ; growth tends lower

FMCG sales increased 21.6% in 3QCY08 as compared to 18.8% growth in 2QCY08 and 10.8% growth in 3QCY07. FMCG Volume growth is 6.8% (QoQ decline of 150bp) and 360bp lower than 1QCY08 volume growth of 10.4%. Sales growth suggests higher realizations due to price increases affected by the company. HUL also reported market share loss in key categories like toilet Soaps, shampoos and skin care, while market share increased in detergents and coffee. Decline in volume growth suggests slow down in consumer off-take.

FMCG SALES GROWTH (%)



TREND IN VOLUME GROWTH (%)



Source: Company/Motilal Oswal Securities

VALUE MARKET SHARE (%)

	3QCY07	2QCY08	3QCY08
Detergents	37.0	38.3	37.9
Soaps	53.2	52.7	50.3
Shampoo	47.7	46.5	46.1
Skin care	55.0	53.4	52.7
Toothpaste	30.0	30.0	29.6
Tea	23.4	23.2	23.3
Coffee	46.5	46.9	47.1

Source: Company/Motilal Oswal Securities

SEGMENTAL

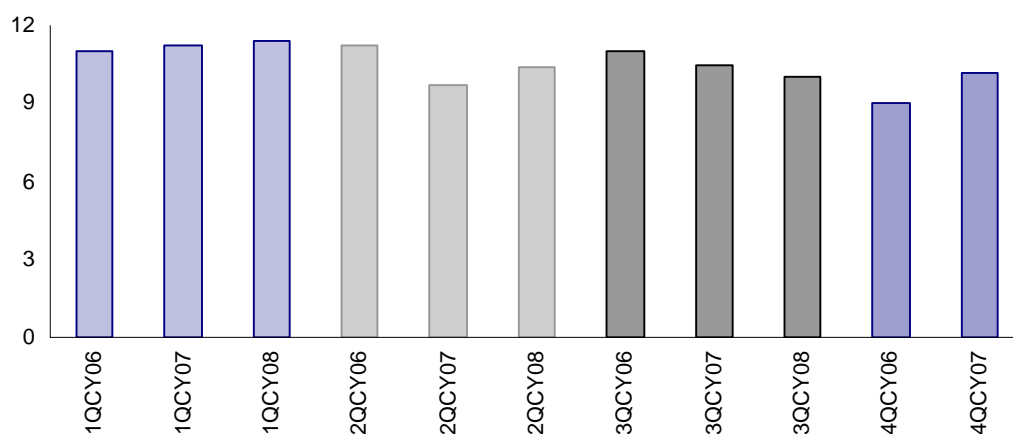
	3QCY08	3QCY07	CHANGE %	9MCY08	9MCY07	CHANGE %
Net Sales (Rs m)						
Soaps and Detergents	19,863	15,761	26.0	57,450	46,992.3	22.3
Personal Products	10,496	8,899	18.0	31,365	26,155	19.9
Beverages	4,422	3,917	12.9	12,945	11,286	14.7
Processed Foods	1,739	1,293	34.5	4,759	3,947	20.6
Exports	2,961	3,146	-5.9	10,885	10,023	8.6
EBIT (Rs m)						
Soaps and Detergents	2,685	2,569	4.5	7,981	6,955	14.8
Personal Products	2,555	2,116	20.8	8,045	6,697	20.1
Beverages	627	551	13.8	1,739	1,690	2.9
Processed Foods	26	17	50.9	81	57	41.7
Exports	317	62	407.7	782	229	241.0
EBIT Margin (%)						
Soaps and Detergents	13.5	16.3		13.9	14.8	
Personal Products	24.3	23.8		25.6	25.6	
Beverages	14.2	14.1		13.4	15.0	
Processed Foods	1.5	1.3		1.7	1.5	
Exports	10.7	2.0		7.2	2.3	

Source: Company/Motilal Oswal Securities

Gross margin declines 112bp, EBITDA margin declines 148bp....

