

# Volume momentum to continue; re-instate with Buy

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## Re-instate with Buy; PO of Rs360

Hindustan Unilever, a subsidiary of Unilever Plc, is India's largest Fast Moving Consumer Goods Company (FMCG excl cigarette). We reinstate coverage at Buy and a PO of Rs360. Our PO is based on a target of 26x 1yr fwd PE that is in line with its current multiple and validated by DCF. This is at 10% premium to ITC's target PE- justified given HUL's higher RoE and a converging growth differential.

## Strong volume growth to continue

Post a shift in strategy in 2009 from 'preserving margins' to 'profitable volume growth', HUL volumes grew 8% to 14% yoy for the past six quarters. We expect volumes to continue to grow at ~10% led by i) increased reach especially in [rural India](#), ii) growth in personal products segment and iii) focus on modern trade .

## Upside pot'l to estimates; Domestic focus limits global risk

Our 15% EPS CAGR over FY11E-13E is led by: i) 11% revenue growth and ii) 120bp margin improvement due to selective price increases and faster growth of high margin personal products. Positive margin surprise in case of a strong correction in commodity prices can provide upside potential in medium term. Demand risk due to any global slowdown is limited as HUL derives over 90% revenue domestically.

## Current multiples can sustain given resumed growth

Post a 23% YTD outperformance, HUL trades at 26x 1yr fwd PE which is in line with 5yr historical avg despite higher growth and hence is conservative. We expect current multiple to sustain led by robust volume uptick, improving margins and better RoE. Key risks: i) competitive intensity can drive HUL to up A&P spends, pressuring margins and ii) failure in monsoon can impact rural demand.

## Stock Data

|                             |                      |
|-----------------------------|----------------------|
| Price                       | Rs320.50             |
| Price Objective             | Rs360.00             |
| Date Established            | 9-Sep-2011           |
| Investment Opinion          | C-1-7                |
| Volatility Risk             | HIGH                 |
| 52-Week Range               | Rs264.45-Rs348.00    |
| Mrkt Val / Shares Out (mn)  | US\$14,992 / 2,159.5 |
| Average Daily Volume        | 3,048,591            |
| BofAML Ticker / Exchange    | HINLF / NSI          |
| Bloomberg / Reuters         | HUVR IN / HLL.NS     |
| ROE (2012E)                 | 88.3%                |
| Net Dbt to Eqty (Mar-2011A) | -62.3%               |
| Est. 5-Yr EPS / DPS Growth  | 15.0% / 15.0%        |
| Free Float                  | 49.0%                |

## Estimates (Mar)

| (Rs)                       | 2010A  | 2011A  | 2012E  | 2013E  | 2014E  |
|----------------------------|--------|--------|--------|--------|--------|
| Net Income (Adjusted - mn) | 21,027 | 21,533 | 24,673 | 28,349 | 32,530 |
| EPS                        | 9.64   | 9.97   | 11.43  | 13.13  | 15.06  |
| EPS Change (YoY)           | 0.4%   | 3.5%   | 14.6%  | 14.9%  | 14.7%  |
| Dividend / Share           | 6.98   | 6.58   | 8.57   | 10.50  | 12.80  |
| Free Cash Flow / Share     | 14.40  | 9.08   | 12.56  | 15.08  | 16.80  |

## Valuation (Mar)

|                       | 2010A  | 2011A  | 2012E  | 2013E  | 2014E  |
|-----------------------|--------|--------|--------|--------|--------|
| P/E                   | 33.26x | 32.14x | 28.05x | 24.41x | 21.28x |
| Dividend Yield        | 2.18%  | 2.05%  | 2.67%  | 3.28%  | 3.99%  |
| EV / EBITDA*          | 22.50x | 22.79x | 19.83x | 17.26x | 15.02x |
| Free Cash Flow Yield* | 4.54%  | 2.83%  | 3.92%  | 4.71%  | 5.24%  |

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 26.

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Refer to important disclosures on page 27 to 29. Analyst Certification on Page 25. Price Objective Basis/Risk on page 25. Link to Definitions on page 25.11086804

# iQprofile<sup>SM</sup> Hindustan Unilever

| Key Income Statement Data (Mar)          | 2010A   | 2011A   | 2012E   | 2013E   | 2014E   |
|--|---------|---------|---------|---------|---------|
| <b>(Rs Millions)</b>                     |         |         |         |         |         |
| Sales                                    | 177,659 | 196,945 | 217,922 | 240,889 | 266,603 |
| Gross Profit                             | 29,521  | 29,150  | 33,494  | 38,479  | 44,214  |
| Sell General & Admin Expense             | NA      | NA      | NA      | NA      | NA      |
| Operating Profit                         | 28,052  | 27,356  | 31,558  | 36,382  | 41,933  |
| Net Interest & Other Income              | (982)   | (54)    | 75      | 197     | 313     |
| Associates                               | NA      | NA      | NA      | NA      | NA      |
| Pretax Income                            | 27,071  | 27,302  | 31,632  | 36,579  | 42,246  |
| Tax (expense) / Benefit                  | (6,044) | (5,769) | (6,959) | (8,230) | (9,717) |
| Net Income (Adjusted)                    | 21,027  | 21,533  | 24,673  | 28,349  | 32,530  |
| Average Fully Diluted Shares Outstanding | 2,182   | 2,160   | 2,160   | 2,160   | 2,160   |

## Key Cash Flow Statement Data

|   |          |          |          |          |          |
|---|----------|----------|----------|----------|----------|
| Net Income                              | 21,027   | 21,533   | 24,673   | 28,349   | 32,530   |
| Depreciation & Amortization             | 1,469    | 1,794    | 1,936    | 2,097    | 2,281    |
| Change in Working Capital               | 12,975   | (3,130)  | 3,024    | 4,627    | 3,960    |
| Deferred Taxation Charge                | NA       | NA       | NA       | NA       | NA       |
| Other Adjustments, Net                  | 993      | 1,527    | 0        | 0        | 0        |
| Cash Flow from Operations               | 36,463   | 21,724   | 29,633   | 35,072   | 38,770   |
| Capital Expenditure                     | (5,041)  | (2,116)  | (2,500)  | (2,500)  | (2,500)  |
| (Acquisition) / Disposal of Investments | (9,315)  | 34       | 0        | 0        | 0        |
| Other Cash Inflow / (Outflow)           | NA       | NA       | NA       | NA       | NA       |
| Cash Flow from Investing                | (14,355) | (2,082)  | (2,500)  | (2,500)  | (2,500)  |
| Shares Issue / (Repurchase)             | 2        | (22)     | 0        | 0        | 0        |
| Cost of Dividends Paid                  | (17,827) | (16,556) | (21,466) | (26,307) | (32,074) |
| Cash Flow from Financing                | (22,044) | (16,578) | (21,466) | (26,307) | (32,074) |
| Free Cash Flow                          | 31,423   | 19,608   | 27,133   | 32,572   | 36,270   |
| Net Debt                                | (18,922) | (16,400) | (22,068) | (28,332) | (32,529) |
| Change in Net Debt                      | (4,283)  | (3,064)  | (5,668)  | (6,265)  | (4,196)  |

## Key Balance Sheet Data

|                               |        |         |         |         |         |
|-------------------------------|--------|---------|---------|---------|---------|
| Property, Plant & Equipment   | 24,361 | 24,682  | 25,246  | 25,649  | 25,868  |
| Other Non-Current Assets      | 15,129 | 14,703  | 14,703  | 14,703  | 14,703  |
| Trade Receivables             | 6,716  | 9,432   | 10,896  | 10,840  | 11,997  |
| Cash & Equivalents            | 18,922 | 16,400  | 22,068  | 28,332  | 32,529  |
| Other Current Assets          | 28,040 | 35,120  | 38,354  | 42,397  | 46,922  |
| Total Assets                  | 93,167 | 100,338 | 111,267 | 121,921 | 132,019 |
| Long-Term Debt                | 0      | 0       | 0       | 0       | 0       |
| Other Non-Current Liabilities | 0      | 0       | 0       | 0       | 0       |
| Short-Term Debt               | NA     | NA      | NA      | NA      | NA      |
| Other Current Liabilities     | 67,332 | 73,998  | 81,721  | 90,334  | 99,976  |
| Total Liabilities             | 67,332 | 73,998  | 81,721  | 90,334  | 99,976  |
| Total Equity                  | 25,835 | 26,339  | 29,547  | 31,588  | 32,043  |
| Total Equity & Liabilities    | 93,167 | 100,338 | 111,268 | 121,921 | 132,019 |

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

|                            |       |       |       |       |        |
|----------------------------|-------|-------|-------|-------|--------|
| Return On Capital Employed | 90.5% | 90.3% | 95.1% | 98.6% | 107.6% |
| Return On Equity           | 90.5% | 82.5% | 88.3% | 92.7% | 102.2% |
| Operating Margin           | 15.8% | 13.9% | 14.5% | 15.1% | 15.7%  |
| EBITDA Margin              | 16.6% | 14.8% | 15.4% | 16.0% | 16.6%  |

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

|                          |        |        |        |        |         |
|--------------------------|--------|--------|--------|--------|---------|
| Cash Realization Ratio   | 1.7x   | 1.0x   | 1.2x   | 1.2x   | 1.2x    |
| Asset Replacement Ratio  | 3.4x   | 1.2x   | 1.3x   | 1.2x   | 1.1x    |
| Tax Rate (Reported)      | 22.3%  | 21.1%  | 22.0%  | 22.5%  | 23.0%   |
| Net Debt-to-Equity Ratio | -73.2% | -62.3% | -74.7% | -89.7% | -101.5% |
| Interest Cover           | NM     | NM     | NM     | NM     | NM      |

## Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 26.

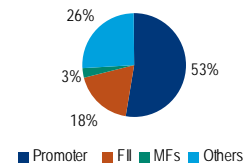
## Company Description

HUL, a 53% subsidiary of Unilever, is largest Indian Fast Moving Consumer Goods Company (FMCG excl cigarette). It has a portfolio of over 50 brands across categories such as soaps, detergents, foods, ice cream and water purifiers. It has about 15,000 employees. Key strengths are extensive distribution network (its products are available in over 6mn outlets), powerful brands (most of its brands are market leaders and straddle price segments), strong balance sheet, and high-quality management.

## Investment Thesis

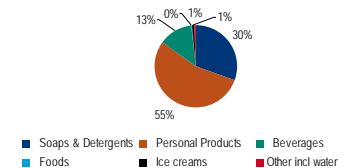
Our Buy on HUL is led by resumption in the strong volume growth due to higher reach and growth in relatively under-penetrated personal products. Margins are expected to improve on the back of improving product mix and selective price increases. Risk to earnings from global slowdown is limited as HUL derives over 90% of revenue from domestic markets. We expect current multiple to sustain led by this.

