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Stock Rating
Underweight

Industry View
In-Line

Hindustan Unilever

Sharp Increase in Royalty Payment: Downgrade to UW

What's Changed	
Rating	**Equal-weight to Underweight**
Price Target	**Rs510.00 to Rs405.00**
EPS F13e, F14e and F15e	**+4.2%, -6.0%, -11.4%**

HUL's royalty payments to Unilever and tax rate are both jumping. We thus project a F13-F15 earnings CAGR of just 6% – the lowest in our coverage universe. At a F15e P/E of 28x, we find risk-reward unfavorable – switch to OW-rated Dabur and ITC.

We see significant downside from current levels: Although we think consumer industry fundamentals are intact, HUL's earnings upgrade cycle has clearly peaked: Positives (input costs, benign competition, share gains) are largely factored in – and now offset by a ~700bps rise in effective tax rate over the next three years and a step increase in royalty payments to Unilever.

We view the stock as vulnerable to sector rotation and P/E multiple compression: 12-month forward P/E is now 250bps above its three-year average. Investors seeking growth in the Indian consumer staples industry are unlikely to favor HUL as a value pick. We expect P/E to subside below the long-term average. We return to probability-weighted valuation to exhibit the impact of lowered earnings estimates and multiple contraction.

3Q volume growth disappointing; will add to investor concerns: Run-rate in volume growth has been decelerating with Q3 growth at 5% (lowest in three years) despite strong growth in laundry and recovery in CSD channel sales. According to management, sluggish growth in FAL, Dove sachets and Wheel constrained volume growth for the quarter.

HUL's royalty payment to parent to jump 175bps over the next five years: Currently, the net royalty charge for HUL is 1.4% of sales. A new agreement (taking effect 1 February) schedules phased increases to 3.15% of sales by March 2018.

Key Ratios and Statistics

Reuters: HLL.NS Bloomberg: HUVR IN
India Consumer

Price target	Rs405.00
Up/downside to price target (%)	(16)
Shr price, close (Jan 22, 2013)	Rs480.90
52-Week Range	Rs579.60-373.10
Sh out, dil, curr (mn)	2,162
Mkt cap, curr (mn)	Rs1,039,465
EV, curr (mn)	Rs1,021,165
Avg daily trading value (mn)	Rs1,132

Fiscal Year ending	03/12	03/13e	03/14e	03/15e
ModelWare EPS (Rs)	11.92	15.24	16.08	17.26
Prior ModelWare EPS (Rs)	-	14.62	17.12	19.47
Consensus EPS (Rs)§	12.06	14.75	16.95	19.22
Revenue, net (Rs mn)	217,356	252,833	287,391	326,827
EBITDA (Rs mn)	32,944	40,714	45,424	51,703
ModelWare net inc (Rs mn)	25,756	32,939	34,760	37,308
P/E	34.1	31.6	29.9	27.9
P/BV	25.0	23.6	20.4	18.3
RNOA (%)	196.9	150.4	173.5	293.9
ROE (%)	96.8	93.8	78.9	73.2
EV/EBITDA	26.1	24.9	22.0	19.1
Div yld (%)	1.8	2.0	2.3	2.6
FCF yld ratio (%)	3.7	3.2	3.9	4.2
Leverage (EOP) (%)	(52.1)	(62.9)	(78.4)	(91.5)

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

Hindustan Unilever: Financial Summary

HUL: Income Statement

(Rs m, Year Ending Mar)	F2012	F2013E	F2014E	F2015E
Net sales	**217,356**	**252,833 e**	**287,391 e**	**326,827 e**
Raw material Consumed	117,378	135,538 e	154,032 e	173,684 e
Gross Profit	**99,978**	**117,295**	**133,359**	**153,143**
Margin (%)	*46.0%*	*46.4%*	*46.4%*	*46.9%*
Total Operating costs	184,366	212,120	241,967	275,124
Other Operating Income	-46	0	0	0
Operating Profit	**32,944**	**40,714 e**	**45,424 e**	**51,703 e**
Growth (%)	*23%*	*24%*	*12%*	*14%*
Margin (%)	*15.2%*	*16.1% e*	*15.8% e*	*15.8% e*
Interest	12	223 e	223 e	223 e
Depreciation/ amortzn	2,183	2,353	2,507	2,661
Other Income	2,783	5,203 e	4,923 e	5,251 e
Non-recurring income	1,189	0 e	0 e	0 e
Profit before Tax	**34,721**	**43,340**	**47,617**	**54,070**
Income Tax	7,776	10,402 e	12,857 e	16,762 e
Effective Tax Rate (%)	22%	24%	27%	31%
Net Profit	26,914	32,939 e	34,760 e	37,308 e
Net Profit (adjusted)	**25,756**	**32,939 e**	**34,760 e**	**37,308 e**
Growth (%)	*22.3%*	*27.9% e*	*5.5% e*	*7.3% e*
Net Margin	*11.8%*	*13.0% e*	*12.1% e*	*11.4% e*
Modelware EPS	**11.92**	**15.24 e**	**16.08 e**	**17.26 e**
Growth (%)	*23.5%*	*27.8% e*	*5.5% e*	*7.3% e*
DPS	7.50	9.50 e	11.00 e	12.50 e
Payout Ratio (%)	73.1%	72.9% e	80.0% e	84.7% e

Source: Company Data, Morgan Stanley Research

HUL: Balance Sheet

(Rs m, Year Ending Mar)	F2012	F2013E	F2014E	F2015E
Share Capital	2,162	2,162 e	2,162 e	2,162 e
Reserves & Surplus	32,968	41,881 e	48,823 e	54,520 e
Shareholders' Funds	35,129	44,043	50,985	56,681
TOTAL LIABILITIES	**35,129**	**44,043**	**50,985**	**56,681**
Net Fixed Assets	23,631	23,277	22,770	22,109
Investments	24,382	24,382 e	24,382 e	24,382 e
Cash	18,300	27,722 e	39,973 e	51,876 e
Debtors	6,790	8,266 e	9,395 e	10,685 e
Inventory	25,167	31,278 e	35,546 e	40,081 e
Loans & advances	8,820	11,377 e	12,933 e	14,707 e
Other current assets	351	352 e	352 e	351 e
Current liabilities	74,453	84,753	96,508	109,653
Net Current Assets	-33,327	-33,481	-38,283	-43,829
Deferred tax assets	2,142	2,142 e	2,142 e	2,142 e
Total ASSETS	**35,129**	**44,043**	**50,985**	**56,681**

Source: Company Data, Morgan Stanley Research

HUL: Cash Flow Statement

(Rs m, Year Ending Mar)	F2012	F2013E	F2014E	F2015E
Net income reported	26,914	32,939	34,760	37,308
Depreciation	2,183	2,353	2,507	2,661
Chg in working cap	4,353	155	4,802	5,546
Net decrease in inventories	2,941	(6,112)	(4,268)	(4,535)
Net decrease in debtors	2,642	(1,476)	(1,130)	(1,289)
Net decrease in Other Assets	(652)	(2,558)	(1,555)	(1,775)
Net increase in creditors	(2,834)	8,268	8,817	9,793
Net increase in other liab	2,256	2,032	2,937	3,352
Cash flow from operations	33,404	35,447	42,070	45,515
Capital expenditure	(1,234)	(2,000)	(2,000)	(2,000)
Cash flow from investing	(13,009)	(2,000)	(2,000)	(2,000)
LT Debt raised	-	-	-	-
ST debt raised	-	-	-	-
Dividend (incl. tax)	(18,839)	(24,025)	(27,819)	(31,612)
Others	457	-	-	-
Cash flow from financing	(18,380)	(24,025)	(27,819)	(31,612)
Net chg in cash	2,015	9,421	12,251	11,903