Gross margins have declined 112bp despite selective price increases across product categories. EBITDA margin declined 148bp YoY (v/s est of 50bp decrease) due to 90bp increase in other expenses despite 50bp lower advertising spend. EBITDA grew only 6.4% v/s est of 16.1% growth.

TREND IN AD-SPEND (% OF SALES)

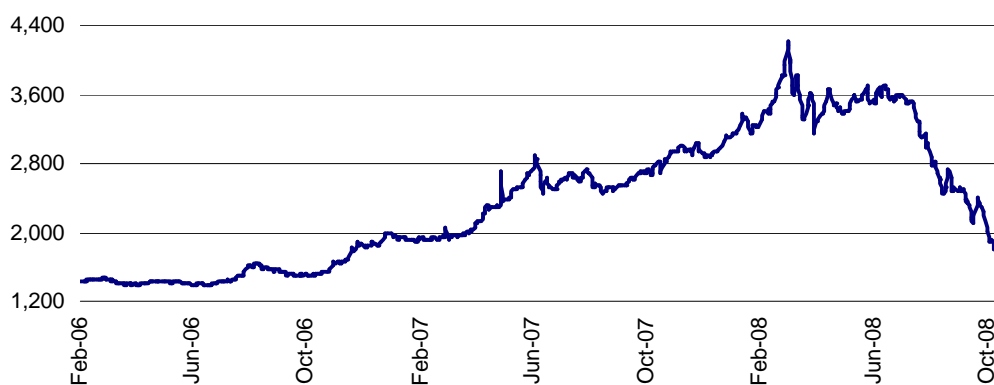


Source: Company/Motilal Oswal Securities

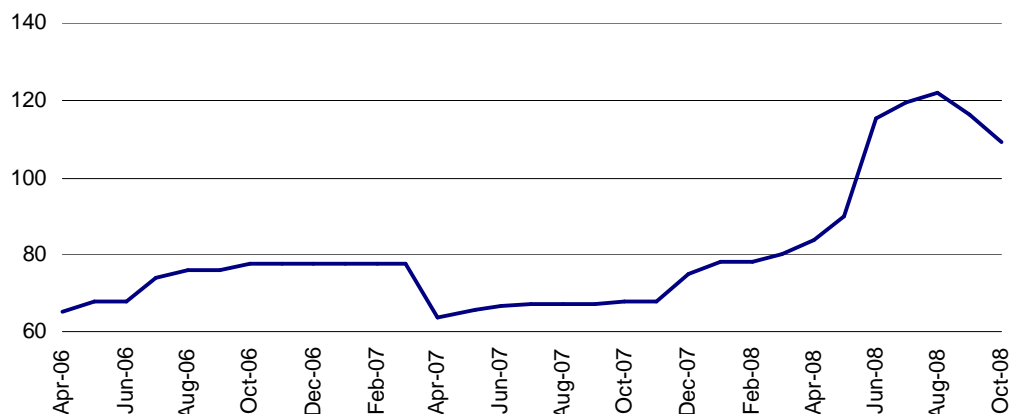
.....but future outlook positive as raw material prices ease off

Prices of key inputs like palmoil have declined 55% from the peak. LAB (Linear Alkyl Benzene) prices have also softened 9% from the peak. We believe input costs will tend to remain benign for the coming period. Decline in price of raw material will not only improve the operating performance of the company but could also improve the market share in soaps and detergent. However, HUL has also hinted at price cuts in key categories if the raw material prices remain low. We believe high competitive intensity in Soaps and Detergents will prevent any significant margin expansion on sustained basis.