## Chart 1: Shareholding pattern (Jun 11)



Source:NSE

## Chart 2: Earnings profile (FY11)



Source:Company

## Stock Data

Price to Book Value 23.4x

## Bull Bear case

### Bull & Bear case

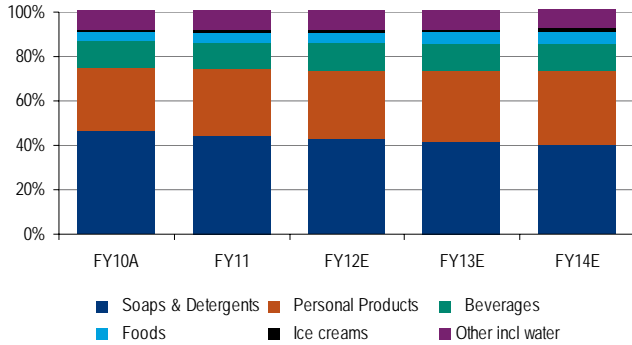
| Theme                | Bull case  | Bear case   | BofAML view  |
|----------------------|--|---|--|
| <b>Volume growth</b> | <ul style="list-style-type: none"> <li>With focus on volume growth, HUL can grow volumes at ~10% yoy led by i) increased reach and ii) stabilizing A&amp;P spends at 14% of revenue.</li> <li>White-space opportunities like fabric softeners, liquid soaps etc can lead to strong growth in pockets of the portfolio.</li> <li>In urban areas, HUL is developing strategic relationships with Modern Trade formats by way of co-branding, co-development of products, etc. This will help maintain volume growth as modern trade grows in urban India.</li> </ul> | <ul style="list-style-type: none"> <li>While HUL's volume growth has remained strong post a change in the corporate strategy, competitive intensity can limit market share gains. Given this volume growth is not sustainable</li> </ul>  | <ul style="list-style-type: none"> <li>While competitive intensity will remain high, especially in soaps, detergents and shampoos that witness high penetration, volume growth will be led by skin care, oral care, processed foods and white-space opportunities like hair conditioners, facial cleansing, liquid soaps, etc.</li> <li>Rural markets are less penetrated than urban markets. Given HUL's strong distribution network, it is best placed to benefit from increasing rural prosperity.</li> <li>HUL is well placed to benefit from growth in modern trade given strategic relationships.</li> </ul> |
| <b>Input costs</b>   | <ul style="list-style-type: none"> <li>As commodity prices correct, we expect HUL's margins to improve as a result of lower raw material costs and selective price increases.</li> </ul>   | <ul style="list-style-type: none"> <li>Even if the commodity prices correct, margins can remain pressured as competition is likely to cut prices.</li> </ul>  | <ul style="list-style-type: none"> <li>Expect margins to have bottomed out and improve modestly over the medium term, led by i) strong growth in higher margin personal products segment, ii) stable A&amp;P as a % of revenue and iii) selective price hikes.</li> <li>Strong correction in commodity prices can provide margin surprise. Estimated margin impact per 5% correction: crude oil prices is 74bp, palm oil is 30bp and tea/coffee is 28bp.</li> </ul>  |
| <b>Competition</b>   | <ul style="list-style-type: none"> <li>While competitive intensity remains high, especially in highly penetrated segments like soaps, shampoos and detergents, relatively underpenetrated segments like toothpastes, skin care, etc. offer strong volume growth opportunities.</li> <li>Competitive forces in white spaces will also help market development, especially in rural areas.</li> </ul>  | <ul style="list-style-type: none"> <li>Competitive intensity will increase going forward as players like P&amp;G, ITC, etc. eye market share gains in India.</li> </ul>   | <ul style="list-style-type: none"> <li>Companies like ITC, P&amp;G, etc. that eye market share gains led by aggressive pricing, will gain at the cost of smaller players as has been observed in detergents/shampoos over the past two years.</li> </ul>   |
| <b>Valuation</b>     | <ul style="list-style-type: none"> <li>With consistent volume growth accompanied by margin improvement, HUL will at least sustain its current multiple.</li> <li>Further upside to valuation is possible in case margins surprise positively led by strong correction in raw material prices.</li> <li>Bull case DCF value is INR392</li> </ul>  | <ul style="list-style-type: none"> <li>High competitive intensity limits margin gains as price increases cannot be passed on freely. In case commodity prices rise from here, margin and hence DCF value can come under pressure.</li> <li>Bear case DCF value is INR286</li> </ul> | <ul style="list-style-type: none"> <li>We expect current multiples to sustain led by robust volume growth, improving margins and better RoE.</li> <li>Upside risk to estimates and PO of Rs360 led by better-than-expected margin gains.</li> </ul>  |

Source: BofA Merrill Lynch Global Research

## Initiate at Buy with PO of Rs360

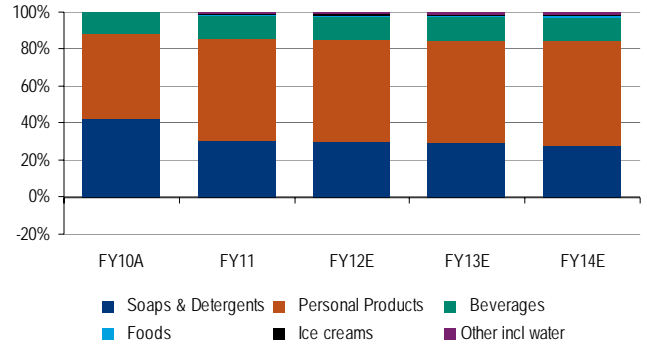
HUL, a subsidiary of Unilever Plc, is India's largest Fast Moving Consumer Goods Company (FMCG excl cigarette). HUL has a portfolio of more than 50 brands across categories such as soaps, detergents, foods, ice cream and water purifiers. It has about 15,000 employees and an annual turnover of ~US\$4.3bn. We reinstate coverage with Buy for ~14% upside potential.

Chart 3: Revenue composition- Low penetration segments growing faster



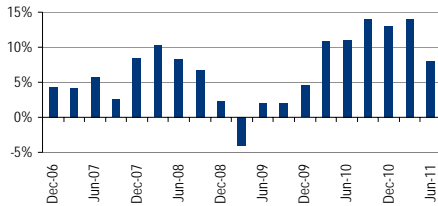
Source: Company, BofA Merrill Lynch Global Research

Chart 4: EBIT composition- Low penetration segments increasing contribution to earnings



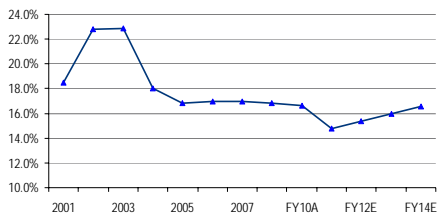
Source: Company, BofA Merrill Lynch Global Research

Chart 5: Volume growth picked up post 2009



Source: Company

Chart 6: Margins are expected to improve as commodity prices correct



Source: Company, BofA Merrill Lynch Global Research

## Investment thesis

### PO of Rs360 offers about 14% upside potential

We reinstate coverage on HUL with a Buy rating and a PO of Rs360, implying ~14% upside potential. Post ~23% YTD outperformance, the stock currently trades at 26.5x 1yr fwd PE multiple, which is in the middle of the 5yr trading range of 20x to 30x. We expect the stock to maintain its current multiple as volume growth remains strong led by the changed strategy and margins improve. We see upside risk to margins in the medium term led by softening raw material prices.

### Estimate 15% EPS CAGR; high dividend payout to continue

We estimate 15% EPS CAGR over FY11-13, led by: (1) 11% revenue growth, and (2) 120bp margin improvement. Revenue growth will be mainly led by personal products and processed foods business that are relatively under penetrated. We expect dividend payout ratio to remain upwards of 70% as HUL continues to generate strong free cash flows.

### Strong volume growth led by strategy to sustain

Since 2009, HUL has been focusing on volume growth to protect its market shares across categories instead of its earlier focus on protection of margins. This has resulted in 8% to 14% yoy volume growth for the past six quarters driven by i) improved market reach, ii) competitive pricing, iii) new product innovations, esp in personal products and iv) focus on modern trade channel that currently forms ~10% of revenue. We expect volume growth to sustain at ~10%yoy over FY11-13.

### Margins have likely bottomed out; can surprise positively

While HUL's focus on volumes grew since 2009, margins suffered due to i) higher A&P spends, ii) competitive intensity and iii) higher commodity prices. However, we believe that margins have likely bottomed out and expect 120bp margin improvement over FY11-13 led by i) selective price increases, ii) stable A&P spends at the current levels (~14% of revenue) and iii) as high margin personal products that is relatively under-penetrated grows faster. Strong correction in softening raw material prices can provide positive margin surprise medium term.

### Services can be a long-term opportunity: not in estimates

HUL is expanding its service based delivery portfolio in skin care, ice creams and coffee through owned as well as franchisee model. HUL runs over 140 Lakme Beauty Salons that operate in the Rs10bn organized 'beauty service' market growing at 25% yoy. Its 150 Swirl's parlors have garnered 12% of the Rs4bn 'ice cream parlor' market that is growing at ~23%. 'Coffee chains' is another Rs10bn opportunity growing at ~25%, which HUL is exploring on a pilot basis.

### Risks and concerns

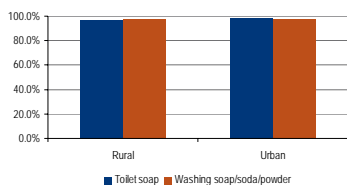
#### Competitive intensity in FMCG sector is high

Companies like Nestle, Procter & Gamble, ITC, Godrej as well as regional players like Rohit Surfactants (makers of Ghari detergents) and Jyothy Laboratories in the pockets dominate the Indian FMCG space. High competitive intensity can impact margins led by price wars and unforeseen rise in A&P spends.

#### Rural demand is linked to monsoons

Monsoon plays a very important role in the Indian economy. Agriculture that is primarily dependent on monsoons is the main source of income in rural India. Given this, rural demand that forms ~45% of HUL's sales is dependent on monsoon performance.

**Chart 7: Soaps and detergents are highly penetrated segments**



Source: National Sample Survey Organization

#### Low growth segment dominates the revenue profile

Soap & detergents dominate the revenue profile of HUL with more than 45% of HUL's revenue flowing through this segment. Given high penetration volume growth can remain muted. Moreover competitive intensity remains high in these segments. HUL is trying to mitigate this risk by controlling costs in soaps & detergents and focusing on other segments like skin care, toothpaste, etc. that are relatively underpenetrated.

## Valuation

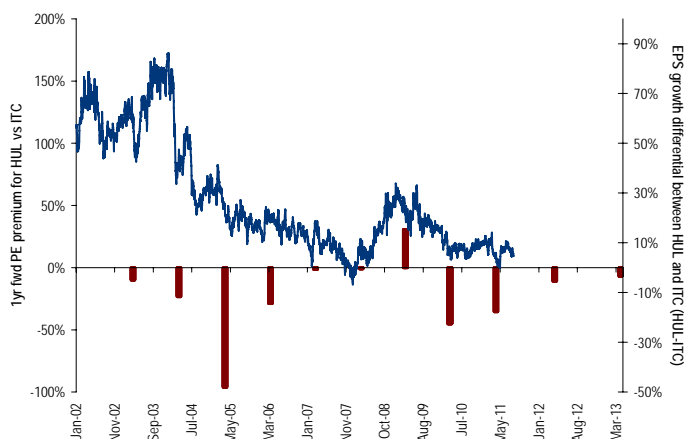
Our PO of Rs360 is based on a target PE of 26x which is validated by-

- i) Comparative analysis with closest peer ITC
- ii) DCF value
- iii) HUL's historical trading range

### Analysis relative to ITC: expect 10% premium to continue

Historically, HUL has traded at a premium to its closest large-cap peer ITC led by higher RoE. However, over time valuation premium has shrunk led by lower growth in HUL vs ITC. We expect the growth differential to narrow to ~5% in FY12 and FY13. Given this we expect HUL premium to sustain at ~10% vs ITC led by higher RoE (HUL at 83% vs ITC at 33%) but marginally lower growth.

Chart 8: HUL premium vs ITC likely to sustain at ~10%



Source: Bloomberg for prices, Company, BofAML Global Research

Table 1: HUL vs ITC relative comparison

|                                       | HUL  | ITC   |
|---------------------------------------|--|---|
| Earnings growth                       | <ul style="list-style-type: none"> <li>15% estimated EPS CAGR</li> <li>Highly diversified</li> <li>Personal products comprising of oral care, shampoos, skin care etc form 55% of EBIT</li> </ul>  | <ul style="list-style-type: none"> <li>19% estimated EPS CAGR</li> <li>80% EBIT comes from cigarette</li> </ul>   |
| Diversification                       |  |   |
| Regulatory risk                       | <ul style="list-style-type: none"> <li>Low govt intervention</li> </ul>  | <ul style="list-style-type: none"> <li>Govt intervention in the form of taxes is key to volume growth</li> </ul>  |
| Return ratio- ROE                     | <ul style="list-style-type: none"> <li>83%</li> </ul>  | <ul style="list-style-type: none"> <li>33%</li> </ul>   |
| Competitive intensity in key segments | <ul style="list-style-type: none"> <li>Higher competitive in most of the segments of operation</li> <li>45% value share in toilet soaps</li> <li>39% value share in detergents</li> <li>46% value share in shampoos and</li> <li>20% value share in 'oral care'</li> </ul> | <ul style="list-style-type: none"> <li>Four key players in cigarettes dominate the market</li> <li>Over 70% volume share in cigarettes</li> <li>-5% value share in other FMCG segments</li> </ul> |
| Key market shares                     |  |   |

Source: BofA Merrill Lynch Global Research

### DCF value of Rs360 validates target multiple based PO

Based on our assumptions (table 2), we get a DCF value of Rs360 per share with 60% of it accounted for by the terminal value. PO at target PE of 26x is in line with DCF.