Source: Company Data, Morgan Stanley Research

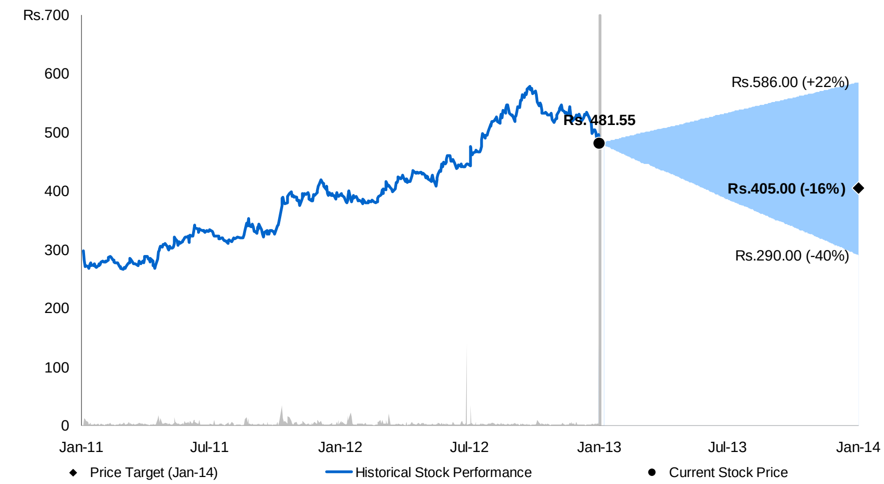
HUL: Ratio Analysis

	F2012	F2013E	F2014E	F2015E
Net sales growth (%)	12.1%	16.3% e	13.7% e	13.7% e
EBITDA growth (%)	22.7%	23.6%	11.6%	13.8%
EBIT margin (%)	14.2%	15.2%	14.9%	15.0%
Return on Avg Equity (%)	83.5%	83.2% e	73.2% e	69.3% e
ROE - Beg Period (%)	96.8%	93.8% e	78.9% e	73.2% e
Sales/Total Assets (x)	6.2	5.7	5.6	5.8
Sales/Net FA (x)	9.2	10.9	12.6	14.8
Debtor turnover (days)	11.4	11.9	11.9	11.9
Inventory turnover (days)	42.3	45.2	45.1	44.8
Net debt/Equity (%)	(52.1%)	(62.9%) e	(78.4%) e	(91.5%) e
EPS	11.9	15.2	16.1	17.3
DPS	7.5	9.5	11.0	12.5
BVPS	16.25	20.38 e	23.59 e	26.22 e
PE	34.1	31.6 e	29.9 e	27.9 e
Div Yield	1.8%	2.0% e	2.3% e	2.6% e
P/BV	25.0	23.6 e	20.4 e	18.3 e
P/sales	4.0	4.1	3.6	3.2
EV/EBITDA	26.1	24.9 e	22.0 e	19.1 e
EV/Sales	4.0	4.0	3.5	3.0

E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

Risk-Reward Snapshot: Hindustan Unilever (HLL.NS, Rs481.55, UW, PT Rs405)

Vulnerable to Sector Rotation and P/E Multiple Compression



Price Target Rs405		Residual income model, probability-weighted (5% bull case, 60% base case, 35% bear case).
Bull Case Rs586	36x base case F2014e EPS	**HUL manages to drive out competition as industry growth inflects:** HUL is able to gain market share across categories over the next 3-5 years and generates strong ~16% revenue CAGR F12-F15e. HUL's margins expand by ~250bps by F2015 driven by mix improvement and improved margin profile of Soaps and Detergents segment (+300bps)
Base Case Rs458	28x base case F2014e EPS	**Relatively strong volume growth and margin expansion:** HUL's revenue continues to outpace the market at 14.5% CAGR F12-F15e, and the company gains further market share from local/regional players over the next 3-5 years. HUL's operating margins compress by ~30bps over F2013e-15e, driven by increase in royalty payments, offset partially by mix improvement. By F15, Personal Products margins remain at F12 (25%) levels whilst Soaps & Detergent margins improve to 13.5%
Bear Case Rs290	18x base case F2014e EPS	**Competitors target new equilibrium market shares as HUL's profitability is impaired:** HUL loses market share over the next five years and records revenue CAGR of ~10%. HUL's margins contract by 20bps pa and stabilize in F24, resulting overall margin contraction of 110bps (vs. F12 levels) at 14.1%.

Why Downgrade to Underweight?

- Increase in royalty payments to Unilever and a sharp increase in tax rate lead us to project a F13-F15 earnings CAGR of merely 6% – the lowest in our coverage universe.
- Current 12-month forward PER is 250bps above the average over the last three years, rendering the stock vulnerable to sector rotation and consequent multiple compression.
- F15e PER is now at an 18% premium to ITC and an 8% discount to JUBI
- Run-rate in volume growth has been decelerating with Q3 growth at 5% (lowest in three years).

Key Value Drivers

- *Personal products:* Acceleration/ deceleration in revenue growth.
- *Market share:* Further gain/loss in market share across all categories.
- *New businesses:* Success or failure in entering new businesses such as packaged foods, water etc.
- *Margin expansion or contraction:* Driven by competitive and cost pressures and mix impact.

Potential Catalysts

- Step up in competitive activity, increased promotion.
- Input cost volatility.
- Volume market share.

Key Upside Risks

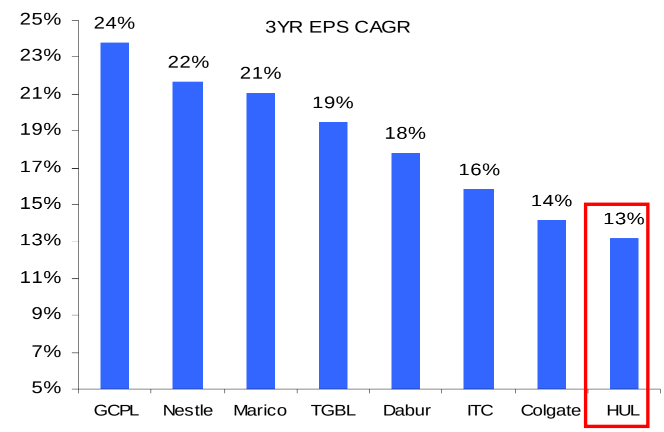
- Benign input environment.
- Sharp recovery in volume growth.
- Continued gains in market share.
- Benign competitive activity.
- Successful portfolio rationalization.