SHARP DECLINE IN PALM OIL PRICES (MALAYSIAN RINGIT/METRIC TONNES)



LAB PRICE TEND LOWER (RS/KG)

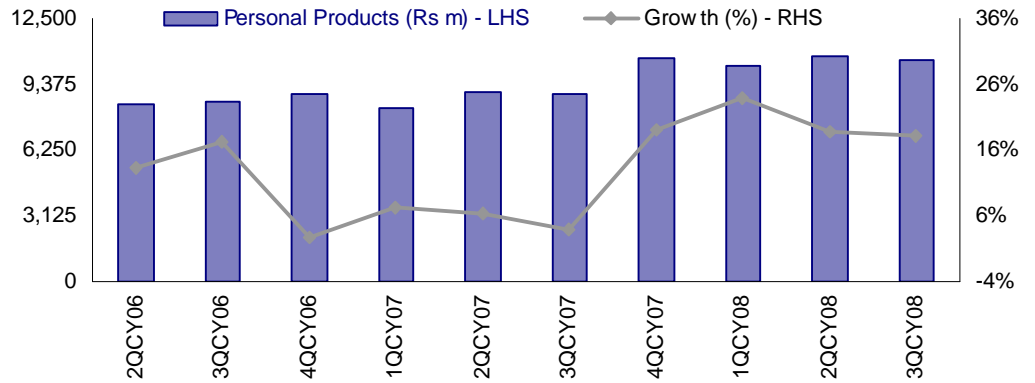


Source: Company/Motilal Oswal Securities

Personal care reports 18% growth; market share declines

Personal care has reported 18% increase in sales and 20.8% increase in PBIT as margins expanded 57bp. HUL reported sequential decline in market share in all of its key categories like hair care, skin care and oral care. Market share in hair care, skin care and oral care declined 40bp, 70bp and 40bp respectively. High-end Ponds range continued to gain ground in high end stores and modern trade channels. We expect personal care volume growth to slow down in 4QCY08 as benefit of lower base effect will be over.

PERSONAL PRODUCTS GROWTH

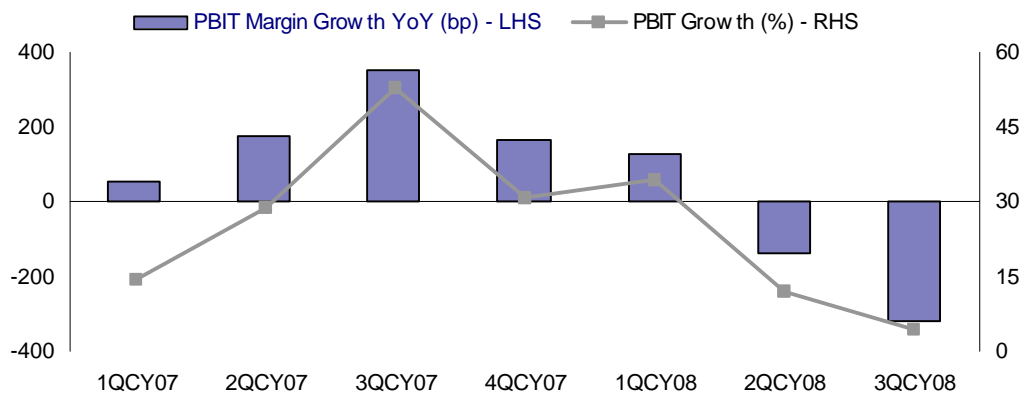


Source: Company/Motilal Oswal Securities

Soaps and detergents – margin declines; volume growth to slowdown

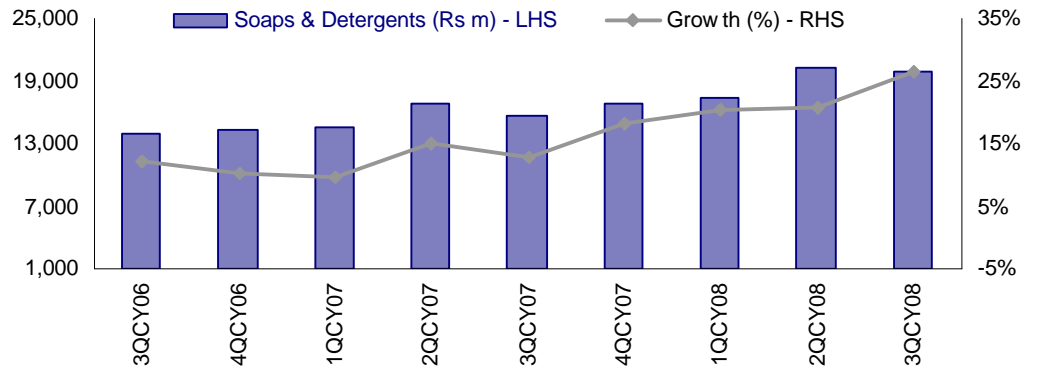
Soaps and Detergents (48% of revenues) reported 26% increase in sales but only 4.5% increase in PBIT as margin declined 279bp. Market share in detergents declined 40bp QoQ to 37.9%, while decline in toilet soaps was steeper by 240bp to 50.3%. Growth in personal wash was price lead with Lux and Lifebouy leading category growth. Detergent reported mid-single digit volume growth with all three brands – Surf, Rin and Wheel doing well.