**Table 2: DCF assumptions**

|                         |              |
|-------------------------|--------------|
| Risk free rate          | 8%           |
| 2yr Beta                | 0.4          |
| Market premium          | 7%           |
| <b>WACC</b>             | <b>10.8%</b> |
| <b>Terminal Gr rate</b> | <b>5%</b>    |

Source: Bloomberg, BofA Merrill Lynch Global Research

**Table 3: DCF sensitivity table**

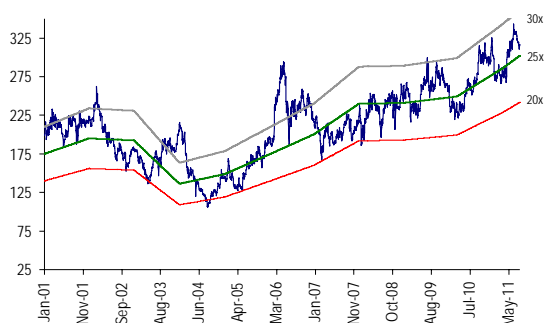
| Terminal Growth Rate | WACC |      |       |            |       |       |       |       |  |
|----------------------|------|------|-------|------------|-------|-------|-------|-------|--|
|                      | 9.3% | 9.8% | 10.3% | 10.8%      | 11.3% | 11.8% | 12.3% | 12.8% |  |
| 3.5%                 | 404  | 369  | 340   | 314        | 292   | 273   | 256   | 241   |  |
| 4.0%                 | 428  | 389  | 355   | 327        | 303   | 282   | 264   | 248   |  |
| 4.5%                 | 458  | 412  | 374   | 342        | 315   | 292   | 272   | 255   |  |
| 5.0%                 | 494  | 440  | 396   | <b>360</b> | 330   | 304   | 282   | 263   |  |
| 5.5%                 | 540  | 474  | 423   | 381        | 347   | 318   | 293   | 272   |  |
| 6.0%                 | 600  | 518  | 456   | 406        | 367   | 334   | 306   | 283   |  |
| 6.5%                 | 681  | 575  | 497   | 438        | 391   | 353   | 322   | 296   |  |

Source: BofA Merrill Lynch Global Research

**Target PE in in line with historical trading average**

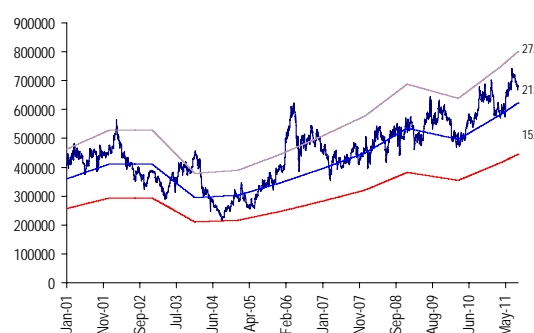
Our target PE of 26x is in line with HUL's 5yr historical trading average. HUL's PE and EV/EBITDA chart suggests a gradual re-rating since 2010 as strong volume growth resumed. As we expect volume growth to remain strong, we expect HUL to maintain its current 1yr fwd multiple.

**Chart 9: PE band shows re-rating since Mar-10**



Source: Bloomberg for prices, Company, BofA Merrill Lynch Global Research

**Chart 10: EV/EBITDA shows re-rating since Mar-10**



Source: Bloomberg for prices, Company, BofA Merrill Lynch Global Research

**Comparative analysis vs industry peers**

- HUL trades at about 5 to 10% premium vs Godrej Consumer, Dabur and Marico given high RoE at ~83% vs these peers in the range of 30% to 45%.
- As compared to Nestle, HUL trades at ~49% discount led by i) Nestle's 76% market share Baby Foods. This is a difficult to enter segment as advertising is prohibited and ii) comparable RoE.
- Colgate India trades at ~10% premium led by higher RoE but similar growth.

**Table 4: Peer valuation**

| Company name       | Currency | Yr End   | Rating    | Mcap (USD mn) | EPS Growth   |              |              | FY11-13 CAGR | P/E          |              |              | ROE          |              |              | EV/Sales    |             |             | EV/EBITDA    |              |              |
|--------------------|----------|----------|-----------|---------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------|-------------|-------------|--------------|--------------|--------------|
|                    |          |          |           |               | FY11         | FY12         | FY13         |              | FY11         | FY12         | FY13         | FY11         | FY12         | FY13         | FY11        | FY12        | FY13        | FY11         | FY12         | FY13         |
| Hindustan Unilever | INR      | March    |           | 15400         | 3.5%         | 14.6%        | 14.9%        | 14.7%        | 31.7x        | 27.7x        | 24.1x        | 82.5%        | 88.3%        | 92.7%        | 3.3x        | 3.x         | 2.7x        | 22.2x        | 22.2x        | 22.2x        |
| ITC                | INR      | March    | Buy       | 34603         | 21.2%        | 20.0%        | 18.4%        | 19.2%        | 31.5x        | 26.2x        | 22.1x        | 33.2%        | 35.5%        | 38.1%        | 7.1x        | 6.x         | 5.2x        | 19.3x        | 16.2x        | 13.8x        |
| Godrej Consumer    | INR      | March    | Not Rated | 3,017         | 33.1%        | 19.5%        | 20.3%        | 19.9%        | 28.1x        | 23.5x        | 19.6x        | 38.4%        | 31.8%        | 29.9%        | 3.7x        | 3.x         | 2.6x        | 21.1x        | 16.8x        | 14.x         |
| Dabur India        | INR      | March    | Not Rated | 4,102         | 125.3%       | 19.9%        | 19.6%        | 19.7%        | 32.8x        | 27.4x        | 22.9x        | 48.9%        | 43.8%        | 40.6%        | 4.2x        | 3.3x        | 2.9x        | 23.x         | 18.5x        | 15.8x        |
| Marico             | INR      | March    | Not Rated | 2,218         | -17.5%       | 42.8%        | 23.6%        | 32.8%        | 42.5x        | 29.8x        | 24.1x        | 36.5%        | 32.1%        | 30.6%        | 2.9x        | 2.4x        | 2.x         | 22.x         | 17.9x        | 14.9x        |
| <b>Average</b>     |          |          |           |               | <b>40.5%</b> | <b>25.6%</b> | <b>20.5%</b> | <b>22.9%</b> | <b>33.7x</b> | <b>26.7x</b> | <b>22.2x</b> | <b>39.3%</b> | <b>35.8%</b> | <b>34.8%</b> | <b>4.5x</b> | <b>3.7x</b> | <b>3.2x</b> | <b>21.4x</b> | <b>17.4x</b> | <b>14.6x</b> |
| Nestle             | INR      | December | Not Rated | 9,478         | 25.0%        | 10.1%        | 29.7%        | 19.5%        | 52.7x        | 47.8x        | 36.9x        | 114.0%       | 89.1%        | 74.8%        | 5.8x        | 4.9x        | 4.x         | 28.8x        | 23.7x        | 19.1x        |
| Colgate India      | INR      | March    | Not Rated | 3,085         | -4.9%        | 16.2%        | 14.7%        | 15.4%        | 34.9x        | 30.x         | 26.2x        | 159.2%       | 108.0%       | 98.5%        | 4.5x        | 3.4x        | 3.x         | 17.9x        | 14.8x        | 12.8x        |
| <b>Average</b>     |          |          |           | <b>10,272</b> | <b>28.3%</b> | <b>21.1%</b> | <b>20.2%</b> | <b>20.5%</b> | <b>36.x</b>  | <b>29.9x</b> | <b>24.7x</b> | <b>69.0%</b> | <b>58.1%</b> | <b>55.0%</b> | <b>4.5x</b> | <b>3.7x</b> | <b>3.2x</b> | <b>22.x</b>  | <b>18.4x</b> | <b>15.9x</b> |

Source: Bloomberg for consensus, BofA Merrill Lynch Global Research

Current share price: Rs320

Trough price: Rs286

Upside price: Rs392

Table 5: Sensitivity to segmental performance

| Yr ending 31 Mar                        | FY13E  |      |
|---|--------|------|
|   | EBITDA | EPS  |
| <b>100bps change in segment revenue</b> |        |      |
| - Soaps & Detergents                    | 0.6%   | 0.6% |
| - Personal Products                     | 1.0%   | 1.0% |
| - Beverages                             | 0.2%   | 0.2% |
| <b>100bps change in segment margin</b>  |        |      |
| - Soaps & Detergents                    | 5.2%   | 5.5% |
| - Personal Products                     | 4.0%   | 4.2% |
| - Beverages                             | 1.5%   | 1.6% |

Source: BofA Merrill Lynch Global Research

## Stress report

We have done a stress-test to look at the likely downside to our current earnings estimates and its impact on our PO. The trough price represents the stock price at which we believe the stock will offer attractive long-term appreciation potential.

### Downside scenario: what can go wrong?

- Volume growth can fall back to sub 5% level led by heightened competitive intensity.
- A&P spends, instead of stabilizing, can further move up impacting margins.
- Raw material prices can remain high limiting margin improvement.
- Failure in monsoon leading to lower demand in rural markets that form ~45% of HUL revenue.

### Upside scenario: what can go right?

- Higher than expected volume and pricing growth across segments as competition resorts to price increases that were delayed over the last one year despite increasing raw material cost pressures.
- Raw material prices correct more than expected in addition to the price hikes taken by the HUL. This can improve margins beyond 60bps annually as built into our numbers.
- A&P spends that have increased ~400bps over FY09-11 can moderate benefiting margins.
- Normal monsoon can lead to robust demand in rural India, surprising positively on demand resulting in higher than expected revenue growth esp in personal products.

## Risk-Reward: Positive

- In the worst-case, we think the stock could trade down to a DCF based price level of INR286 which is ~10% downside.
- In the best case, we expect the stock to trade at ~INR392, which is ~23% upside from the current level.
- Overall, the risk-reward appears positive.

Table 6: Earnings outlook for HUL

|                          | BofAML<br>estimates<br>FY13 | Downside<br>scenario<br>FY13 | Upside<br>scenario<br>FY13 | Variance vs. BofAMLe |                |
|--------------------------|-----------------------------|------------------------------|----------------------------|----------------------|----------------|
|                          |                             |                              |                            | Downside<br>FY13     | Upside<br>FY13 |
|                          |                             |                              |                            | Sales (Rs mn)        | 240,889        |
| YoY (%)                  | 10.5%                       | 9.6%                         | 12.4%                      |                      |                |
| EBITDA (Rs mn)           | 38,479                      | 35,880                       | 42,179                     | -6.75%               | 9.57%          |
| EBITDA margin (%)        | 16%                         | 15.2%                        | 17.0%                      |                      |                |
| YoY (%)                  | 14.9%                       | 11.1%                        | 19.1%                      |                      |                |
| Net Income (Rs mn)       | 28,349                      | 26,335                       | 31,216                     | -7.10%               | 10.06%         |
| YoY (%)                  | 14.9%                       | 10.9%                        | 19.3%                      |                      |                |
| EPS (Rs)                 | 13.13                       | 12.19                        | 14.46                      | -7.16%               | 10.05%         |
| YoY (%)                  | 14.9%                       | 10.9%                        | 19.3%                      |                      |                |
| Free Cash Flow/Share(Rs) | 15.1                        | 14.0                         | 16.7                       | -7.28%               | 10.60%         |

Source: BofA Merrill Lynch Global Research estimates



## Financial and operating analysis

### Expect 15% EPS CAGR led by revenue and better margins

We expect 15% EPS CAGR over FY11-13 driven by (1) 11% revenue CAGR led by strong growth in personal products as well as foods, but muted growth in commodity sensitive segment of soaps & detergents, and (2) 120bp improvement in EBITDA margin led by scaled price increases and softening commodity prices.

### Key factors to watch and sensitivity

Key factors impacting earnings for HUL will be

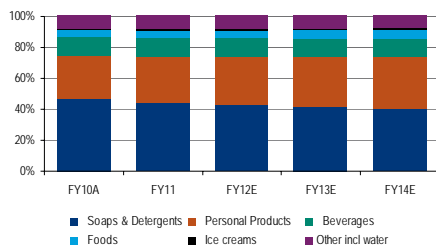
- Prices of key raw materials i) crude oil linked derivatives used in detergents, ii) palm/ veg oils used in soaps, iii) tea and iv) coffee used in beverages.
- We believe HUL's focus on profitable volume growth will continue in medium term given its keenness to arrest fall in market shares across categories. However any change in strategy by parent Unilever will be a key development to watch.

Table 7: Raw material sensitivity per 5% change in prices

|                   | EBITDA margin impact | EPS impact |
|-------------------|----------------------|------------|
| Crude derivatives | 74bps                | 6.6%       |
| Palm/ veg oil     | 30bps                | 2.7%       |
| Tea & coffee      | 28bps                | 2.5%       |

Source: BofA Merrill Lynch Global Research

Chart 11: Revenue composition- Low penetration segments growing faster



Source: Company, BofA Merrill Lynch Global Research

### Revenue CAGR of 11% led by personal products/foods

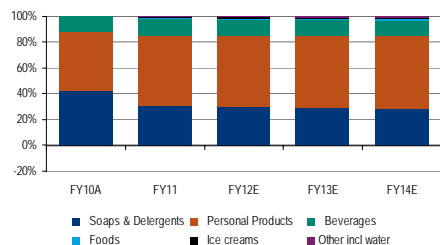
We expect HUL's revenue to grow at 11% CAGR over FY11-13. This should be led by i) ~7% revenue growth in soaps & detergents, ii) ~15% growth in personal products, and iii) 10-20% growth in beverages, foods and ice creams.

