



Hindustan Unilever

STOCK INFO.	BLOOMBERG
BSE Sensex: 15,261	HUVR IN
	REUTERS CODE
S&P CNX: 4,440	HLL.BO

30 July 2007

Neutral

Previous Recommendation: Neutral

Rs209

Equity Shares (m)	2,206.8
52-Week Range	263/166
1,6,12 Rel. Perf. (%)	6/-8/-52
M.Cap. (Rs b)	460.7
M.Cap. (US\$ b)	11.3

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	28.1	16.9	56.5	67.0	3.6	26.3
12/07E	136,539	17,752	7.7	10.1	25.5	15.3	60.1	72.1	2.9	22.7
12/08E	149,183	19,187	8.7	13.2	22.5	14.8	65.4	79.4	2.7	19.5

- HUL's 2QCY07 topline growth at 12.9% YoY to Rs34.8b was in line with our estimate. Adjusted PAT was higher at Rs4.7b as against our estimate of Rs4.3b. Gross margins were flat at 46.6%, aided by the benefits of selective price increases and strong currency gains. EBITDA increased 23% YoY, as EBITDA margin expanded 125bp mainly due to a 150bp decline in ad-spend to 9.7% of sales from 11.2% in 1QCY07.
- All the major product categories except personal care witnessed good growth. Soaps and detergents grew 14.6%, while the growth in Beverages, Processed Foods and Ice Cream was 20.9%, 25% and 23.9%, respectively. Personal Care reported yet another quarter of sedate performance, with just 6% sales growth.
- Management has guided that full-year ad-spend would be in line with past trends. Competitive scenario in laundry continues to be challenging although selective price increases and strong currency have been instrumental in preserving the HUL's gross margins. Water project rollout has been extended to 6 states and the management expects to extend it to the rest of the country in the coming year. Operating environment continues to be competitive, as more global brands enter the personal care segment & continued cost inflation in inputs like crude, palm oil & agro-based products.
- The company has announced a buyback of its equity, equivalent to 25% of its networth. Total buyback spend could be a maximum of Rs6.3b and would be through open market purchases at a price not exceeding Rs230/share (17% premium to Friday's closing of Rs196). The buyback price will be viewed as a positive for the stock, in our opinion. We are maintaining our CY07 and CY08 EPS estimates at Rs7.7 and Rs8.7, respectively. The stock trades at 25.5x CY07E and 22.5x CY08E earnings. We maintain **Neutral**.

QUARTERLY PERFORMANCE

(Rs Million)

Y/E DECEMBER	CY06				CY07				CY06	CY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales (incl service inc)	27,981	30,832	30,660	31,561	31,843	34,814	34,350	35,532	121,034	136,539
YoY Change (%)	11.6	8.7	12.2	6.1	13.8	12.9	12.0	12.6	9.4	12.8
Total Expenditure	24,675	26,686	26,631	26,561	28,224	29,695	30,050	30,924	104,553	118,892
EBITDA	3,306	4,146	4,029	5,000	3,620	5,120	4,300	4,608	16,481	17,648
YoY Change (%)	35.8	19.9	17.0	3.8	9.5	23.5	6.7	-7.8	14.2	7.1
Margins (%)	11.8	13.4	13.1	15.8	11.4	14.7	12.5	13.0	13.6	12.9
Depreciation	339	301	320	342	329	333	335	355	1,302	1,352
Interest	21	34	34	18	51	110	15	-97	107	80
Other Income	694	814	968	1,070	908	1,063	1,200	1,403	3,545	4,575
PBT	3,640	4,625	4,643	5,709	4,147	5,739	5,150	5,754	18,617	20,791
Tax	700	833	812	875	809	1,020	970	1,041	3,220	3,840
Rate (%)	19.2	18.0	-17.5	15.3	19.5	18.5	18.8	18.1	-17.3	18.5
Adjusted PAT	2,940	3,793	3,830	4,834	3,339	4,719	4,180	4,713	15,397	16,950
YoY Change (%)	32.4	26.2	17.7	10.2	13.6	24.4	9.1	-2.5	17.5	10.1
Extraordinary Inc/(Exp)	1,489	13	1,377	278	590	212	0	0	3,157	802
Reported Profit	4,429	3,806	5,208	5,112	3,929	4,931	4,180	4,713	18,554	17,752
YoY Change (%)	77.0	35.1	59.8	-1.9	-11.3	29.6	-19.7	-7.8	31.8	-4.3