PBIT GROWTH IN SOAPS AND DETERGENTS CONTINUES TO DECLINE (%)



Source: Company/Motilal Oswal Securities

SOAP AND DETERGENT GROWTH (%)

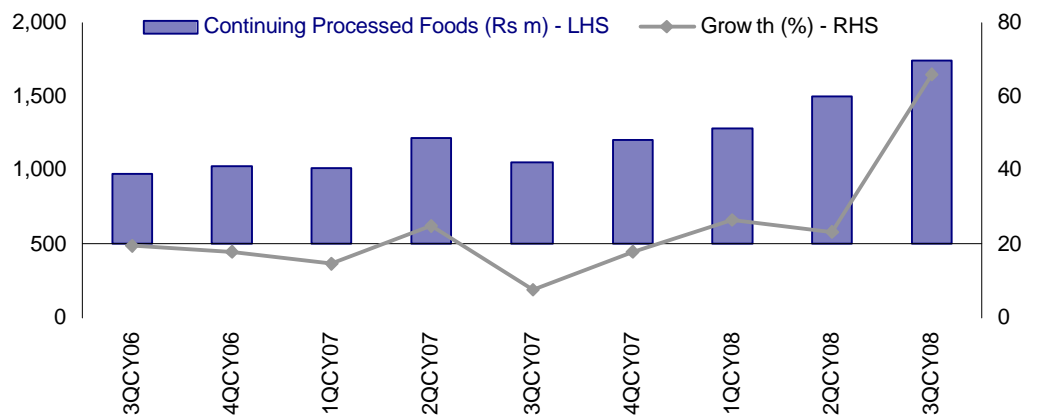


Source: Company/Motilal Oswal Securities

Processed food drives growth in food and beverages

Food and beverages segment reported 18.7% increase in revenue and a 17.7% increase in PBIT on the back of a strong traction in processed food segment. Processed foods posted a 34.5% increase in revenue (adj for Modern Food, it grew 65.7%) and 51% increase in PBIT driven by strong volumes in Knorr and Kissan. Beverages reported 12.9% increase in sales and 13.8% increase in PBIT due to strong performance in both tea and coffee with 10bp and 20bp market share gain.

STRONG GROWTH IN PROCESSED FOODS



Source: Company/Motilal Oswal Securities

Valuation and view

We believe declining consumer confidence and higher base effect in personal care will result in decline in volume growth to 5% in 4QCY08. We expect new food initiatives like Kissan Amze Brainfood, which is still in the test stage, will start contributing after 2-3 years only. We are factoring in 4.9% volume growth for HUL in CY09.

We are increasing sales growth estimates for CY08 to 19.8% from 18.7%. Sales growth for CY09 is estimated at 10.6% (12.6% earlier), which factors in lower volume growth of 4.9% (7.2% earlier). We are now factoring in 80bp EBIDTA margin decline in CY08 and 100bp expansion in CY09 to 12.9% (13.3% earlier) and 13.9% (14% earlier). We are reducing CY08 and CY09 PAT growth estimates by 1.7% and 2%. We now arrive at an EPS of Rs9.2 for CY08 and Rs10.7 for CY09. The stock trades at 24.6x CY08E and 20.9x CY09E earnings. Maintain **Neutral**.