Downgrade to UW: Rise in Royalty Payments a Likely De-rating Catalyst

Unfavorable Risk-Reward at Current Valuations

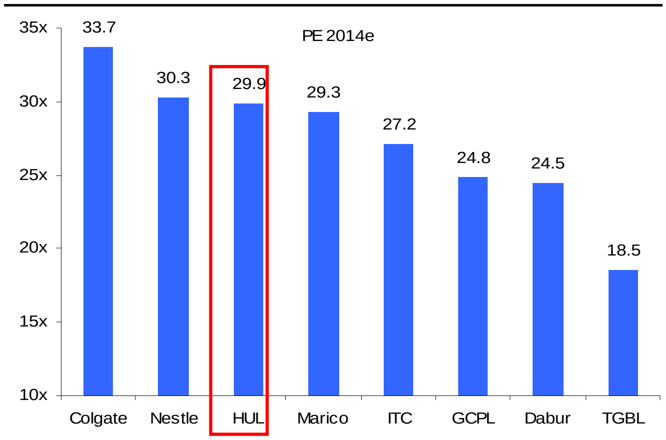
- **Consumer industry fundamentals remain in a sweet spot…** We cite easing input costs, strong volume growth, share gains vs. regional/unorganized players, stable competitive intensity and continuing strong pricing power.
- **…but our base case model does not fully capture several likely investor concerns about HUL:** These include potential rise in competition from regional and unorganized players (following moderation in input costs), volatility in volume growth, and relative value.
- **HUL's earnings upgrade cycle is close to peak:** We note volatility around volume growth trends, sharp increase in tax rates (from 24% to 31% over F13e-15e), and step increase in royalty payouts.
- **Premium valuations…** HUL is trading at 30x F2015e earnings vs. the Morgan Stanley India Consumer average P/E of 27x. F15e PER is now also at an 18% premium to ITC (vs. 10% average premium over the last three years) and only 8% discount to JUBI, which offers 44% three-year EPS CAGR (F13-15e) vs. 6% for HUL.
- **…amidst sluggish earnings growth – we forecast 6% F13-F15 earnings CAGR:** That's the lowest in our coverage universe. In our base case, we factor in F13-F15 volume CAGR of 7-8% – at the upper end of the historical band since 2003 – and 30bps margin compression between F12-F15, driven by increase in royalty payments, offset partially by mix improvement.
- **…and strong trailing operating performance:** Barring the recently reported quarter, HUL's volume growth has been strong amid steep price increases. Overall, it has managed to arrest the decline in market share of its key brands over the last 2-3 years – surprising our expectations and the Street's for volume growth and market share trend.
- **Investors seeking growth in Indian consumer staples are unlikely to favor HUL as a value pick:** We expect valuations to subside below the long-term average.
- **We return to a probability-weighted approach and lower our target price to Rs405:** That implies 16% downside from current levels. At our target price, HUL would trade at 25.5x 12-month forward earnings, marginally below its five-year average of 26x.

Exhibit 1
HUL now offers the lowest three-year earnings CAGR in our consumer coverage universe…



E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

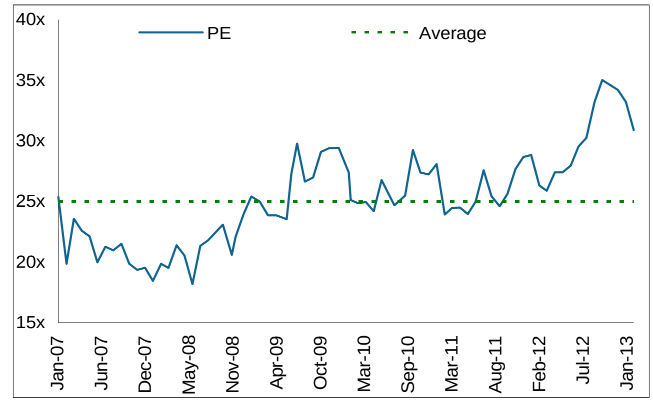
Exhibit 2
…yet it still carries a premium multiple



E = Morgan Stanley Research estimates. Source: Company data, Morgan Stanley Research

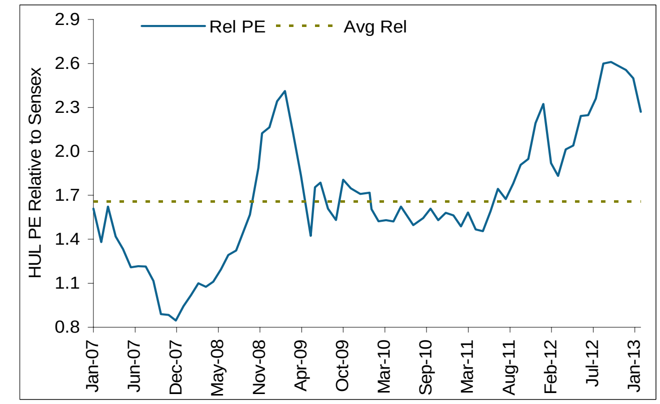
Increase in royalty: Although competitive intensity in the consumer sector is not disruptive, it remains at elevated levels. This combined with volatile volume trends and HUL's focus on market share, would mean that increase in royalties may not be offset by price increases near term. We still factor margin expansion of 70bps F12-F15; however, these estimates are now tempered by 80bps.

Exhibit 3
HUL: Absolute Forward P/E (One-Year)



Source: Thomson Reuters, Morgan Stanley Research

Exhibit 4
HUL: Relative Forward P/E (One-Year) to Sensex



Source: Thomson Reuters, Morgan Stanley Research

Exhibit 5
HUL: Trading at ~38x Implied F14e Personal Products Earnings

Soaps & Detergents

Soaps and Detergents	F 12	F 13e	F 14e
Revenues	106,363	128,944	146,418
Growth	20.9%	21.2%	13.6%
EBIT	12,333	16,763	19,766
EBIT margin	11.6%	13.0%	13.5%
NOPLAT	9,470	12,740	14,430
Tax	2,863	4,023	5,337
Tax rate	23.2%	24.0%	27.0%

DCF Assumptions	
Growth rate during F2015-25E	12.0%
Growth rate post F2025E	6.0%
ROIC during C2015E-25E	80.0%
ROIC after C2025E	60.0%
WACC	12.2%
No. of years in the first period	10
Fair value (Rs. per share)	**150**

Personal Products

PP	F 12	F 13e	F 14e
Revenues	68,459	75,989	87,387
Growth	17.0%	11.0%	15.0%
EBIT	17,446	19,985	22,284
EBIT margin	25.5%	26.3%	25.5%
Tax	4,050	4,796	6,017
Tax rate	23.2%	24.0%	27.0%
PAT	13,396	15,189	16,267
Fair Value		625,254	
HUL Stock Price		496	
Implied value of PP (Rs per share)		289	
PER		38.4	

Other Businesses

Food, Beverage & Ice Cream	F12	F13e	F14e
Revenues			
Food	13,595	15,291	17,349
Beverage	26,174	29,839	33,419
Total	**39,769**	**45,130**	**50,768**
P/S - HUL		2.0	
Fair Value		90,259	
Fair value (Rs. per share)		42	

Others	F 12	F 13e	F 14e
Revenues			
Water	6,364	9,545	10,691
Total	6,364	9,545	10,691
P/S - HUL		2.9	
Fair Value		31,463	
Fair value (Rs. per share)		15	

Source: Company data, Morgan Stanley Research estimates

Estimate Revisions

F2013: We increase our earnings estimates for HUL, driven largely by higher other income reported by the company over the past two quarters.

F2014 and F2015: Our estimates for F14 and F15 include the respective impact of increases in royalty payments to Unilever of 50bps and a presumptive 35bps, plus higher tax rates (27% vs. 25% earlier for F14e and 31% vs. 26% earlier for F15e) as the company's tax benefits come to an end. However, our revised assumption for higher other income limits our estimate cuts.

We believe consensus numbers have yet to incorporate the impact of he higher royalty payments to Unilever and the effect of higher corporate tax rates on the company's earnings.

Exhibit 6

What's Changed

Hindustan Unilever	F2013e			F2014e			F2015e		
	New	Old	% chg	New	Old	% chg	New	Old	% chg
Sales	252,833	251,267	0.6%	287,391	285,095	0.8%	326,827	323,221	1.1%
Operating Profit	40,714	40,922	-0.5%	45,424	48,444	-6.2%	51,703	55,735	-7.2%
Adjusted Net Profit	32,939	31,608	4.2%	34,760	36,995	-6.0%	37,308	42,088	-11.4%
EPS	15.2	14.6	4.2%	16.1	17.1	-6.0%	17.3	19.5	-11.4%

Source: Company Data, Morgan Stanley Research

Exhibit 7

Where we differ from consensus

HUL	EPS			Sales			EBITDA		
	2013	2014	2015	2013	2014	2015	2013	2014	2015
Consensus	15.26	17.54	19.52	265,236	305,121	347,963	40,765	48,004	55,721
Mse	15.24 e	16.08 e	17.26 e	252,833 e	287,391 e	326,827 e	40,714 e	45,424 e	51,703 e
Diff	0%	-8%	-12%	-5%	-6%	-6%	0%	-5%	-7%

Source: Thomson Reuters, Morgan Stanley Research

HUL Increases Royalty Payment to Parent

HUL's board has approved a proposal to enter into a new agreement with its parent for provision of technology, trademark licenses and other services (with effect from 1 February 2013).