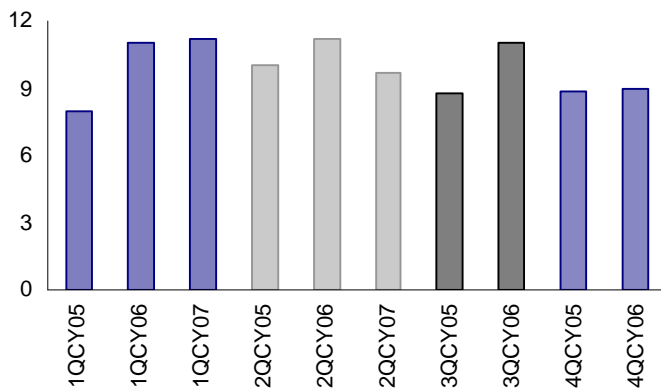
E: MOST Estimates

Lower ad-spend boosts profit margins

HLL's 2QCY07 topline growth at 12.9% was in line with expectations although PAT growth at 24.4% was ahead of expectations. The company maintained gross margins at 46.7%, aided by strong currency and select price increases across product categories. While we have been positively surprised at the gross margin level, EBITDA margins have increased by 130bp, mainly due to lower ad-spend arising from phasing out and lower advertising due to pending renegotiation with one of the prominent channels.

We note that if the advertising had been in line with 1QCY07 levels, EBITDA margins would have declined by 20bp. The management has guided that ad-spends would be competitive and would move towards annual spend levels. We note that the company has plans to re-launch *Fair & Lovely* during 3QCY07. We also expect the company to launch some initiatives in food products by the end of the year, which would require strong advertising push. We are maintaining CY07 ad-spend estimates at 11% of sales.

TREND IN AD-SPEND (% OF SALES)

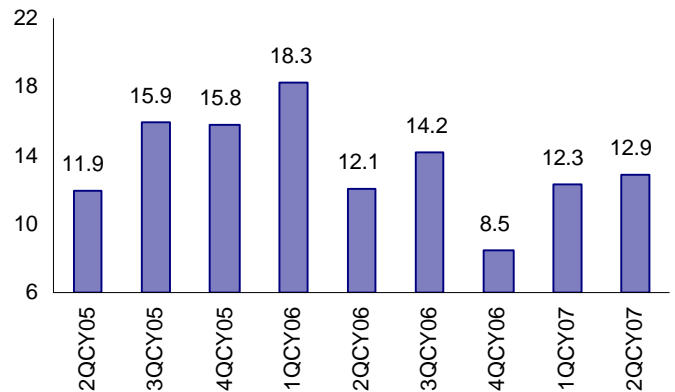


Source: Company/Motilal Oswal Securities

FMCG sales maintain growth trend

FMCG sales increased 12.9% in 2QCY07 as compared to 12.6% growth during 1QCY07. Volume growth during the quarter was 5.9% and the rest was contributed by the increase in realizations. Barring the aberration in 4QCY06, FMCG sales growth has been consistently in double digits. The company has been able to maintain market share in most categories.

TREND IN FMCG SALES GROWTH (%)



Source: Company/Motilal Oswal Securities

VALUE MARKET SHARE (%)

	2QCY06	1QCY07	2QCY07
Detergents	35.3	36.4	37.8
Toilet Soaps	54.6	55.3	54.0
Shampoo	48.0	46.9	47.5
Skin care	54.7	54.8	55.1
Toothpaste	30.2	30.0	30.0
Tea	25.5	23.7	24.3
Coffee	47.7	40.7	47.4

Source: Company/Motilal Oswal Securities

SEGMENTAL BREAK-UP

	2QCY07	2QCY06	CH. %	1HCY07	1HCY06	CH. (%)
Net Sales (Rs M)						
Soaps & Deter.	16,687	14,559	14.6	31,132	27,745	12.2
Personal Products	8,978	8,467	6.0	17,199	16,126	6.7
Beverages	3,633	3,006	20.9	7,338	6,182	18.7
Processed Foods	1,334	973	37.2	2,645	1,855	42.6
Ice Creams	622	505	23.1	944	770	22.7
Exports	3,331	3,287	1.3	6,850	6,042	13.4
Others	637	379	67.9	1,270	719	76.5
EBIT (Rs M)						
Soaps and Deter.	2,684	2,084	28.8	4,428	3,608	22.7
Personal Products	2,632	2,414	9.0	4,662	4,282	8.9
Beverages	569	407	39.7	1,125	1,027	9.5
Processed Foods	-19	42	-146.0	55	45	20.8
Ice Creams	107	109	-2.0	120	117	2.1
Exports	34	156	-78.1	167	236	-29.3
Others	-297	-192	54.2	-454	-243	86.8
EBIT Margin %						
Soaps and Deter.	16.1	14.3		14.2	13.0	
Personal Products	29.3	28.5		27.1	26.6	
Beverages	15.7	13.5		15.3	16.6	
Processed Foods	-1.4	4.3		2.1	2.4	
Ice Creams	17.1	21.5		12.7	15.2	
Exports	1.0	4.7		2.4	3.9	
Others	-46.6	-50.7		-35.7	-33.8	