Table 8: Segmental revenue break-up

| INR mn                | FY10A          | FY11           | FY12E          | FY13E          | FY14E          |
|-----------------------|----------------|----------------|----------------|----------------|----------------|
| - Soaps & Detergents  | 82,656         | 87,916         | 94,070         | 100,655        | 107,700        |
| - Personal Products   | 50,479         | 58,441         | 67,207         | 77,288         | 88,881         |
| - Beverages           | 21,424         | 23,440         | 26,018         | 28,880         | 32,057         |
| - Foods               | 7,308          | 9,026          | 10,831         | 12,455         | 14,324         |
| - Ice creams          | 2,310          | 2,746          | 3,213          | 3,694          | 4,249          |
| - Others (incl water) | 13,520         | 15,377         | 16,584         | 17,917         | 19,392         |
| <b>Total Revenue</b>  | <b>177,659</b> | <b>196,945</b> | <b>217,922</b> | <b>240,889</b> | <b>266,603</b> |
| <b>YoY Growth</b>     |                |                |                |                |                |
| - Soaps & Detergents  | 1.5%           | 6.4%           | 7.0%           | 7.0%           | 7.0%           |
| - Personal Products   | 16.1%          | 15.8%          | 15.0%          | 15.0%          | 15.0%          |
| - Beverages           | 15.0%          | 9.4%           | 11.0%          | 11.0%          | 11.0%          |
| - Foods               | 10.9%          | 23.5%          | 20.0%          | 15.0%          | 15.0%          |
| - Ice creams          | 16.6%          | 18.9%          | 17.0%          | 15.0%          | 15.0%          |
| - Others (incl water) | -9.5%          | 13.7%          | 15.0%          | 15.0%          | 15.0%          |
| <b>Total Revenue</b>  | <b>6.4%</b>    | <b>10.9%</b>   | <b>10.7%</b>   | <b>10.5%</b>   | <b>10.7%</b>   |

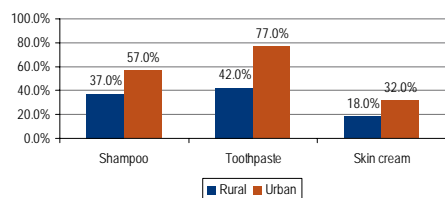
Source: Company, BofA Merrill Lynch Global Research

Chart 12: EBIT composition- Low penetration segments increasing contribution to earnings



Source: Company, BofA Merrill Lynch Global Research

Chart 13: Category penetrations remain low in personal products (CY10)



Note: Category penetration equals % of households reporting usage of a category at least once in a year

Source: Industry data; BofA Merrill Lynch Global Research

### Expect 120bp EBITDA margin improvement over FY11-13

EBITDA margins declined 160bp over the past two years as HUL could not pass on the increase in raw material cost due to competitive intensity. A&P spends as a % of revenue rose in personal products and foods. However, over FY11-13, we expect 120bp margin improvement due to i) selective price increases across categories, ii) stabilizing A&P spends and iii) as high margin personal products segment grows faster. Softening raw material costs can provide margin upside esp in commodity sensitive category of Soaps & Detergents.

Table 9: EBITDA

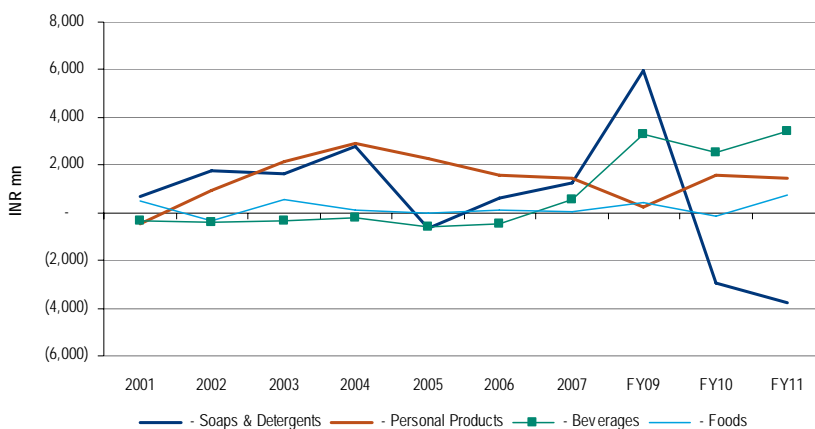
| INR mn                     | FY10A         | FY11          | FY12E         | FY13E         | FY14E         |
|----------------------------|---------------|---------------|---------------|---------------|---------------|
| - Soaps & Detergents       | 12,607        | 9,149         | 10,260        | 11,481        | 12,823        |
| - Personal Products        | 13,330        | 15,539        | 18,072        | 21,015        | 24,433        |
| - Beverages                | 3,287         | 3,719         | 4,180         | 4,697         | 5,278         |
| - Foods                    | 84            | 140           | 223           | 318           | 438           |
| - Ice creams               | 193           | 263           | 324           | 391           | 471           |
| - Others (incl water)      | 19.7          | 339.3         | 435.9         | 576.6         | 771.0         |
| <b>Total EBITDA</b>        | <b>29,521</b> | <b>29,150</b> | <b>33,494</b> | <b>38,479</b> | <b>44,214</b> |
| EBITDA Margin              | FY10A         | FY11          | FY12E         | FY13E         | FY14E         |
| - Soaps & Detergents       | 15.3%         | 10.4%         | 10.9%         | 11.4%         | 11.9%         |
| - Personal Products        | 26.4%         | 26.6%         | 26.9%         | 27.2%         | 27.5%         |
| - Beverages                | 15.3%         | 15.9%         | 16.1%         | 16.3%         | 16.5%         |
| - Foods                    | 1.2%          | 1.6%          | 2.1%          | 2.6%          | 3.1%          |
| - Ice creams               | 8.4%          | 9.6%          | 10.1%         | 10.6%         | 11.1%         |
| - Others (incl water)      | 0.1%          | 2.2%          | 2.6%          | 3.2%          | 4.0%          |
| <b>Total EBITDA Margin</b> | <b>16.6%</b>  | <b>14.8%</b>  | <b>15.4%</b>  | <b>16.0%</b>  | <b>16.6%</b>  |

Source: Company, BofA Merrill Lynch Global Research

### Capital allocation to focus on low penetration segments

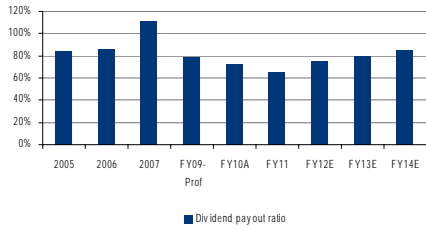
We expect HUL to focus on investing in personal products and foods that are relatively underpenetrated. In the case of soaps and detergents, the company will likely scale up its third-party procurement as seen over the past two years. We expect capital employed in Soaps & Detergents to remain negative going ahead while expect it to remain positive in personal products with an upward bias.

Chart 14: Capital employed by segment



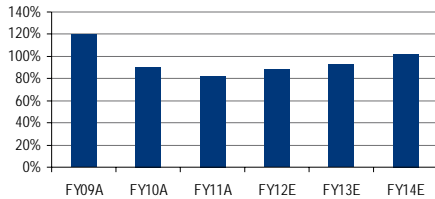
Source: Company

**Chart 15: Payout ratio to remain high**



Source: Company, BofA Merrill Lynch Global Research

**Chart 16: Expect RoE to improve**



Source: Company, BofA Merrill Lynch Global Research

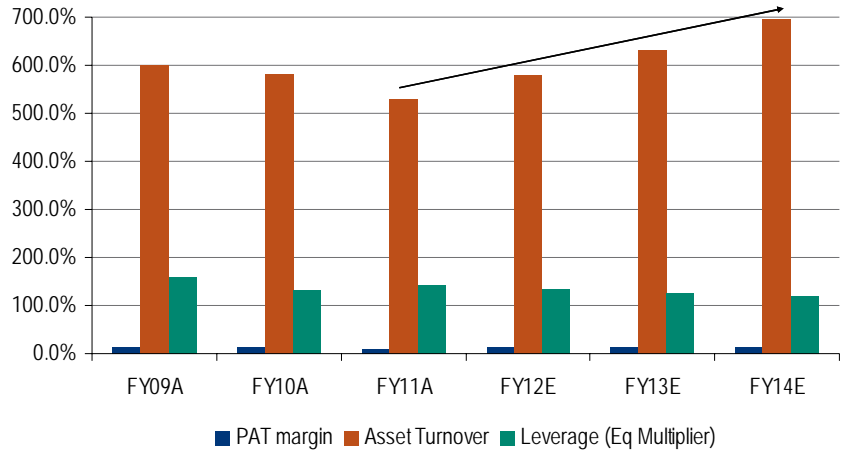
**Sustained dividend payout backed by strong cash flows**

We expect strong free cash flows to continue going forward and over 55% jump in free cash generated over FY11-13 led by i) working capital efficiency, and ii) 30% higher PAT. We also expect the payout ratio to remain upwards of 70%.

**Expect return ratios to improve**

We estimate RoE to inch up to 93% in FY13 from the current 83% led by i) higher asset turnover as third-party procurement increases especially in soaps & detergents and ii) improvement in PAT margin.

**Chart 17: Dupont analysis chart - Asset turnover to be the main driver of RoE improvement**



Source: BofA Merrill Lynch Global Research

## Changed strategy focuses on volume growth

HUL's strategy is driven by its parent Unilever. In the past decade, Unilever followed a strategy based on 'Power Brands' that formed significant portion of annual sales and profits. During this time HUL focused on 30 national and 10 regional brands out of a portfolio of 110. These brands contributed significant portion (>75%) of HUL's annual profits. While HUL directed A&P efforts on growing power brands, limited support was offered to the rest of the portfolio. Post 2004, 'One Unilever' strategy augmented this till 2009 with a focus on cost savings by streamlining internal systems.

While 'Power Brands' helped in protecting margins, volume growth suffered despite attempts to migrate customers to power brands. Smaller brands were de-focused, thereby ceding market share to regional competitors. This as well as rising competitive intensity, resulted in HUL losing market share over time.

## Strategy change and analysis of this strategy

In the backdrop of falling market shares and stable margins, since 2009, Unilever adopted the current 'Compass Strategy' that focuses on 'profitable volume growth'. Given its clear focus on market share gains while controlling costs in the supply chain, we expect HUL to at least protect its market share in the medium term. Table below gives the four key focus areas and related activities.

Table 10: Compass-based strategy of growth

| Focus                       | Activity  |
|-----------------------------|---|
|                             | <ul style="list-style-type: none"> <li>Faster launches in new category/ product segments</li> <li>Support brands with effective A&amp;P</li> <li>Re-launch products to strengthen portfolio</li> </ul>  |
| More brands and innovations | <ul style="list-style-type: none"> <li>Exploit white spaces - fabric softener is an example</li> <li>Identify experience-based product delivery ex. Swirl parlors, Bru World cafes, Lakme salons</li> <li>Rural footprint tripled in 2010</li> </ul>              |
| Higher reach                | <ul style="list-style-type: none"> <li>Strategic relationships with modern trade</li> <li>Re-engineer the cost base in supply chain</li> </ul>  |
| Improve the processes       | <ul style="list-style-type: none"> <li>Monitor effectiveness of marketing investment</li> <li>Incorporate performance-based culture among employees through higher variable compensation, empowering managers to take on the spot decisions to compete</li> </ul> |
| People                      |   |

Source: Company, BofA Merrill Lynch Global Research

## Acquisitions have added products to portfolio

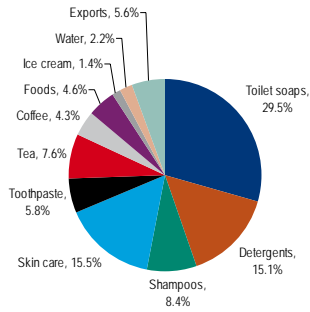
Over time, HUL has also adopted an inorganic approach to augment its product portfolio. Lakme and Modern Foods are some of its key acquisitions. We believe HUL can opportunistically adopt the inorganic route even in future to exploit white spaces or enhance its portfolio.