Currently, HUL's royalty costs are 1.4% of sales. According to management, the new agreement envisages royalty costs increasing in a phased manner to 3.15% of sales by March 2018. That means an increase of 175bps over the next five years – a 50bps increase in F14 and 30-70bps per annum thereafter from F15 through F18).

Based on our calculations, we believe F15 earnings will be crimped by ~6%, *ceteris paribus*. Following the full impact of increased royalty (by F18) earnings will decline by ~11%, *ceteris paribus*.

Rationale for doing it – there are likely to be both internal and external factors:

- From an internal perspective, Unilever has become more global in its strategies with activities like brand development being driven at a regional level – this may have driven a change in royalty structures.

- External factors would also have played a role. We believe the planned change now brings the royalty structure more in line with current practices amongst HUL's peer group

What is the current structure? HUL currently has two agreements with its parent:

- *Technical Collaboration Agreement (TCA):* Provides payment of 1% royalty on net sales of specific products manufactured with technical inputs developed by Unilever.

- *Trade Mark License Agreement (TMLA):* Provides for payment of trademark royalty at the rate of 1% of net sales on specific brands, where Unilever owns the trademark and HUL is the licensed user.

Currently, the total impact of both these agreements is a royalty cost of 1.4% of turnover.

What is the new structure and implementation schedule?

1) HUL will enter into a new agreement, effective 1 February 2013, with Unilever for the provision of technology, trade mark license and other services.

2) The new agreement envisages that the existing royalty cost of c. 1.4% of turnover will increase, in a phased manner, to a royalty cost of c. 3.15% of turnover no later than the financial year ending 31 March 2018 – i.e. a total estimated increase of 1.75% of turnover.

3) The increase in royalty cost, in the period from 1 February 2013 to 31 March 2014, is estimated to be 0.5% of turnover, and thereafter in a range of 0.3% to 0.7% of turnover in each financial year, leading up to a total estimated royalty cost increase of 1.75% of turnover compared to existing arrangements, no later than the financial year ending 31 March 2018

Q3F13: In-line Results but Disappointing Volume Growth

HUL reported revenue, operating profit and adjusted profit growth of 10%, 12% and 15%, respectively: Our expectations were 8%, 13% and 14%, respectively. Domestic FMCG revenue growth of 15% was driven by 15% growth in HPC and 13% growth in foods segment.

Key Takeaways

1) Volume growth in domestic consumer business at 5% was lower than our and market estimates of ~8% growth, we believe

2) Gross margins declined by 40bps but EBITDA margins expanded by 30bps, respectively.

3) Interestingly advertisement & promotion expenses increased 100bps yoy while other expenses decreased 80bps yoy.

Key Positives

1) Soaps & Detergent (S&D) revenue grew by 20% (3% above our estimates). Double-digit volume growth reported in 'Surf' and 'Rin'.

2) Personal product (PP) margins (28.3%) were 225bps above our estimates for the quarter and the highest in eight quarters.

3) Beverage business revenues (18%) and EBIT margins (17.7%) were 6% and 270bps above our estimates, driven by strong operating performance in the tea segment – extended distribution, effective activation and continued market development.

Key Negatives

1) S&D EBIT margins came in at 12.4% (down 100bps yoy) and 260bps below our expectations. This needs to be viewed in the context of the recent sharp fall in key input costs and lower volume contribution from "Wheel" brand during 3Q.

2) Personal Products revenue growth has disappointed with 13% growth (despite positive base impact) and came in 6% below our estimates

3) Foods business continues to disappoint with revenue growth and profitability trends below estimates.

Management commented, "*In an environment that continued to be challenging, we have delivered another quarter of broad based growth and margin expansion. The business is consistently winning in the marketplace by remaining sharply focused on the needs of our large consumer base and successfully leveraging Unilever's strong global innovation pipeline and best practices.*"

Exhibit 8

HUL: Q3F13 Income Statement

Rs Million	Dec-12	Dec-11	YoY
Net sales	**64,337**	**58,443**	**10.1%**
(Inc)/ dec in stock	834	(274)	-404.6%
Consumption of raw materials	25,519	23,460	8.8%
Purchase of goods	7,838	7,613	3.0%
Gross Profit	**30,146**	**27,644**	**9.1%**
GPM	*46.9%*	*47.3%*	*-40 bps*
Staff costs	3,427	2,741	25.0%
Advertising costs	8,222	6,902	19.1%
Other expenditure	9,821	9,408	4.4%
Expenditure	55,660	49,850	11.7%
Operating profit	8,676	8,593	1.0%
Operational other income	2,211	1,112	98.8%
Operating profit incl operational income	**10,888**	**9,705**	**12.2%**
Margin %	16.9%	16.6%	30 bps
Interest	75	5	1572.2%
Depreciation	593	568	4.3%
Other income	1,337	801	67.0%
Profit before tax	11,557	9,933	16.3%
Tax	2,794	2,312	20.9%
Exceptional items Adjustment	(49)	(83)	
Reported net profit	8,714	7,538	15.6%
Net profit (Adjusted)	**8,762**	**7,621**	**15.0%**
Tax Rate	24.2%	23.3%	90 bps
ASP % of sales	12.8%	11.8%	100 bps

Source: Company data, Morgan Stanley Research
Exceptional items include profit on sale of properties of Rs. 246.5mn (Dec'11: Rs. Nil) and restructuring costs of Rs. 319.3mn (Dec'11: Rs. 123mn. Adjustment also made for Tax credit.

Exhibit 9

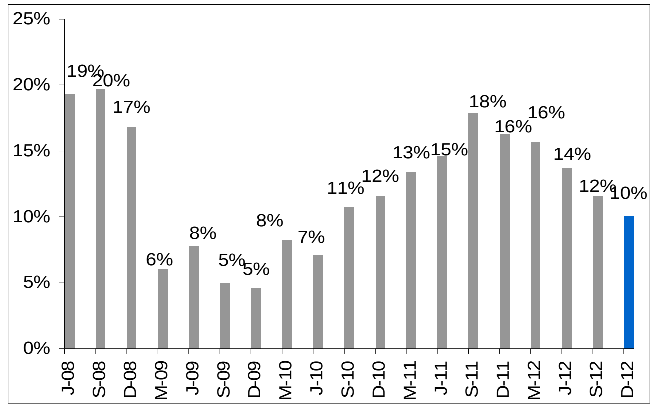
HUL: Q3F13 Segment Analysis

Rs Million	Dec-12	Dec-11	YoY
Segment Revenue			
Soaps and Detergents	31,712	26,481	20%
Personal Products	20,489	18,134	13%
Beverages	7,929	6,709	18%
Packaged Foods	3,301	3,067	8%
Segment Revenue ex Export & Others	63,432	54,391	17%
Others	2,902	5,104	-43%
Total Segment Revenue	**66,334**	**59,495**	**11%**
Less: Inter segment Revenue	-	-	
Net sales/income from operations	66,334	59,495	11%
Domestic FMCG	63,432	54,391	17%
Segment EBIT			
Soaps and Detergents	3,937	3,559	10.6%
Personal Products	5,789	4,865	19.0%
Beverages	1,404	1,052	33.5%
Packaged Foods	(26)	(60)	-55.9%
Segment EBIT ex Export & Others	11,103	9,416	18%
Others	(186)	359	
Total Segment Results	**10,917**	**9,776**	**11.7%**
Less: Interest expense	(75)	(5)	
Add: Unallocable income net	643	38	
Total profit before tax	**11,484**	**9,809**	**17.1%**
EBIT Margins			
Soaps and Detergents	12.4%	13.4%	-102 bps
Personal Products	28.3%	26.8%	142 bps
Beverages	17.7%	15.7%	203 bps
Packaged Foods	-0.8%	-1.9%	115 bps
Segment EBIT ex Export & Others	17.5%	17.3%	19 bps
Others	-6.4%	7.0%	-1346 bps
Total	**16.5%**	**16.4%**	**3 bps**
Capital employed			
Soaps and Detergents	(3,917)	(4,831)	-19%
Personal Products	(2,560)	610	-520%
Beverages	1,089	2,282	-52%
Packaged Foods	2,011	1,850	9%
Others	(294)	961	-131%
Total capital employed in segments	**(3,670)**	**872**	**-521%**
Add: Unallocable corporate assets (net)	37,597	37,656	0%
Total capital employed in company	**33,927**	**38,528**	**-12%**