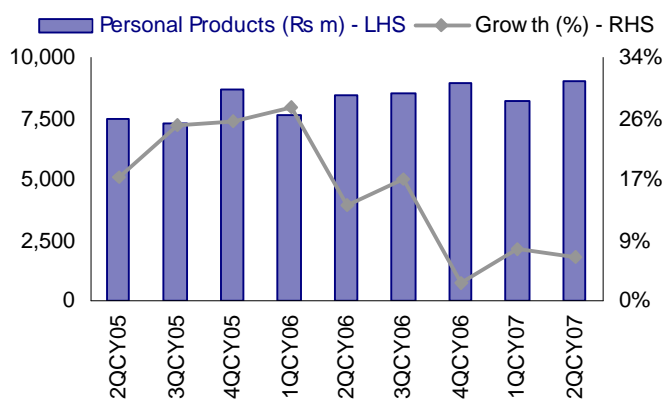
Source: Company/Motilal Oswal Securities

Personal care – low growth phase continues

HLL’s personal care portfolio grew by 6% YoY, single-digit growth for three quarters in a row. De-stocking of inventory ahead of the *Fair & Lovely* re-launch in July has been cited as one of the reasons for low growth. The company has been able to hold on the market shares in most of the segments like shampoos, skin creams and oral care. The company has launched new variants in *Clinic All Clear*, new high-end skin care products in *Ponds* and *Pepsodent Centre Fresh* and shampoos under the *Dove* brand.

While HUL has been able to hold on to its market shares, the company does not seem to be gaining from the rising use of branded personal care products as has been the case with some of the competitors. While the management seems confident regarding the bounce back in growth numbers, we foresee heightened competitive activity across price points. We also expect the competition to gain from the expansion in distribution at the expense of HUL, which might keep sales low for the coming few quarters.

TREND IN PERSONAL PRODUCTS AND GROWTH (%)



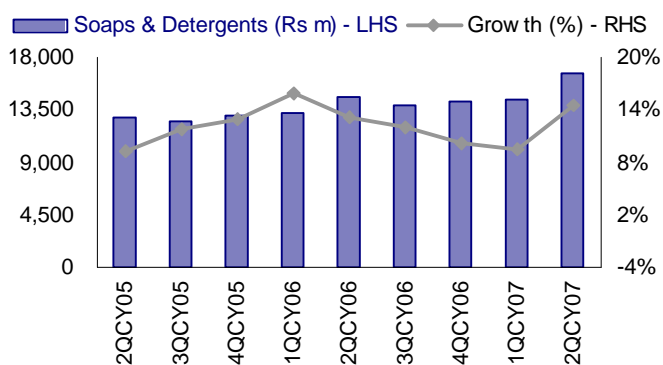
Source: Company/Motilal Oswal Securities

Toilet soaps and detergents – strong bounce back

Toilet soaps and detergents grew by 14.6% in 2QCY07 despite selective price increase undertaken in many brands and change in pack sizes of few others. Toilet soaps brands like *Lux*, *Dove* and *Breeze* did well. The company undertook reduction in pack size of *Lifebuoy* by 8%, the benefits of

which would be reflected during the coming quarters. Laundry continues to be a competitive category although all the brands did well during last quarter. We expect cost pressures to sustain in the Soaps & Detergents segment, as increase in crude and vegetable oil prices would have its impact.