Table 11: Acquisitions table

| Year | Target                                 | % acquired                                       | Deal value (INR mn) | Synergy benefits / Remarks  |
|------|--|--|---------------------|---|
| 1992 | Kothari General Foods                  |  |                     |   |
| 1993 | Kissan Brand                           | 100% from United Breweries group                 | 250                 | Access to Kissan brand and products portfolio such as sauces, jams, squashes and fruit pulp |
| 1993 | Dollops ice cream                      |  |                     |   |
| 1994 | Kimberley-Clark Lever Ltd              | 50:50 JV with Kimberley-Clark                    | 155                 | Joint venture to manufacture Huggies diapers and feminine care products                     |
| 1995 | Milkfood                               | 100% ice cream marketing and distribution rights |                     |   |
| 1996 | Lakme Lever Ltd<br>(JV with Lakme Ltd) | 50% in Joint venture                             | 1100                | Gained access to the well-defined cosmetics marketing and distribution network of Lakme     |
| 1998 | Lakme                                  | Acquired brand Lakme and 50% equity in the JV    | 2293                | Produce commensurate commercial returns in the longer term                                  |
| 2000 | Modern Foods                           | 74%  | 1055                | Entered bakery food business  |
| 2002 | Modern Foods                           | 26%  | 441                 |   |
| 2003 | Amalgam Group                          | Cooked shrimp and pasteurized crabmeat business  | ~900 - 1000         | Synergy in raw material procurement   |

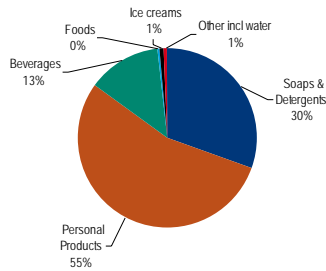
Source: BofA Merrill Lynch Global Research

Chart 18: Revenue by category (FY11)



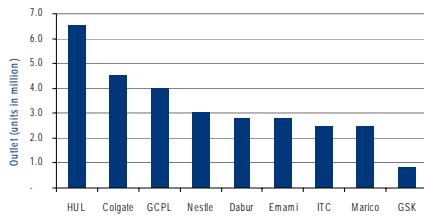
Source: Company, BofA Merrill Lynch Global Research

Chart 19: EBIT by segment (FY11)



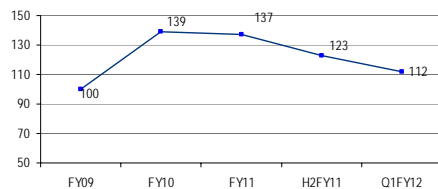
Source: Company, BofA Merrill Lynch Global Research

Chart 20: Market Reach (FY11)



Source: BofA Merrill Lynch Global Research

Chart 21: Indexed Industry GRP in Soaps & Detergents



Source: Company

## Competitive landscape and HUL's strategy

HUL operates in five main segments: i) Soaps and detergents, ii) Personal products (mainly shampoos, skin care and toothpaste), iii) Beverages (mainly tea and coffee), iv) Packaged foods, v) Ice cream and vi) Others that mainly consist of water purifiers.

HUL owns over 40 production units and has tied up with ~150 third-party vendors to whom it contracts out the manufacturing of various products. Third party procurement is high in detergents (~45% of the total sale), beverages (20% to 35%) and processed food (~55%).

### 1. Soaps and Detergents (45% revenue, 30% EBIT)

While HUL is the market leader in soaps and detergents, the categories being highly penetrated are experiencing relatively slower volume growth. Third party procurement is high in detergents at ~45%.

#### HUL strategy

##### Focus is on market share and volume growth

HUL follows a strategy of straddling all price points and deploying a full portfolio in these segments. Post 2009, HUL has been focusing on volume growth vs its earlier focus on protecting margins. This has resulted in HUL aggressively following competition in price cuts, especially in detergents where it cut prices of Surf and Rin by 10%-30% as P&G's Tide Naturals looked to build market share in the mid-market segment. HUL has also focused on increasing reach over the past two year in terms of presence in outlets.

#### A&P spend in a reactive manner

We believe HUL responds in these categories in a reactive manner in terms of A&P spends. Given the industry-wide A&P spends in this segment are on a decline, we expect HUL to also control A&P spend in this segment.

#### Competitive landscape

**Soaps:** HUL has ~45% value share of the toilet soaps market with its key brands Lux, Lifebuoy, Hamam, Breeze, Pears, Dove and Liril. Godrej Consumer Care is the second largest with ~10% market share. The segment grew ~11% in 2010 to Rs105bn. While bar soaps form 88% of this segment, liquid soap is the fastest growing segment with about 50% yoy growth.

Table 12: HUL's key brands- value share of Rs95bn toilet soap market

|          | 2007  | 2008  | 2009  | 2010  |
|----------|-------|-------|-------|-------|
| Lux      | 16.8% | 17.2% | 15.5% | 15.2% |
| Lifebuoy | 14.6% | 15.0% | 14.1% | 13.1% |
| Hamam    | 4.0%  | 4.2%  | 4.4%  | 4.4%  |
| Breeze   | 7.1%  | 6.3%  | 4.4%  | 4.0%  |
| Dove     | 1.4%  | 1.6%  | 2.9%  | 4.0%  |
| Pears    | 2.7%  | 3.0%  | 3.2%  | 3.3%  |
| Liril    | 1.3%  | 1.1%  | 1.1%  | 1.2%  |
| Total    | 47.9% | 48.4% | 45.6% | 45.2% |

Source: Euromonitor

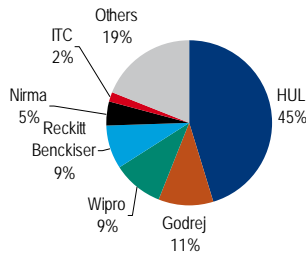
**Detergents:** HUL has ~37% value share of the detergents market with its four key brands, namely Surf, Rin, Wheel and Sunlight. P&G is the second largest with ~17% market share. Laundry aid market is a white space opportunity for companies like HUL in this segment.

**Table 13: HUL's brand-wise value share of INR112bn detergents market**

|              | 2007         | 2008         | 2009         | 2010 Positioning  |
|--------------|--------------|--------------|--------------|-------------------|
| Wheel        | 19.6%        | 19.8%        | 19.7%        | 19.3% Mass market |
| Surf         | 13.0%        | 13.2%        | 13.1%        | 13.0% Premium     |
| Rin          | 7.5%         | 6.4%         | 5.9%         | 5.5% Mid market   |
| Sunlight     | 0.6%         | 0.7%         | 0.7%         | 0.6% Mid market   |
| Others       | 1.6%         | 1.6%         | 1.0%         | 1.0%              |
| <b>Total</b> | <b>42.3%</b> | <b>41.7%</b> | <b>40.4%</b> | <b>39.4%</b>      |

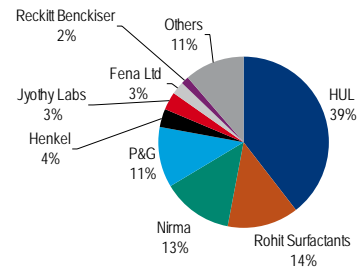
Source: Euromonitor, BofA Merrill Lynch Global Research

**Chart 22: Toilet soap market share by value (CY10)**



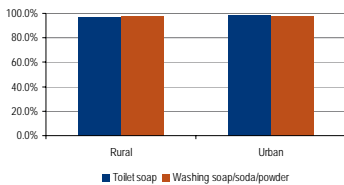
Source:Euromonitor, BofA Merrill Lynch Global Research

**Chart 23: Detergents market share by value (CY10)**



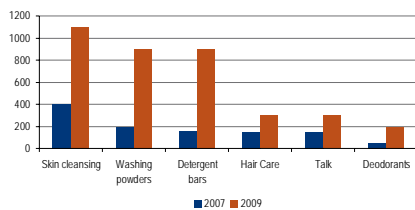
Source:Industry data, BofA Merrill Lynch Global Research

**Chart 24: Soaps and detergents are highly penetrated segments**



Source:National Sample Survey Organization

**Chart 25: Number of brands by category**



Source:Company

**Key Issues**

**1. Highly penetrated categories lower the scope of volume growth**

Soaps and detergents are highly penetrated categories. As per National Sample Survey Organization (NSSO) ~97% households in rural India report using of toilet soaps and ~98% do so in urban India. Penetration for detergents stands at 98% in both rural and urban India. Given this, we believe the segmental volume growth in the category will remain less than 5% and be led by i) population growth, and ii) increase in per capita usage led by increasing prosperity.

**2. Competitive intensity limits passing on rise in cost to customers...**

Given the high penetration, these categories are experiencing high competitive intensity. This has resulted in aggressive pricing by peers, especially P&G, which cut its selling prices by 10% to 30% mainly in the first half of 2010 and the rest of the players followed suit. Given the high competitive intensity, companies find it difficult to pass on the increase in raw material costs through price increases.

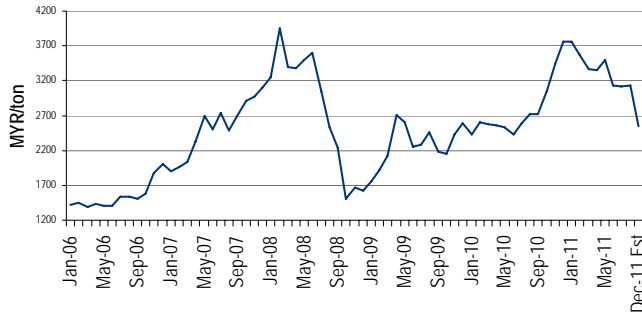
**3. ...however, softening raw material prices can provide cushion**

We expect raw material prices (mainly dependent on crude oil for detergents and on palm oil for soaps) to soften in the medium term. This can provide margin cushion to HUL, especially in the second half of FY12.

**4. Advertising/promotional intensity reducing**

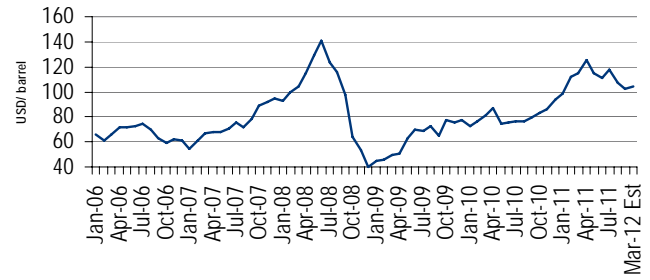
Since FY10, the intensity of A&P in these categories is reducing, likely led by declining incremental benefits of higher A&P spends in the category. We believe this trend will continue in the medium term as the companies have not been able to increase prices despite increasing raw material prices since 2010.

Chart 26: Crude Palm Oil prices have corrected 17% from peak



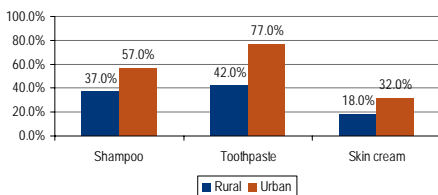
Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 27: Crude Oil prices have corrected 14% from peak



Source: Bloomberg, BofA Merrill Lynch Global Research

Chart 28: Category penetrations remain low in personal products



Source: Industry data; BofA Merrill Lynch Global Research

### White space opportunities

**Detergents:** Laundry aid products comprising fabric softeners, spot/stain removers, starch/ironing aids, etc. offer white-space opportunity in detergents. HUL began marketing its Comfort fabric softener in 2010.

**Soaps:** Liquid soaps, hand sanitizers, etc. offer white-space opportunities where HUL has an established presence.

## 2. Personal Products (30% revenue, 55% EBIT)

As part of its personal products portfolio, HUL is present in Shampoos, Oral Care and Skin-Care products. As per industry estimates, urban penetration in toothpaste stands at 77% and that in rural India is 42%. Shampoos have urban penetration at 57% and rural penetration at 37%. Skin-care products have urban and rural penetration at 32% and 18% respectively. We project segmental revenue growth of ~15% for HUL led by i) increasing penetration in rural India and ii) strong growth in skin care.

### HUL's strategy

#### Growth in toothpaste being led by gel

HUL has seen its growth in toothpaste led mainly by the gel segment. Its Close Up brand enjoys ~60% of the gel market, which in turn forms one-third of the overall toothpaste market. However, given its white toothpaste brand Pepsodent has seen declining market share. HUL's combined market share in toothpaste has fallen to 26.5% in 2011 from 28% in 2009.

#### Premiumization and innovation is focus in skin care

HUL's key focus in case of skin care is on innovation to increase the target market ex. Vaseline range is now extended to face wash, Hand & Body care. Additionally HUL also focuses on premiumisation in this segment.

#### Straddling the pyramid in shampoos

HUL's focus in shampoos is to straddle the pyramid with its five key brands. Re-launch of 'Clear' range of shampoos was a key highlight of this category in FY11.

#### A&P spends are focused on this segment especially on skin care

HUL's A&P spends in Personal Products are focused on growing brands especially in skin care and toothpastes.