Source: Company data, Morgan Stanley Research
Note: Total revenues numbers don't match those in exhibit 1 as certain operational other income gets reclassified in segment break up

Exhibit 10

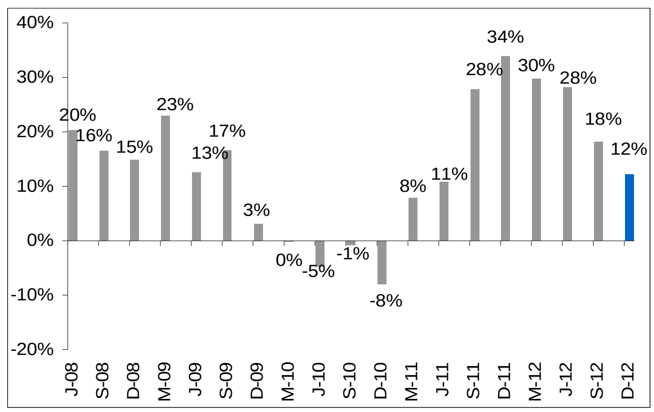
HUL: Quarterly Revenue Growth Trend



Source: Company Data, Morgan Stanley Research

Exhibit 11

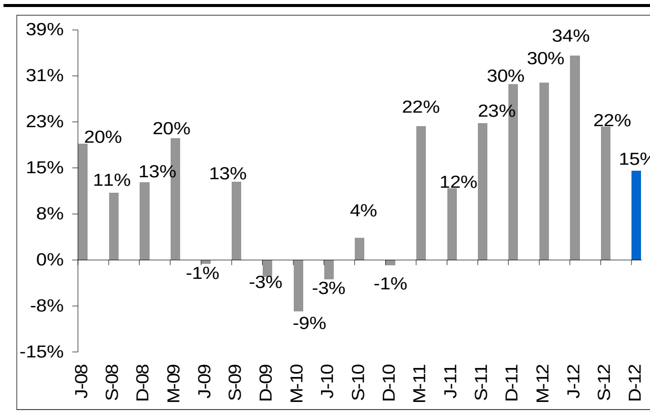
HUL: Operating Profit Growth



Source: Company data, Morgan Stanley Research Note: Operating Profit includes operating income

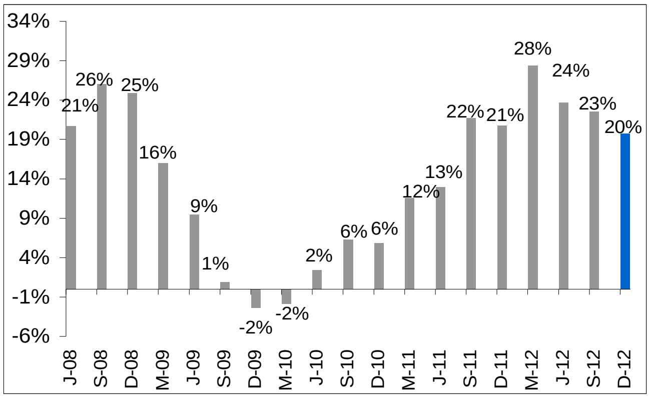
Exhibit 12

HUL: Adjusted Net Profit Growth



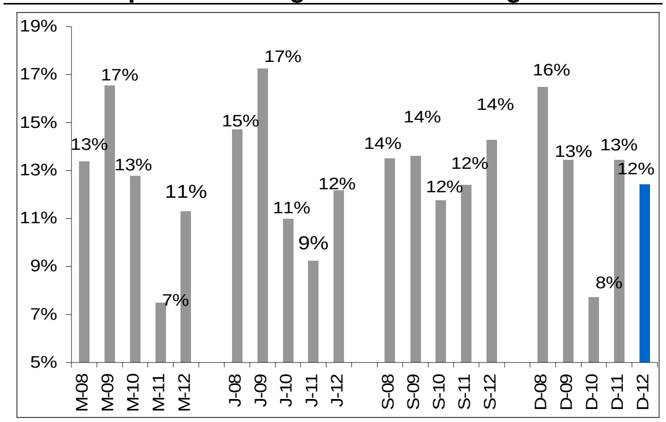
Source: Company data, Morgan Stanley Research

Exhibit 13
HUL: Soaps and Detergents – Revenue Growth



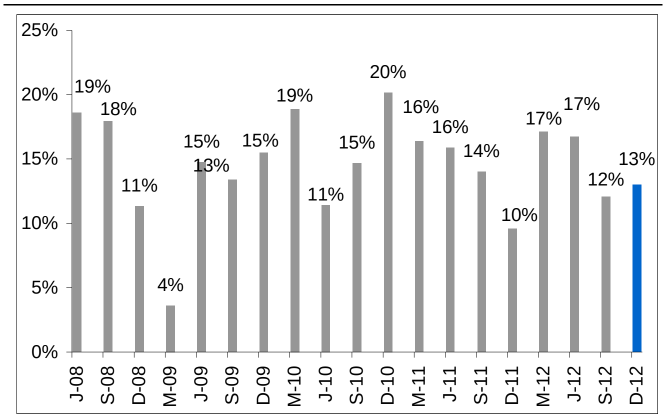
Source: Company Data, Morgan Stanley Research

Exhibit 14
HUL: Soaps and Detergents – EBIT Margins



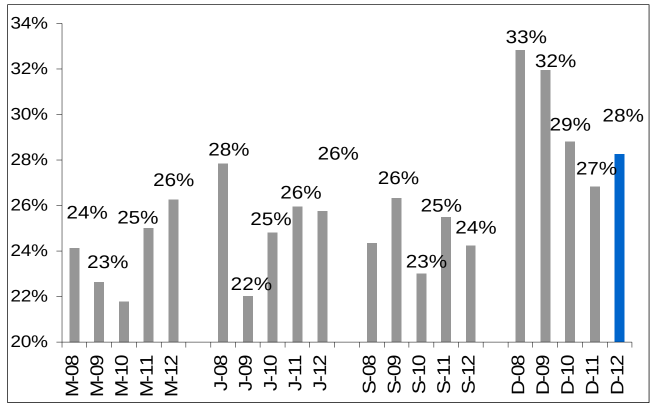
Source: Company Data, Morgan Stanley Research

Exhibit 15
HUL: Personal Products – Revenue Growth



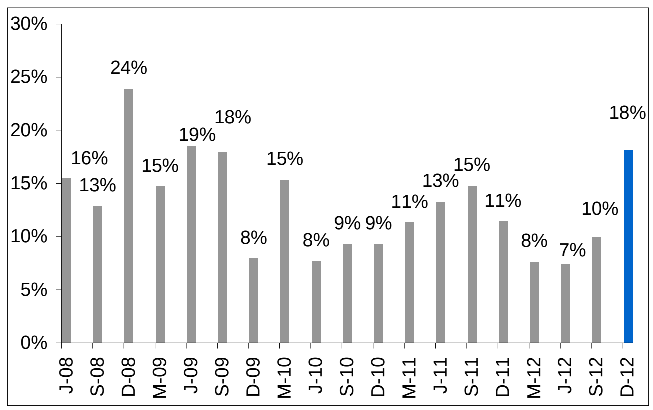
Source: Company data, Morgan Stanley Research