TREND IN SOAPS & DETERGENTS AND GROWTH (%)



Source: Company/Motilal Oswal Securities

Beverages record robust growth

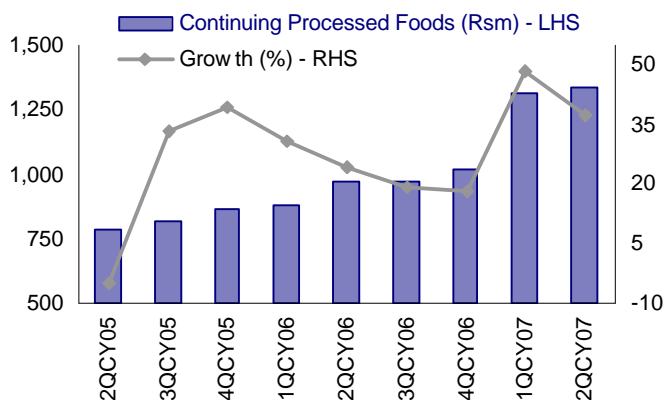
Beverages reported 20.9% increase in sales, backed by strong gains in coffee while all the major tea brands did well. Long-term strategy of the company involves targeting the premium end of the market, with valued-added offerings. We believe that the growth momentum displayed by the beverages business during 2QCY07 is unsustainable, unless the company reduces prices to effectively replace the unorganized sector from the bottom end of the market.

Processed foods and ice creams post strong growth and turnaround

Process Foods business grew by 38% on the back of the merger of Modern Foods business with the company. On a like-to-like basis, the Processed Foods business grew by 25%, with small PBIT loss. Losses were attributed to initial expenses of new ice cream unit in Baddi. All the key brands like *Annapurna*, *Knorr* and *Kwality Walls* contributed to growth. During the quarter, the company launched a Chinese range of foods under *Knorr*. While we do not expect Modern Foods to accelerate growth in the medium term, Ice Creams and *Knorr* range will continue to drive growth. HLL has aggressive plans for food and plans to launch a

slew of new variants under the foods segment. Although the company is showing high growth on a small base, long-term growth would be a function of success of new products in the coming years.

TREND IN PROCESSED FOODS



Source: Company/Motilal Oswal Securities

Buyback of shares seems a positive move

HUL has announced buyback of shares, with a maximum price of Rs230. The company will buy back shares from

open market upto Rs6.3b over the coming 12 months starting from the date of approval by the shareholders, which is expected to be sometime in September. The company will be able to buy back upto 1.5% of the paid up capital. We believe that although the buyback quantum is not large, this a positive move given the strong free cash flows and cash surplus of more than Rs22b with the company.

Valuation and view

HLL is expected to face tough operating environment in the coming quarters. Rising input costs of crude, palm oil and agro-based products could result in a decline in gross margins. Initiatives to launch new products in foods portfolio and rollout of water business will increase costs further. Inflationary pressures coupled with loss of growth momentum in Personal Care business will result in margin decline in the subsequent quarters. The NESAs personal care unit of Assam is facing lockout due to labor unrest. Although the company has tied up with other suppliers, loss of tax benefits on sales from other locations will impact the performance in the coming quarters. The stock trades at 25.5x CY07E and 22.5x CY08E earnings. We 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 two quarters.
- ✂ Food products led by Ice Cream, Beverages and *Knorr* range are growing in high double digits.
- ✂ Margin expansion seems unlikely, as palm oil and crude base inputs prices are rising.

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.
- ✂ Proposed change in the name of the company to Hindustan Unilever Ltd.
- ✂ 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% over CY06-08E.
- ✂ The stock quotes at 25.5x CY07E and 22.5x 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	25.5	21.4	27.7
	CY08E	22.5	18.1	23.7
EV/EBITDA (x)	CY07E	22.7	13.7	16.9
	CY08E	19.5	11.1	14.5
EV/Sales (x)	CY07E	2.9	4.1	3.3
	CY08E	2.7	3.3	2.9
P/BV (x)	CY07E	15.3	5.3	16.5
	CY08E	14.8	4.7	14.9

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	51.4	51.4	51.5
Domestic Inst	16.9	16.5	15.5
Foreign	12.6	12.6	13.9
Others	19.1	19.5	19.2