Table 14: HUL shampoos portfolio

| Brand            | Revenue in INR (FY11) | Value Mkt Share (FY11) | Positioning |
|------------------|-----------------------|------------------------|-------------|
| Clear            | ~1.5bn                | ~5%                    | Premium     |
| Dove             | ~3.0bn                | ~8.3%                  | Premium     |
| Sunsilk          | ~3.7bn                | ~10%                   | Mid-market  |
| Clinic Plus      | ~6.8bn                | ~19.6%                 | Mass-market |
| Lux              | ~0.5bn                | ~1.3%                  | Mass-market |
| <b>Total HUL</b> | <b>~16.0bn</b>        | <b>~45%</b>            |             |

Source: Industry data, BofA Merrill Lynch Global Research

Table 15: HUL 'oral care' portfolio

| Brand            | Revenue (CY10)   | Value Mkt Share (CY10) |
|------------------|------------------|------------------------|
| Pepsodent        | ~INR5.3bn        | ~11.2%                 |
| Close-Up         | ~INR4bn          | ~8.5%                  |
| <b>Total HUL</b> | <b>~INR9.3bn</b> | <b>~19.7%</b>          |

Source: Euromonitor, BofA Merrill Lynch Global Research

Table 16: HUL brand portfolio and market share by category (CY10)

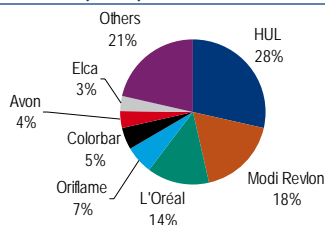
| Category        | Market size | Growth | Brands                  | Competition | Market share |              |              |              |
|-----------------|-------------|--------|-------------------------|-------------|--------------|--------------|--------------|--------------|
|                 |             |        |                         |             | 2007         | 2008         | 2009         | 2010         |
| Color cosmetics | INR17bn     |        | 26% Lakmé               |             | 21.0%        | 20.4%        | 20.6%        | 21.0%        |
|                 |             |        | Elle 18                 |             | 9.1%         | 7.8%         | 7.2%         | 7.6%         |
|                 |             |        | Aviance                 |             | 0.7%         | 0.6%         | 0.5%         | 0.4%         |
|                 |             |        | <b>HUL</b>              |             | <b>30.3%</b> | <b>28.4%</b> | <b>28.0%</b> | <b>28.6%</b> |
|                 |             |        |                         |             |              |              |              |              |
| Skin care       | INR41bn     | 18%    | Fair & Lovely           |             | 45.5%        | 45.3%        | 44.1%        | 42.7%        |
|                 |             |        | Pond's                  |             | 5.4%         | 5.7%         | 6.1%         | 6.0%         |
|                 |             |        | Lakmé                   |             | 5.1%         | 4.6%         | 4.4%         | 4.5%         |
|                 |             |        | Vaseline Intensive Care |             | 2.4%         | 2.4%         | 2.3%         | 2.3%         |
|                 |             |        | Pears                   |             | 0.4%         | 0.4%         | 0.6%         | 0.6%         |
|                 |             |        | Vaseline Lip Guard      |             | 0.1%         | 0.1%         | 0.1%         | 0.1%         |
|                 |             |        | <b>HUL</b>              |             | <b>59.0%</b> | <b>58.5%</b> | <b>57.5%</b> | <b>56.2%</b> |
| Deodorants      | INR8bn      | 40%    | Axe                     |             | 24.5%        | 26.4%        | 26.1%        | 25.2%        |
|                 |             |        | Dove                    |             | 1.0%         | 1.5%         | 2.0%         | 2.8%         |
|                 |             |        | Rexona                  |             | 13.1%        | 11.2%        | 3.5%         | 1.4%         |
|                 |             |        | <b>HUL</b>              |             | <b>38.6%</b> | <b>39.1%</b> | <b>31.6%</b> | <b>29.4%</b> |
|                 |             |        |                         |             |              |              |              |              |

Source: Euromonitor, BofA Merrill Lynch Global Research

Competitive landscape

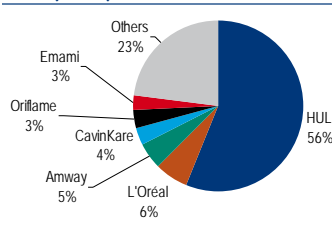
In Shampoos, HUL leads the market with a share of 45%, followed by P&G at 27%. HUL has ~20% market share in toothpaste vs category leader Colgate at ~46%. HUL's market share in skin care is 18% and in cosmetics its share is 26%.

Chart 29: Market share by company in Color Cosmetics (CY10)



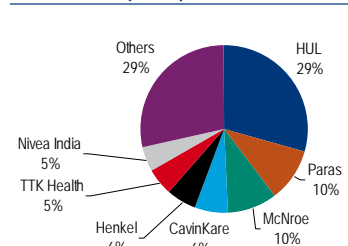
Source:Euromonitor, BofA Merrill Lynch Global Research

Chart 30: Market share by company in Skin Care (CY10)



Source:Euromonitor, BofA Merrill Lynch Global Research

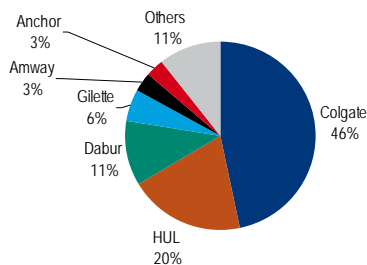
Chart 31: Market share by company in Deodorants (CY10)



Source:Euromonitor, BofA Merrill Lynch Global Research

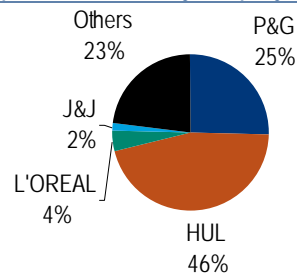


Chart 32: Oral care market share by company (CY10)



Source:Euromonitor, BofA Merrill Lynch Global Research

Chart 33: Shampoo market share by company (CY10)



Source:Euromonitor, BofA Merrill Lynch Global Research

## Key Issues

### Shampoo segment is facing high competitive intensity

Shampoo segment is experiencing high competitive intensity, with P&G having adopted aggressive price cuts in 2011. This has resulted in over 30% price cuts in the segment.

### Skin-care is underpenetrated and witnessing strong volume growth

Skin care, which is relatively underpenetrated compared to other categories like Soaps and Detergents, is experiencing strong volume growth led by increasing reach and affordability.

## 3. Beverages (12% revenue, 13% EBIT)

HUL sells packaged tea and coffee as part of its Beverages portfolio. It has a value share of ~20% in tea and 31% in coffee segment. Tata Global Beverages is the main organized competitor in tea and Nestle in coffee.

### HUL strategy

In tea, HUL has national as well as regional brands. With its strategy to straddle the entire pyramid, it entered into discount segment with a launch of Red Label Dust in 2011. In coffee, HUL dominates in filter coffee and mixed instant coffee.

### Competitive landscape

#### Tea: High competitive intensity in economy segment

Packaged tea market has 300 brands with regional as well as national players. Other than HUL and Tata Global Beverages, Dhunseri, Jay Shree, Wagh Bakri are the brands with strong regional presence. Given lower overheads, regional players offer competitive prices vs pan-India players like HUL. Competitive intensity is slated to increase with the entry of Nestle in instant tea category. Brooke Bond and Lipton are key brands for HUL.

Table 17: Domestic branded tea market players (March 2010)

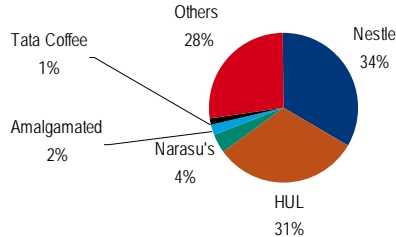
| Company               | Brands  |
|-----------------------|---|
| Hindustan Unilever    | Taj Mahal, Yellow Label, 3 Roses, Top Star, Red Label, Taaza, Super, A1, Tiger, Ruby                  |
| Tata Global Beverages | Temptation, Chakra Gold, Tetley, Tata Tea Premium, Kanna, Devan, Gemini, Tata Tea Gold, Tata Tea Agni |
| Duncans               | Runglee Rungliot, Double Diamond, Sargam, Shakti TeaNo. 1   |
| Goodricke             | Castleton, Badamtam, Premium, Darjeling, Thurbo, Fine estate, Goodricke, Zabardast                    |
| Eveready              | Jaago, Classic, Tez, Premium Gold   |
| Jay Shree             | Antique, Everest Classic, Jaandar, Birla Premium, Sadabahar, Shandaar, Kanchenjunga, Sangam           |
| Dhunseri              | Lal Ghoda, Kala Ghoda, Chote Lal  |
| HML                   | Harrisson's Gold, Spencer, Mountain Mist, Surya   |

Source:Industry data, BofA Merrill Lynch Global Research

**Coffee: domination by large corporates**

Nestle and HUL dominate the branded coffee market in India. Nestle leads with over 34% value share followed by HUL at 31%. HUL is present in mixed instant coffee and filter coffee market with its brand 'Bru'.

**Chart 34: Value market share - branded coffee (CY10)**



Source:Euromonitor, BofA Merrill Lynch Global Research

**Table 18: Domestic branded coffee market players**

| Company            | Brands  |
|--------------------|---|
| Nestle             | Nescafe Classic, Nescafe Mild, Sunrise                          |
| Hindustan Unilever | Bru, Deluxe Green Label   |
| Tata Coffee        | Mr Bean, Tata Cafe, Mysore Gold Coffee, Tata Kaapi,             |
| CCL Products       | Continental Spéciale , Continental Premium, Continental Supreme |

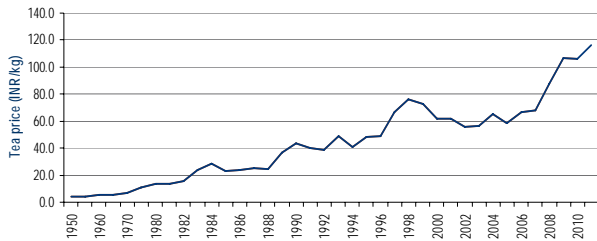
Source:Industry data, BofA Merrill Lynch Global Research

**Key Issues**

**Tea and coffee prices are in structural uptrend**

Post 2007, tea prices have risen consistently led by i) higher annual demand vs supply, ii) increasing shortages, and iii) lack of a large new capacity coming on stream. We expect price uptrend in tea to continue in the medium term led by this. Similarly, coffee prices are increasing since 2004 led by i) higher demand growth vs supply, ii) declining inventory, and iii) declining production post FY12.

**Chart 35: Tea prices are at an all-time high and can go higher**



Source:J Thomas Tea Statistics; BofA Merrill Lynch Global Research

**Chart 36: Coffee prices**



Source:Crisil; BofA Merrill Lynch Global Research

#### 4. Processed foods (5% revenue, 0.5% EBIT)

HUL sells its processed foods portfolio under 'Kissan' (Ketchups, Jams), 'Knorr' (Soups, Meals, and Noodles) and 'Annapurna' (Salt and Atta/flour) brand names.

#### HUL's strategy

##### High A&P spends along with product innovations

HUL's focus in this category is on innovations backed by strong marketing efforts.

#### Competitive landscape

Table below lists competition in the categories where HUL is present.

Table 19: HUL's processed food presence

| Category    | Market size (INR bn) | Category CAGR | Competition            | HUL market share |
|-------------|----------------------|---------------|------------------------|------------------|
| Ketchups    | 5.7                  | 14.0%         | Nestle (Maggi), Heinz  | ~24%             |
| Jams        | 2.5                  | 18.0%         | SIL, Tops              | ~65%             |
| Soups       | 1.5                  | 24.6%         | Nestle (Maggi)         | ~70%             |
| Noodles     | 21.9                 | 18.5%         | Nestle, ITC, Top Ramen | <3%              |
| Salt        | 10.1                 |               | Tata, ITC, Dandi       |                  |
| Atta/ flour | 8.1                  | 15.6%         | ITC, Pillsbury         | ~18%             |

Source: BofA Merrill Lynch Global Research

#### Key Issues

##### Food inflation

Agri commodities are the key raw materials in this segment. Also, cost increases cannot be freely passed on to consumers given the competitive intensity. Given this, margins in the segment can fluctuate depending on agri commodity prices.

##### Underpenetrated market, large opportunity

While processed food is estimated to be US\$21bn annual opportunity in India, it is highly underpenetrated with ~20% households reporting usage in urban India and less than 10% in rural India across various categories. Rural market is dominated by a large number of unorganized players led by cheaper prices.

#### 5. Ice Creams (1% revenue, 1% EBIT)

HUL sells ice creams under its 'Wall's' and 'Cornetto' brands. It also runs Swirl's parlors that are owned as well as franchisee-based ice cream parlors.