Exhibit 16
HUL: Personal Products – EBIT Margins



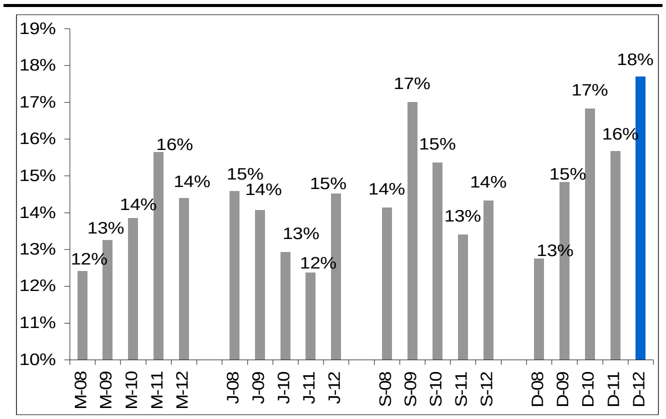
Source: Company Data, Morgan Stanley Research

Exhibit 17
HUL: Beverages – Revenue Growth



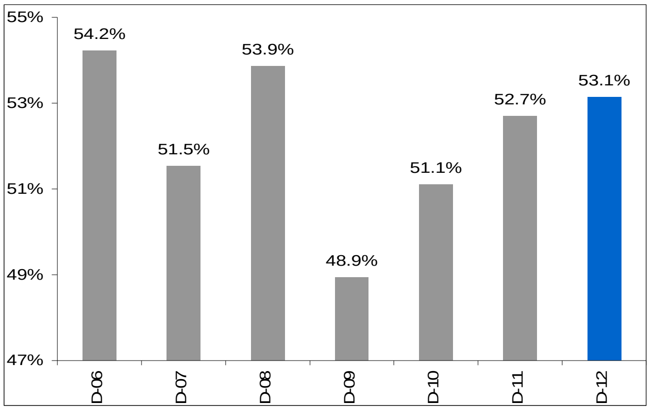
Source: Company Data, Morgan Stanley Research

Exhibit 18
HUL: Beverages – EBIT Margins



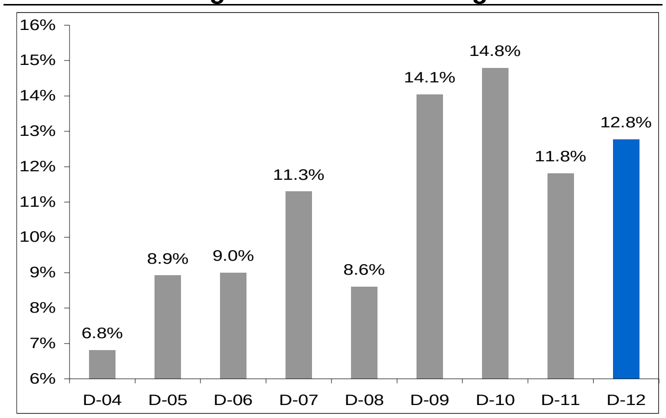
Source: Company Data, Morgan Stanley Research

Exhibit 19
HUL: COGS as a Percentage of Sales



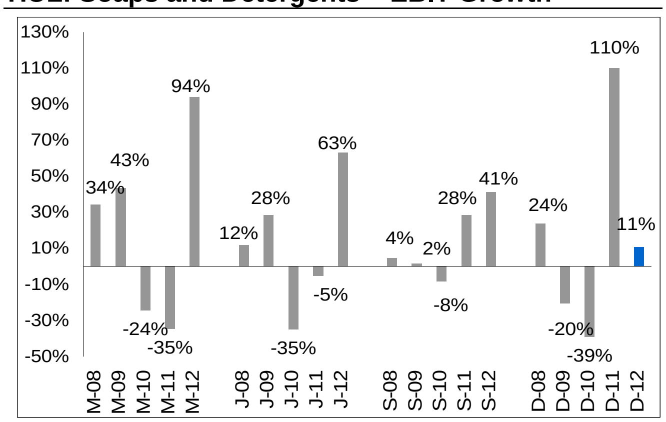
Source: Company Data, Morgan Stanley Research

Exhibit 20
HUL: Advertising Cost as a Percentage of Sales



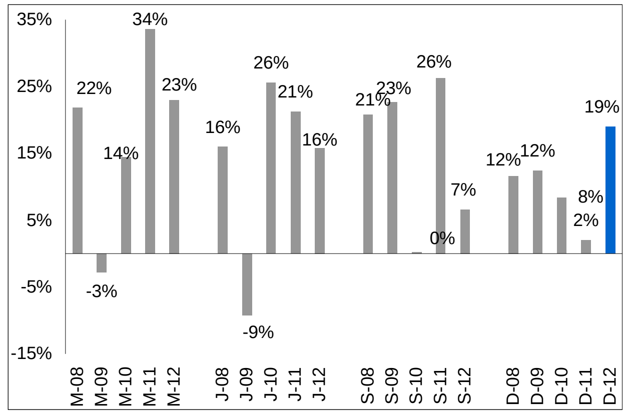
Source: Company Data, Morgan Stanley Research

Exhibit 21
HUL: Soaps and Detergents – EBIT Growth



Source: Company Data, Morgan Stanley Research

Exhibit 22
HUL: Personal Products – EBIT Growth



Source: Company Data, Morgan Stanley Research

HUL: Valuation Methodology and Risk-Reward Framework

We continue to value HUL based on a residual income model: Key assumptions in our base case include:

- 6% terminal growth rate: We increase our terminal growth rate assumption for HUL from 5% based on HUL's ability to innovate and drive growth ahead of the market and gain market share, as reflected over the last 2-3 years.
- 12.2% cost of equity (unchanged)
- Terminal ROE of 70%: This is up from 65%, reflecting our belief that HUL will be able to sustain higher ROEs through better asset turns and higher profit margins.

Whereas we had been using our base case value alone, we now shift back to a probability-weighted approach: We believe this approach provides for a better valuation framework to exhibit the impact of lowered earnings estimates and multiple contraction. We apply the following weights:

- 60% to our base case
- 35% to our bear case: This scenario captures the possibility of severe multiple compression coupled with further downward earnings revision. We see a good probability that it may play out because currently, input costs have plateaued for most consumer companies, and this increases the risk of return of competition from the regional /local/unorganised players (which lost share over the last two years amid onerous inflation). We believe muted earnings growth provides limited headroom for HUL to respond effectively to competitive pressures.
- 5% to our bull case value: We have little visibility into this scenario playing out.

Exhibit 23
HUL: Key Assumptions

Beta	0.70
Risk free rate	8.0%
Market premium	6.0%
Cost of equity	12.2%
Terminal ROE	70.0%
Terminal growth	6.0%
ROE (F11-23e)	71.9%

Source: Company Data, Morgan Stanley Research

Exhibit 24
Price Target Calculation

	Bull	Base	Bear
New Value (Rs/share)	586	458	290
Old Value (Rs/share)	732	510	272
% Change	-20%	-10%	+7%
Probability	5%	60%	35%
Price Target		405	

Source: Company Data, Morgan Stanley Research

Base Case

Relatively strong volume growth and margin expansion: HUL continues to grow ahead of the market at 14.5% CAGR F12-F15e and continues to gain market share from local/regional players over the next 3-5 years. HUL's margins expand by ~70bps by F2015 driven by mix improvement cushioned by increase in royalty payments and competitive intensity across business segments. By F15, Personal Products margins remain at F12 (25%) levels whilst Soaps & Detergent margins improve to 13.5%.