Hindustan Unilever: an investment profile

Company description

HUL 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.
- 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.
- High crude prices would increase material costs.

Recent developments

- Pure IT launch extended to 600 towns

Valuation and view

- We estimate CY08 EPS estimate at Rs9.2 and CY09 EPS estimate at Rs10.7.
- The stock trades at 24.6x CY08 and 20.9x CY09 earnings. 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)	CY08E	24.6	17.7	24.5
	CY09E	20.9	15.2	19.2
EV/EBITDA (x)	CY08E	21.9	11.3	15.7
	CY09E	18.1	9.6	12.3
EV/Sales (x)	CY08E	2.8	3.3	3.2
	CY09E	2.5	2.7	2.7
P/BV (x)	CY08E	26.1	4.4	21.3
	CY09E	21.5	3.8	16.5

SHAREHOLDING PATTERN (%)

	SEP-08	JUN-08	SEP-07
Promoter	52.1	52.1	51.4
Domestic Inst	16.0	15.9	16.8
Foreign	14.2	14.7	13.5
Others	17.8	17.4	18.4

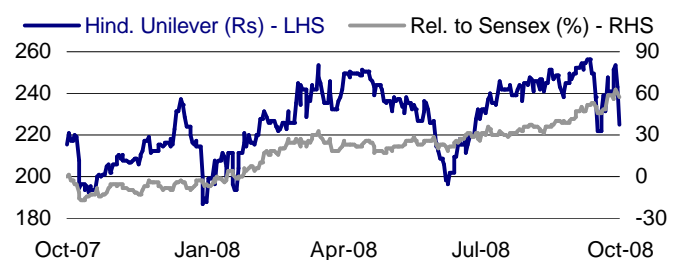
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY08	9.2	9.4	-2.6
CY09	10.7	11.0	-2.4

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
225	226	0.3	Neutral

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E DECEMBER	2005	2006	2007	2008E	2009E	
Net Sales	110,605	121,034	137,178	164,279	181,721	
Change (%)	11.4	9.4	13.3	19.8	10.6	
Total Expenditure	-96,172	-104,553	-118,321	-143,136	-156,506	
EBITDA	14,433	16,481	18,857	21,143	25,215	
Change (%)	0.4	14.2	14.4	2.1	19.3	
Margin (%)	13.0	13.6	13.7	12.9	13.9	
Depreciation	-1,245	-1,302	-1,384	-1,523	-1,578	
Int. and Fin. Charges	-192	-107	-255	-250	-250	
Other Income - Recurring	3,048	3,545	4,627	5,215	5,445	
Profit before Taxes	16,045	18,617	21,845	24,584	28,832	
Change (%)	6.6	16.0	17.3	12.5	17.3	
Margin (%)	14.5	15.4	15.9	15.0	15.9	
Tax	-2,530	-2,952	-3,765	-4,221	-4,923	
Deferred Tax	-410	-268	-389	-443	-519	
Tax Rate (%)	15.8	17.3	19.0	19.0	18.9	
Profit after Taxes	13,105	15,397	17,691	19,920	23,390	
Change (%)	10.6	17.5	14.9	12.6	17.4	
Margin (%)	11.8	12.7	12.9	12.1	12.9	
Non-rec. (Exp)/Income	976	3,157	1,564	1,293	0	
Reported PAT	14,081	18,554	19,255	21,213	23,390	