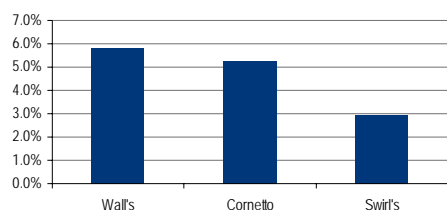
#### HUL's strategy

HUL's strategy is focused on expanding distribution and innovations. It continues to build 'Out of Home' presence through expansion of Swirl's parlors that are 150 in numbers currently. Moreover, segmenting the product portfolio to target specific consumer segments has been a key strategy in ice creams. For example, Paddle Pop range was directed at children, while bulk ice cream range Kwaliti Wall's Selection was targeted at families.

#### Competitive landscape

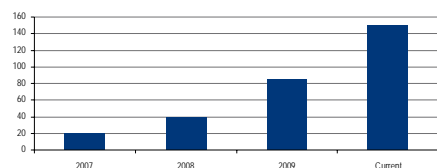
Ice cream market in India is estimated to be ~INR24bn with more than ~100mn tons of ice cream produced annually and growing at ~20% yoy. Organized sector forms over 50% of this. Amul is the largest in this segment with ~31% market share followed by HUL at ~14% share. Local chains like Naturals (Mumbai), Nirula's (Delhi) and Mama Mia (Kolkata) offer strong regional competition.

Chart 37: Indicative market share of HUL's various ice cream brands



Source:Euromonitor, BofA Merrill Lynch Global Research

Chart 38: Consistent increase in Swirl's ice cream parlors



Source:Company

Table 20: Competitive landscape

| Name         | Indicative market share | Geography |
|--------------|-------------------------|-----------|
| Amul         | ~31%                    | PAN India |
| HUL          | ~14%                    | PAN India |
| Mother Dairy | ~11%                    | PAN India |
| Vadilal      | ~8%                     | PAN India |
| Natural's    | ~2%                     | Mumbai    |
| Others       | ~34%                    |           |
| <b>Total</b> | <b>100%</b>             |           |

Source: Euromonitor, BofA Merrill Lynch Global Research

### Key Issues

#### Competitive pricing from unorganized players

Nearly half of the ice cream market is unorganized in nature. These players, while having a limited presence, also price their products competitively led by lower overheads.

### 6. Others - mainly water purifiers (2% revenue, -3% EBIT)

As part of this segment, HUL markets its Pureit brand of water purifiers. While HUL entered this segment in 2004, the segment is yet to turn profitable.

#### HUL's strategy

HUL is focused on the mass market in this segment. Its five variants are priced in the range of Rs900-5900. HUL sells this product through direct selling as well as store-based selling. Pureit water purifier is supported by strong A&P spends given the high competitive intensity and focus on market-share gain.

#### Competitive landscape

Water purifier is estimated to be ~US\$500mn market, of which HUL has ~20% market share. Various estimates put the market penetration at 1% to 5% and growth at 18% to 20%. Key players in the segment include HUL, Kent, Whirlpool, Tata Chemicals, Eureka Forbes, Kenstar, Zero B, etc. The segment is also likely to see new entrants like LG, Godrej, etc.

### Key Issues

#### Market is underpenetrated

Various industry estimates put market penetration at 1% to 5%. Further, high competitive intensity has made it difficult for new entrants like HUL to break even.

## Company background

### History

Hindustan Unilever Limited ('HUL') marked its presence in India in 1888 by introducing sunlight soap. Over time, HUL entered into toilet soaps, tea, oral care etc. In 1933, Lever Brothers India Limited was incorporated in India before forming Hindustan Lever Ltd in 1956. Later, it expanded its presence in synthetic detergents, agri-products, etc. In 2007, the name of the company was formally changed to Hindustan Unilever Ltd.

HUL also pursued large number of inorganic initiatives over time. Key acquisitions include Kissan brands from United Breweries Group, merger of Tata Oil Mills Company (TOMCO), 50:50 JV with US-based Kimberley-Clark Corpn, acquisition of Kwality, Milkfood as well as Lakme brands and acquisition of Modern Food Industries etc.

### Shareholding pattern

Unilever's shareholding in HUL has improved marginally over time, led by buybacks in FY07 and FY11.

Table 21: Shareholding pattern

| Name      | Q1-07 | Q2-07 | Q3-07 | Q4-07 | Q1-08 | Q2-08 | Q3-08 | Q4-08 | Q1-09 | Q2-09 | Q3-09 | Q4-09 | Q1-10 | Q2-10 | Q3-10 | Q4-10 | Q1-11 | Q2-11 | Q3-11 | Q4-11 | Q1-12 |
|-----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| Promoters | 51%   | 51%   | 51%   | 51%   | 51%   | 51%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 52%   | 53%   | 53%   |
| FII       | 14%   | 14%   | 13%   | 12%   | 12%   | 13%   | 14%   | 15%   | 14%   | 14%   | 15%   | 14%   | 14%   | 15%   | 15%   | 14%   | 16%   | 17%   | 17%   | 17%   | 18%   |
| MFs       | 3%    | 3%    | 3%    | 4%    | 4%    | 4%    | 2%    | 3%    | 4%    | 4%    | 4%    | 5%    | 4%    | 4%    | 3%    | 3%    | 3%    | 3%    | 3%    | 3%    | 3%    |
| Others    | 32%   | 32%   | 32%   | 33%   | 32%   | 32%   | 31%   | 30%   | 30%   | 30%   | 29%   | 29%   | 29%   | 30%   | 30%   | 30%   | 29%   | 28%   | 27%   | 27%   | 26%   |
| Total     | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  | 100%  |

Source:NSE

Table 22: Stable and experienced management

| Name             | Designation  | Profile   |
|------------------|--|---|
| Nitin Paranjpe   | Managing Director and CEO                          | # Has been with HUL since 1987<br># Bachelor of Engineering (Mechanical) and MBA in Marketing (JBIMS) from Mumbai                   |
| R. Sridhar       | Chief Financial Officer                            | # With HUL since 1989; Has worked with Larsen & Toubro Limited<br># A Chartered Accountant, a Cost Accountant and Company Secretary |
| Gopal Vittal     | Executive Director, Home & Personal Care           | # With HUL for over 19 years; Earlier worked Bharti Airtel<br># MBA from IIM, Calcutta  |
| Hemant Bakshi    | Executive Director, Sales and Customer Development | # Associated with HUL since 1989<br># Graduate from IIT, Bombay, in Chemical Engineering and PGDM from IIM Ahmedabad                |
| Pradeep Banerjee | Executive Director, Supply Chain                   | # Has been with HUL since 1980<br># He holds a Bachelor's Degree in Engineering (Chemical) from IIT Delhi                           |
| Leena Nair       | Executive Director, HR                             | # An Electronic Engineer and is a gold medalist and MBA in HR from XLRI, Jamshedpur   |

Source:Company

Table 23: Key Milestones

| Year | Milestone  | Remarks  |
|------|--|--|
| 1888 | # HUL steps into India with launch of sunlight soap  |  |
| 1895 | # Agents appointed in Mumbai, Chennai, Kolkata and Karachi   |  |
| 1903 | # HUL enters tea market in India with the launch of Brooke Bond Red Label  |  |
| 1913 | # HUL entered India's hand dishwashing market with the launch of Vim scouring powder   |  |
| 1918 | # HUL entered Vanaspati market in India  |  |
| 1924 | # HUL explored the Indian dental market with the launch of Gibbs dental preparations   |  |
| 1933 | # Incorporation of Lever Brothers India Limited  |  |
| 1947 | # Entered cold cream market with the launch of Pond's Cold Cream   |  |
| 1956 | # Hindustan Unilever was formed with merger of Hindustan Vanaspati Manufacturing Company, Lever Brothers India Limited and United Traders  |  |
| 1964 | # HUL entered dairy market with set up of Etah dairy and launched Anik ghee<br># Animal feeds plant set up at Ghaziabad<br># HUL entered shampoo market in India with launch of Sunsilk shampoo  |  |
| 1966 | # HUL entered Baby food market in India<br># Started Nickel catalyst production  |  |
| 1969 | # HUL entered Indian coffee market with launch of Bru coffee   |  |
| 1972 | # Unilever acquired Lipton   |  |
| 1982 | # Government allowed Unilever to hold 51% shares   |  |
| 1986 | # Agri-products unit at Hyderabad started producing Hybrid seeds   |  |
| 1992 | # Brooke Bond acquired Kothari General Foods   |  |
| 1993 | # Brooke Bond India acquired the Kissan brand from the United Breweries Group<br># Acquired the Dollops Icecream business from Cadbury India   |  |
| 1994 | # Tata Oil Mills Company (TOMCO) merged with HUL<br># HUL entered into a 50:50 joint venture "Kimberley-Clark Lever Ltd." with US-based Kimberley-Clark Corporation to market Huggies diapers and Kotex feminine care products<br># Launched the Wall's range of Frozen Desserts<br># HUL entered into a strategic alliance with the Kwaliti Icecream Group families |  |
| 1995 | # "Milkfood's" 100% Icecream marketing and distribution rights were acquired by HUL<br># HUL entered staples business with the launch of Kissan Annapurna salt   |  |
| 1996 | # HUL formed a 50:50 joint venture "Lakme Lever Ltd" with Lakme Ltd<br># Branded atta launched   |  |
| 1998 | # Acquired Lakme brand, factories along with Lakme's 50% equity in Lakme Lever Ltd<br># Pond's India Ltd merged with HUL   |  |
| 2000 | # HUL acquired 74% stake in Modern Food Industries Ltd that was the first public sector company to be disinvested by the Government of India   | The first public sector company to be disinvested by the Government of India                     |
| 2001 | # Project Shakti - a rural initiative launched. Currently ~45,000 Shakti entrepreneurs covering over 100,000 villages across 15 states and reaching to over 3 million homes.   |  |
| 2002 | # HUL acquired the government's remaining stake in Modern Foods<br># HUL entered Ayurvedic health & beauty centre category with the launch of Ayush product range and Ayush Therapy Centres  |  |
| 2003 | # HUL acquired the Cooked Shrimp and Pasteurised Crabmeat business of the Amalgam Group of Companies<br># Hindustan Unilever Network, a Direct to home business was launched<br># Edible oils and fats businesses sold to Bunge Limited  | Amalgam is a leader in value added Marine Products exports                                       |
| 2004 | # HUL entered the water purifier business with the Launch of 'Pureit' water purifier   |  |
| 2007 | # The Company name was formally changed to Hindustan Unilever Limited  |  |
| 2010 | # Hindustan Unilever exited from BPO firm Capgemini Business Services India by selling its 49% stake to IT consultancy firm Cap Gemini SA<br># Bought back 1% shares   | Hindustan Field Services Pvt. Ltd is a joint venture between HUL and Smollan Holdings (Pty) Ltd. |
| 2011 | # HUL demerged its FMCG exports business including specific exports related manufacturing units of the Company into its wholly owned subsidiary Unilever India Exports Ltd (UIEL)  |  |

Source:Company, BofA Merrill Lynch Global Research

## Financial tables

Table 24: Profit and loss statement

| INR mn                     | FY10A          | FY11           | FY12E          | FY13E          | FY14E          |
|----------------------------|----------------|----------------|----------------|----------------|----------------|
| - Soaps & Detergents       | 82,656         | 87,916         | 94,070         | 100,655        | 107,700        |
| - Personal Products        | 50,479         | 58,441         | 67,207         | 77,288         | 88,881         |
| - Beverages                | 21,424         | 23,440         | 26,018         | 28,880         | 32,057         |
| - Foods                    | 7,308          | 9,026          | 10,831         | 12,455         | 14,324         |
| - Ice creams               | 2,310          | 2,746          | 3,213          | 3,694          | 4,249          |
| - Exports                  | 10,053         | 10,997         | 11,546         | 12,124         | 12,730         |
| - Other operations         | 3,467          | 4,380          | 5,037          | 5,793          | 6,662          |
| <b>Total Revenue</b>       | <b>177,659</b> | <b>196,945</b> | <b>217,922</b> | <b>240,889</b> | <b>266,603</b> |
| <b>Total EBITDA</b>        | <b>29,521</b>  | <b>29,150</b>  | <b>33,494</b>  | <b>38,479</b>  | <b>44,214</b>  |
| <b>Depreciation</b>        | <b>1,469</b>   | <b>1,794</b>   | <b>1,936</b>   | <b>2,097</b>   | <b>2,281</b>   |
| <b>Total EBIT</b>          | <b>28,052</b>  | <b>27,356</b>  | <b>31,558</b>  | <b>36,382</b>  | <b>41,933</b>  |
| Unallocated Inc/(Exp)      | (2,393)        | (2,571)        | (2,442)        | (2,320)        | (2,204)        |
| Operating Profit           | 25,659         | 24,785         | 29,115         | 34,062         | 39,729         |
| Interest cost              | (70)           | (2)            | (2)            | (2)            | (2)            |
| Other income               | 1,481          | 2,519          | 2,519          | 2,519          | 2,519          |
| Profit bef Tax             | 27,071         | 27,302         | 31,632         | 36,579         | 42,246         |
| Tax                        | 6,044          | 5,769          | 6,959          | 8,230          | 9,717          |
| <b>PAT bef exceptional</b> | <b>21,027</b>  | <b>21,533</b>  | <b>24,673</b>  | <b>28,349</b>  | <b>32,530</b>  |