See page 6 for discussion of our new base case estimates for F14 and F15.

Exhibit 25
Base Case Residual Income Value

Intrinsic Value	
Equity Capital, Rs mn	50,985
PV of Forecast Period, Rs mn	471,365
PV of Continuing Value, Rs mn	466,040
Equity Value, Rs mn	988,389
No. of Shares (mn)	2,160
Base Case, Rs per share	458

Source: Company Data, Morgan Stanley Research

Bull Case

HUL manages to drive out competition as industry growth inflects: HUL is able to gain market share across categories over the next 3-5 years and generates strong ~16% revenue CAGR F12-F15e (we previously expected 16.3%). Margins expand in Personal Products as well as Soaps and Detergents. HUL's margins expand by ~250bps by F2015 driven by mix improvement and improved margin profile of Soaps and Detergents segment (+300bps, down from +340 bps.)

In addition to the impact of higher royalty payments and higher tax rates, we have tempered our growth assumptions in the bull case. PAT growth in our bull case falls from an average of 16.9% to 13.8% for F14-F30, a fall of ~20%, which is the impact on our bull case PT as well. The impact on our base case is less severe as average PAT does not compress as much.

Bear Case

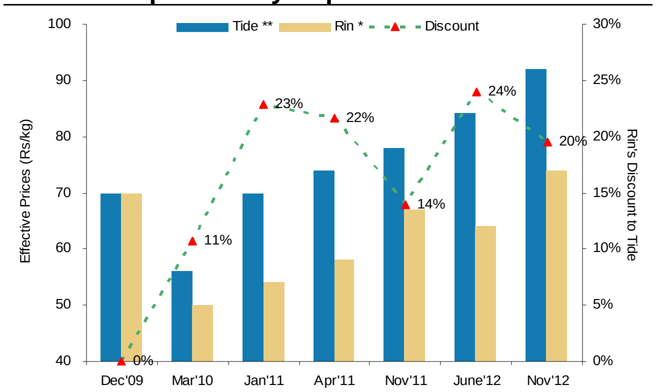
Competitors target new equilibrium market shares as HUL's profitability is impaired: HUL loses market share over the next five years and records revenue CAGR of ~10%. HUL's margins contract by 20bps pa and stabilize in F24, resulting overall margin contraction of 110bps (vs. F12 levels) at 14.1%.

Key Upside Risk – Relatively Benign Competitive Environment

In our view, the competitive intensity from P&G has slowed significantly (following material margin erosion in 2011). HUL, particularly in laundry, is a classic example. The company is clearly determined to defend itself against both P&G and local competitors. The company continues to price its brands at a discount to P&G.

Exhibit 26

HUL: Pricing Rin at an effective discount of 20% to Tide – Low probability of price War



Source: BigBazaar Store Prices, Morgan Stanley Research

It is particularly interesting to note that in a recent consumer conference, P&G indicated a shift in strategy. From addressing white space opportunities across categories and markets, it will implement a more focused approach, targeting the top 40 largest and most profitable businesses, the 20 largest and most promising innovations, and the 10 most important developing markets. India will form a part of this developing market strategy, but here is no business in India that features on the top 40 list.

Exhibit 27

P&G: India Does Not Feature in the Top 40 Businesses Globally

Country / Category	2011 Sales Mix	Country / Category	2011 Sales Mix
USA Mass Cosmetics	4.3%	Japan Premium Cosmetics	0.8%
USA Laundry Detergents	3.0%	UK Laundry Detergents	0.8%
China Mass Cosmetics	2.6%	Brazil Hair Care	0.7%
USA Hair Care	1.8%	USA Colour Cosmetics	0.7%
USA Toilet Paper	1.6%	Japan Hair Care	0.7%
USA Nappies/Diapers/Pants	1.6%	Brazil Nappies/Diapers/Pants	0.7%
USA Kitchen Towels	1.4%	Canada Mass Cosmetics	0.7%
Brazil Men's Shaving	1.4%	USA Deodorants	0.7%
China Nappies/Diapers/Pants	1.4%	Russia Laundry Detergents	0.7%
China Hair Care	1.3%	Germany Mass Cosmetics	0.7%
USA Men's Shaving	1.3%	USA Premium Cosmetics	0.7%
UK Mass Cosmetics	1.1%	USA Skin Care	0.6%
USA OTC	1.0%	Mexico Mass Cosmetics	0.6%
USA Sanitary Protection	0.9%	USA Toothpaste	0.6%
China Skin Care	0.9%	Mexico Laundry Detergents	0.6%
USA Dishwashing	0.9%	USA Wipes	0.6%
Brazil Mass Cosmetics	0.8%	China Laundry Detergents	0.6%
Japan Laundry Detergents	0.8%	USA Toothbrushes	0.5%
Japan Mass Cosmetics	0.8%	USA Men's Toiletries	0.5%
USA Fabric Softeners	0.8%	UK Hair Care	0.5%

Source: Euromonitor

Other Upside Risks to Price Target:

1. *Sharp recovery in volume growth and gains in market share:* HUL is able to drive strong volume growth through successful brand launches and distribution strength.

2. *Successful portfolio rationalization:* HUL is able to turn around its Foods business, especially the Knorr brand. Successful product rationalization would improve the company's margin profile.

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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Equal-weight/Hold	**1301**	**44%**	**497**	**46%**	**38%**
Not-Rated/Hold	**108**	**4%**	**27**	**3%**	**25%**
Underweight/Sell	**478**	**16%**	**111**	**10%**	**23%**
Total	**2,990**		**1071**		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

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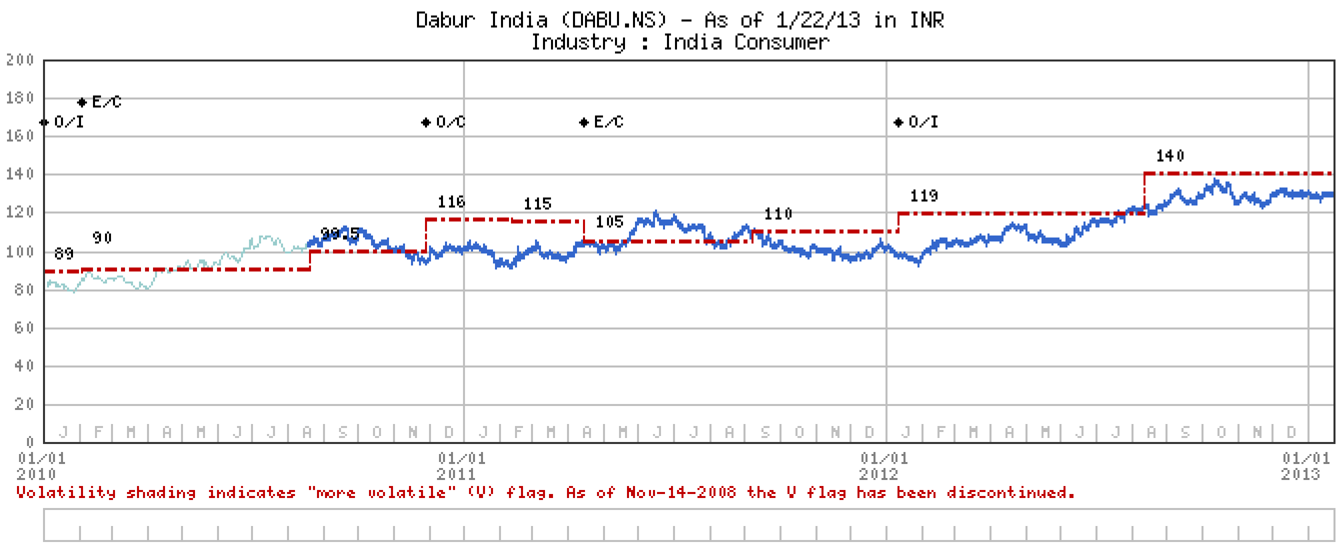
Stock Price, Price Target and Rating History (See Rating Definitions)