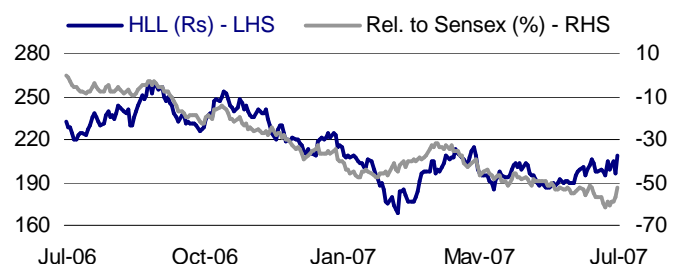
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY07	7.7	9.3	-17.2
CY08	8.7	10.4	-16.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
209	240	15.0	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	2.8	9.3
Total Expenditure	-84,896	-96,172	-104,553	-118,892	-128,823
EBITDA	14,374	14,433	16,481	17,648	20,360
Change (%)	-27.3	0.4	14.2	7.1	15.4
Margin (%)	14.5	13.0	13.6	12.9	13.6
Depreciation	-1,209	-1,245	-1,302	-1,352	-1,402
Int. and Fin. Charges	-1,300	-192	-107	-80	-60
Other Income - Recurring	3,188	3,048	3,545	4,575	4,901
Profit before Taxes	15,053	16,045	18,617	20,791	23,800
Change (%)	-32.9	6.6	16.0	11.7	14.5
Margin (%)	15.2	14.5	15.4	15.2	16.0
Tax	-2,660	-2,530	-2,952	-3,528	-4,255
Deferred Tax	-547	-410	-268	-312	-357
Tax Rate (%)	-21.3	-18.3	-17.3	-18.5	-19.4
Profit after Taxes	11,846	13,105	15,397	16,950	19,187
Change (%)	-32.6	10.6	17.5	10.1	13.2
Margin (%)	11.9	11.8	12.7	12.4	12.9
Non-rec. (Exp)/Income	128	976	3,157	802	0
Reported PAT	11,973	14,081	18,554	17,752	19,187

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	25,998	27,112
Net Worth	20,927	23,056	27,235	28,205	29,318
Loans	14,711	569	726	726	726
Capital Employed	35,638	23,626	27,961	28,931	30,044
Gross Block	23,142	23,751	24,627	25,627	26,627
Less: Accum. Deprn.	-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	29,235	32,422
Deferred Charges	2,260	2,201	2,245	2,392	2,549
Curr. Assets, L&A	33,050	27,630	31,697	32,847	34,541
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	4,177	4,296
Others	6,472	5,634	7,646	7,256	7,381
Curr. Liab. and Prov.	37,143	41,183	45,231	50,301	53,825
Account Payables	20,292	23,450	24,637	27,940	30,273
Other Liabilities	10,773	11,572	13,369	13,870	14,905
Provisions	6,077	6,162	7,224	8,492	8,646
Net Current Assets	-4,093	-13,553	-13,534	-17,455	-19,283
Application of Funds	35,638	23,626	27,961	28,931	30,044

E: MOS Estimates

RATIOS					
Y/E DECEMBER	2004	2005	2006	2007E	2008E
Basic (Rs)					
EPS	5.4	6.0	7.0	7.7	8.7
Cash EPS	5.9	6.5	7.6	8.3	9.3
BV/Share	9.5	10.5	12.3	12.8	13.3
DPS	5.0	5.0	6.0	6.5	7.0
Payout %	92.9	84.0	86.0	84.6	80.5
Valuation (x)					
P/E	38.8	35.1	28.1	25.5	22.5
Cash P/E	35.2	32.0	25.9	23.6	21.0
EV/Sales	4.5	3.9	3.6	2.9	2.7
EV/EBITDA	31.0	30.2	26.3	22.7	19.5
P/BV	22.0	19.9	16.9	15.3	14.8
Dividend Yield (%)	2.4	2.4	2.9	3.1	3.4
Return Ratios (%)					
RoE	56.6	56.8	56.5	60.1	65.4
RoCE	45.9	68.7	67.0	72.1	79.4
Working Capital Ratios					
Debtor (Days)	18	17	13	13	13
Asset Turnover (x)	2.8	4.7	4.3	4.7	5.0
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	16,296	18,958
Int./Div. Received	3,188	3,048	3,545	4,575	4,901
Depreciation and Amort.	1,209	1,245	1,302	1,352	1,402
Interest Paid	-1,300	-192	-107	-80	-60
Direct Taxes Paid	-2,660	-2,530	-2,952	-3,528	-4,255
(Incr)/Decr in WC	-679	6,030	600	3,928	1,948
CF from Operations	12,923	20,789	17,566	22,542	22,894
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	-5,095	-3,188
CF from Invest.	1,650	2,485	-1,838	-5,293	-4,188
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	-16,783	-18,073
Others	-2,320	-1,557	-166	-559	-514
CF from Fin. Activity	-15,659	-26,704	-15,109	-17,342	-18,587
Incr/Decr of Cash	-1,085	-3,430	619	-93	119
Add: Opening Balance	8,065	6,980	3,550	4,169	4,177
Closing Balance	6,980	3,550	4,169	4,077	4,296

N O T E S



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Hindustan Unilever

- | | |
|---|----|
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| 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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