BALANCE SHEET		(RS MILLION)				
Y/E DECEMBER	2005	2006	2007	2008E	2009E	
Share Capital	2,201	2,207	2,177	2,177	2,177	
Reserves	20,855	25,028	12,215	16,597	20,633	
Net Worth	23,056	27,235	14,392	18,774	22,810	
Loans	569	726	885	726	726	
Capital Employed	23,626	27,961	15,278	19,500	23,536	
Gross Block	23,751	24,627	26,691	27,691	28,691	
Less: Accum. Deprn.	-9,896	-10,619	-11,466	-12,989	-14,567	
Net Fixed Assets	13,855	14,007	15,225	14,702	14,124	
Capital WIP	980	1,103	1,856	1,856	1,856	
Investments	20,142	24,139	14,408	19,068	25,311	
Deferred Charges	2,201	2,245	2,124	2,269	2,424	
Curr. Assets, L&A	27,630	31,697	32,774	40,468	44,751	
Inventory	13,218	15,477	19,536	20,535	22,715	
Account Receivables	5,228	4,404	4,434	5,401	5,974	
Cash and Bank Balance	3,550	4,169	2,009	7,131	7,999	
Others	5,634	7,646	6,796	7,401	8,062	
Curr. Liab. and Prov.	41,183	45,231	51,110	58,863	64,931	
Account Payables	23,450	24,637	28,785	34,353	37,561	
Other Liabilities	11,572	13,369	15,610	16,582	18,119	
Provisions	6,162	7,224	6,716	7,928	9,250	
Net Current Assets	-13,553	-13,534	-18,336	-18,395	-20,180	
Application of Funds	23,626	27,961	15,278	19,500	23,536	

E: MOST Estimates

RATIOS						
Y/E DECEMBER	2005	2006	2007	2008E	2009E	
Basic (Rs)						
EPS	6.0	7.0	8.1	9.2	10.7	
Cash EPS	6.5	7.6	8.8	9.9	11.5	
BV/Share	10.5	12.3	6.6	8.6	10.5	
DPS	5.0	6.0	9.1	6.6	7.6	
Payout %	84.0	86.0	111.7	72.1	70.7	
Valuation (x)						
P/E		32.2	27.7	24.6	20.9	
Cash P/E		29.7	25.7	22.8	19.6	
EV/Sales		3.9	3.5	2.8	2.5	
EV/EBITDA		28.4	25.1	21.9	18.1	
P/BV		18.2	34.0	26.1	21.5	
Dividend Yield (%)		2.7	4.0	2.9	3.4	
Return Ratios (%)						
RoE	56.8	56.5	122.9	106.1	102.5	
RoCE	68.7	67.0	144.7	127.4	123.6	
Working Capital Ratios						
Debtor (Days)	17	13	12	12	12	
Asset Turnover (x)	4.7	4.3	9.0	8.4	7.7	
Leverage Ratio						
Debt/Equity (x)	0.0	0.0	0.1	0.0	0.0	

CASH FLOW STATEMENT		(RS MILLION)				
Y/E DECEMBER	2005	2006	2007	2008E	2009E	
OP/(loss) before Tax	13,189	15,179	17,473	19,620	23,637	
Int./Div. Received	3,048	3,545	4,627	5,215	5,445	
Depreciation and Amort.	1,245	1,302	1,384	1,523	1,578	
Interest Paid	-192	-107	-255	-250	-250	
Direct Taxes Paid	-2,530	-2,952	-3,765	-4,221	-4,923	
(Incr)/Decr in WC	6,030	600	2,641	5,182	2,652	
Change in Deff	-59	44	-122	145	155	
CF from Operations	20,731	17,610	21,983	27,213	28,295	
Extraordinary Items	976	3,157	1,564	1,293	0	
(Incr)/Decr in FA	-645	-998	-2,818	-1,000	-1,000	
(Pur)/Sale of Investments	2,154	-3,997	9,731	-4,660	-6,243	
CF from Invest.	2,485	-1,838	8,478	-4,367	-7,243	
Issue of Shares	0	0	-6,263	0	1	
(Incr)/Decr in Debt	-14,141	157	159	-159	0	
Dividend Paid	-11,006	-15,100	-23,316	-16,807	-19,354	
Others	-1,498	-210	-3,202	-782	-831	
CF from Fin. Activity	-26,645	-15,153	-32,622	-17,724	-20,184	
Incr/Decr of Cash	-3,430	619	-2,161	5,122	868	
Add: Opening Balance	6,980	3,550	4,169	2,009	7,131	
Closing Balance	3,551	4,169	2,008	7,131	7,999	



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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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