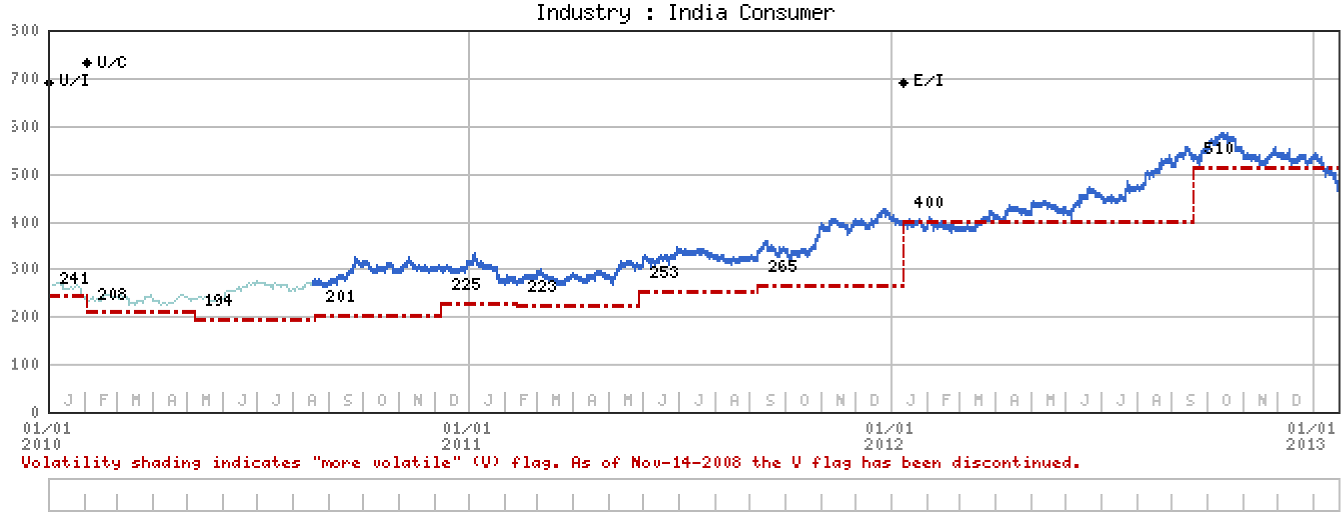


Stock Rating History: 1/1/10 : O/I; 2/3/10 : E/C; 11/29/10 : O/C; 4/15/11 : E/C; 1/12/12 : O/I

Price Target History: 11/9/09 : 89; 2/3/10 : 90; 8/20/10 : 99.5; 11/29/10 : 116; 2/11/11 : 115; 4/15/11 : 105; 9/8/11 : 110; 1/12/12 : 119; 8/13/12 : 140

Source: Morgan Stanley Research   Date Format : MM/DD/YY   Price Target   No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst)   Stock Price (Covered by Current Analyst)
Stock and Industry Ratings (abbreviations below) appear as ◆ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Hindustan Unilever (HLL.NS) - As of 1/22/13 in INR
Industry : India Consumer



Stock Rating History: 1/1/10 : U/I; 2/3/10 : U/C; 1/12/12 : E/I

Price Target History: 11/9/09 : 241; 2/3/10 : 208; 5/7/10 : 194; 8/20/10 : 201; 12/7/10 : 225; 2/11/11 : 223; 5/28/11 : 253; 9/8/11 : 265; 1/12/12 : 400; 9/19/12 : 510

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
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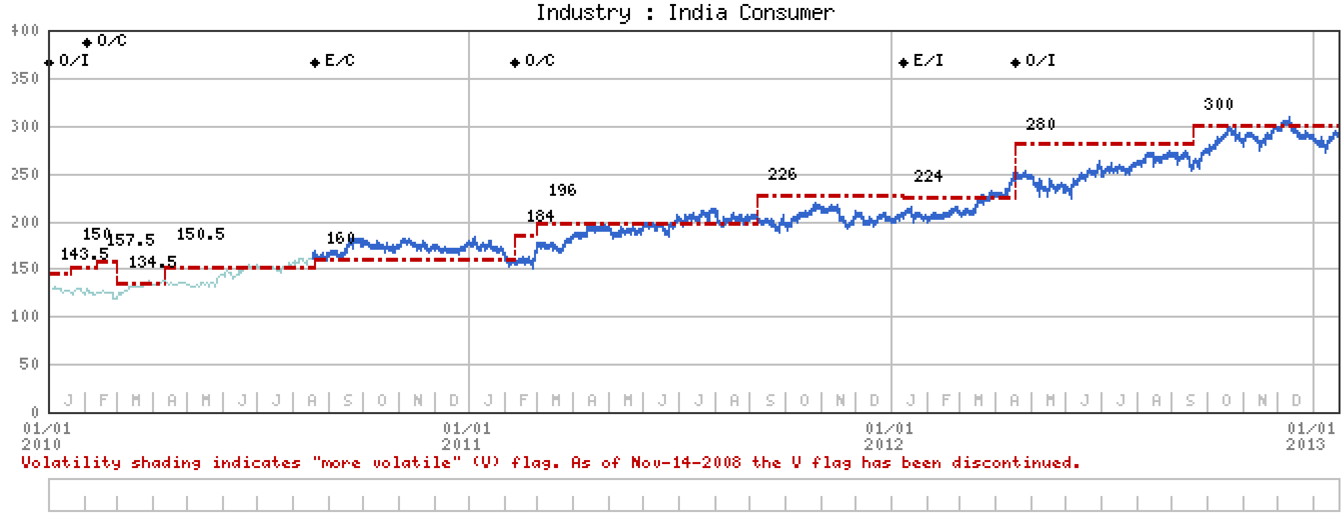
Industry : India Consumer



Stock Rating History: 1/1/10 : O/I; 2/3/10 : O/C; 8/20/10 : E/C; 2/10/11 : O/C; 1/12/12 : E/I; 4/18/12 : O/I

Price Target History: 11/9/09 : 143.5; 1/20/10 : 150; 2/11/10 : 157.5; 3/1/10 : 134.5; 4/12/10 : 150.5; 8/20/10 : 160; 2/10/11 : 184; 3/1/11 : 196; 9/8/11 : 226; 1/12/12 : 224; 4/18/12 : 280; 9/19/12 : 300

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ▬
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Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
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Industry Coverage:India Consumer

Company (Ticker)	Rating (as of)	Price* (01/22/2013)
Girish Achhipalia		
Asian Paints (ASPN.NS)	O (01/16/2013)	Rs4,413.05
Nillai Shah		
Colgate-Palmolive India (COLG.NS)	E (01/12/2012)	Rs1,483.8
Cox & Kings Ltd (COKI.NS)	O (11/30/2010)	Rs131.6
Dabur India (DABU.NS)	O (01/12/2012)	Rs129.75
Godrej Consumer Products Limited (GOCP.NS)	O (01/12/2012)	Rs704.1
Hindustan Unilever (HLL.NS)	U (01/23/2013)	Rs480.9
ITC Ltd. (ITC.NS)	O (04/18/2012)	Rs289.15
Jubilant Foodworks Ltd (JUBI.NS)	E (11/05/2012)	Rs1,266.05
Marico Limited (MRCO.NS)	O (01/12/2012)	Rs224.1
Nestle India (NEST.NS)	O (01/12/2012)	Rs4,700.75
Tata Global Beverages Ltd (TAGL.NS)	U (11/19/2012)	Rs151.85
United Spirits Ltd (UNSP.NS)	++	Rs1,761

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