Source: Company; BofA Merrill Lynch Global Research

Table 25: Balance sheet

| Yr ending 31 <sup>st</sup> Dec, INR mn | FY10A         | FY11A         | FY12E         | FY13E         | FY14E         |
|--|---------------|---------------|---------------|---------------|---------------|
| <b>ASSETS</b>                          |               |               |               |               |               |
| Gross Fixed Assets                     | 35,820        | 37,596        | 40,096        | 42,596        | 45,096        |
| Accumulated Depreciation               | (14,199)      | (15,905)      | (17,841)      | (19,938)      | (22,219)      |
| <b>Net Fixed Assets</b>                | <b>21,621</b> | <b>21,692</b> | <b>22,255</b> | <b>22,658</b> | <b>22,877</b> |
| Capital Work in Progress               | 2,740         | 2,991         | 2,991         | 2,991         | 2,991         |
| <b>Net Fixed Assets</b>                | <b>24,361</b> | <b>24,682</b> | <b>25,246</b> | <b>25,649</b> | <b>25,868</b> |
| Investments                            | 12,641        | 12,607        | 12,607        | 12,607        | 12,607        |
| - Investments - near cash              | 11,642        | 11,401        | 11,401        | 11,401        | 11,401        |
| Inventories                            | 21,799        | 28,113        | 30,509        | 33,725        | 37,324        |
| Receivables                            | 6,716         | 9,432         | 10,896        | 10,840        | 11,997        |
| Other Assets                           | 6,240         | 7,007         | 7,845         | 8,672         | 9,598         |
| Cash and Bank Balances                 | 18,922        | 16,400        | 22,068        | 28,332        | 32,529        |
| <b>Total Current Assets</b>            | <b>53,678</b> | <b>60,952</b> | <b>71,318</b> | <b>81,569</b> | <b>91,448</b> |
| <b>Creditors for Goods</b>             | <b>43,737</b> | <b>47,262</b> | <b>52,301</b> | <b>57,813</b> | <b>63,985</b> |
| <b>Other Current Liabilities</b>       | <b>23,595</b> | <b>26,736</b> | <b>29,419</b> | <b>32,520</b> | <b>35,991</b> |
| <b>Total Current Liabilities</b>       | <b>67,332</b> | <b>73,998</b> | <b>81,721</b> | <b>90,334</b> | <b>99,976</b> |
| Net Current Assets excl Cash           | (32,577)      | (29,446)      | (32,470)      | (37,097)      | (41,057)      |
| <b>Total Assets</b>                    | <b>23,347</b> | <b>24,243</b> | <b>27,450</b> | <b>29,491</b> | <b>29,947</b> |
| <b>LIABILITIES</b>                     |               |               |               |               |               |
| Equity Share Capital                   | 2182          | 2160          | 2160          | 2160          | 2160          |
| Other Reserves                         | 265           | 25            | 25            | 25            | 25            |
| Share Premium Reserve                  | 712           | 9             | 9             | 9             | 9             |
| General Reserve                        | 22677         | 24146         | 27354         | 29395         | 29850         |
| Total Reserves                         | 23,653.5      | 24,179.7      | 27387         | 29428         | 29884         |
| <b>Net Worth</b>                       | <b>25835</b>  | <b>26339</b>  | <b>29547</b>  | <b>31588</b>  | <b>32043</b>  |
| Accumulated Def Tax Asset              | -2488         | -2097         | -2097         | -2097         | -2097         |
| <b>Total Liabilities</b>               | <b>23347</b>  | <b>24243</b>  | <b>27450</b>  | <b>29491</b>  | <b>29947</b>  |

Source: Company; BofA Merrill Lynch Global Research

**Table 26: Cash flow statement**

| INR mn                         | FY10A           | FY11A           | FY12E           | FY13E           | FY14E           |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Profit after tax and XO        | 22,020          | 23,060          | 24,673          | 28,349          | 32,530          |
| Depreciation                   | 1,469           | 1,794           | 1,936           | 2,097           | 2,281           |
| <b>Op profit bef W.Cap chg</b> | <b>23,489</b>   | <b>24,854</b>   | <b>26,609</b>   | <b>30,445</b>   | <b>34,811</b>   |
| Changes in working cap         | 12975           | -3130           | 3024            | 4627            | 3960            |
| <b>Cash from operations</b>    | <b>36,463</b>   | <b>21,724</b>   | <b>29,633</b>   | <b>35,072</b>   | <b>38,770</b>   |
| Capex                          | -5041           | -2116           | -2500           | -2500           | -2500           |
| (Inc) / dec in investments     | -9315           | 34              | 0               | 0               | 0               |
| <b>Cash from investing</b>     | <b>(14,355)</b> | <b>(2,082)</b>  | <b>(2,500)</b>  | <b>(2,500)</b>  | <b>(2,500)</b>  |
| <b>Free cash flow</b>          | <b>22,108</b>   | <b>19,642</b>   | <b>27,133</b>   | <b>32,572</b>   | <b>36,270</b>   |
| Increase in share capital      | 2               | -22             | 0               | 0               | 0               |
| Chg in debt                    | -4219           | 0               | 0               | 0               | 0               |
| Dividend paid plus tax         | -17827          | -16556          | -21466          | -26307          | -32074          |
| <b>Cash from financing</b>     | <b>(22,044)</b> | <b>(16,578)</b> | <b>(21,466)</b> | <b>(26,307)</b> | <b>(32,074)</b> |
| Total cash flow                | 64              | 3,064           | 5,668           | 6,265           | 4,196           |
| Opening cash                   | 19,815          | 30,565          | 27,801          | 33,468          | 39,733          |
| <b>Closing cash</b>            | <b>19,879</b>   | <b>33,628</b>   | <b>33,469</b>   | <b>39,733</b>   | <b>43,929</b>   |

Source: Company; BofA Merrill Lynch Global Research

**Table 27: Key Ratios**

|                                | FY10A   | FY11    | FY12E   | FY13E   | FY14E   |
|--------------------------------|---------|---------|---------|---------|---------|
| <b>Margins</b>                 |         |         |         |         |         |
| EBITDA                         | 16.6%   | 14.8%   | 15.4%   | 16.0%   | 16.6%   |
| EBIT                           | 15.8%   | 13.9%   | 14.5%   | 15.1%   | 15.7%   |
| PAT                            | 11.8%   | 10.9%   | 11.3%   | 11.8%   | 12.2%   |
| Effective tax rate             | 22.3%   | 21.1%   | 22.0%   | 22.5%   | 23.0%   |
| <b>Per Share Data</b>          |         |         |         |         |         |
| EPS (INR)                      | 9.64    | 9.97    | 11.43   | 13.13   | 15.06   |
| CEPS (INR)                     | 14.20   | 14.33   | 16.41   | 18.79   | 21.53   |
| Dividend Payout %              | 72%     | 66%     | 75%     | 80%     | 85%     |
| Dividend Per Share (INR)       | 6.98    | 6.58    | 8.57    | 10.50   | 12.80   |
| Book-value (INR)               | 11.84   | 12.20   | 13.68   | 14.63   | 14.84   |
| <b>Growth Ratios</b>           |         |         |         |         |         |
| Revenue                        | 6.4%    | 10.9%   | 10.7%   | 10.5%   | 10.7%   |
| EBITDA                         | 4.9%    | -1.3%   | 14.9%   | 14.9%   | 14.9%   |
| EBIT                           | 4.6%    | -2.5%   | 15.4%   | 15.3%   | 15.3%   |
| PAT                            | 0.6%    | 2.4%    | 14.6%   | 14.9%   | 14.7%   |
| EPS                            | 0.4%    | 3.5%    | 14.6%   | 14.9%   | 14.7%   |
| <b>Return Ratios</b>           |         |         |         |         |         |
| RONW                           | 91%     | 83%     | 88%     | 93%     | 102%    |
| ROCE                           | 90%     | 89%     | 90%     | 96%     | 109%    |
| <b>Other Key Metrics</b>       |         |         |         |         |         |
| Debt to equity ratio           | -118.3% | -105.5% | -113.3% | -125.8% | -137.1% |
| Assets Turnover                | 779%    | 828%    | 843%    | 846%    | 897%    |
| DSO                            | 13.80   | 17.48   | 18.25   | 16.43   | 16.43   |
| Current assets as a % of sales | 30.2%   | 30.9%   | 32.7%   | 33.9%   | 34.3%   |
| Cash and cash equivalents      | 30,565  | 27,801  | 33,468  | 39,733  | 43,929  |
| Free cash flow                 | 22,108  | 19,642  | 27,133  | 32,572  | 36,270  |

Source: Company; BofA Merrill Lynch Global Research



## Price objective basis & risk

### Hindustan Unilever (HINLF)

Our PO of INR360 is based on a target 1yr fwd PE of 26x which is in line with DCF value and is at 10% premium to target PE of ITC- justified given higher RoE for HUL and converging growth differential. The target PE is also in line with the average of the last five years trading multiple.

Key risks: i) high competitive intensity can drive HUL to increase A&P spends that can impact margins and ii) failure in monsoon can pose risk to demand especially in rural India.

## Link to Definitions

### Consumer & Retail

Click [here](#) for definitions of commonly used terms.

## Analyst Certification

I, Prasad Deshmukh, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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India - Consumer Coverage Cluster

| Investment rating | Company                  | BofA Merrill Lynch ticker | Bloomberg symbol | Analyst         |
|-------------------|--------------------------|---------------------------|------------------|-----------------|
| BUY               | Hindustan Unilever       | HINLF                     | HUVR IN          | Prasad Deshmukh |
|                   | ITC Limited              | ITCTF                     | ITC IN           | Prasad Deshmukh |
|                   | McLeod Russel India Ltd. | XCVFF                     | MCLR IN          | Prasad Deshmukh |

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

| Business Performance       | Numerator  | Denominator  |
|----------------------------|--|--|
| Return On Capital Employed | $\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$   | 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   | $\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$ |  |
| EV / EBITDA                | Enterprise Value   | Basic EBIT + Depreciation + Amortization   |

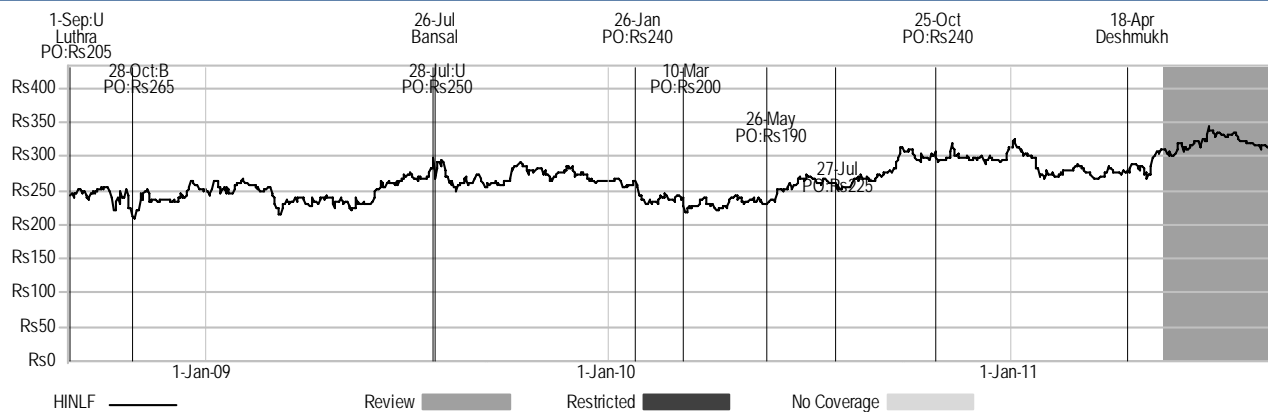
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## Important Disclosures

### HINLF Price Chart



B : Buy, N : Neutral, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of [August 31, 2011] or such later date as indicated.

### Investment Rating Distribution: Consumer Products Group (as of 01 Jul 2011)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy               | 35    | 60.34%  | Buy                         | 19    | 59.38%  |
| Neutral           | 13    | 22.41%  | Neutral                     | 7     | 63.64%  |
| Sell              | 10    | 17.24%  | Sell                        | 6     | 60.00%  |

### Investment Rating Distribution: Global Group (as of 01 Jul 2011)

| Coverage Universe | Count | Percent | Inv. Banking Relationships* | Count | Percent |
|-------------------|-------|---------|-----------------------------|-------|---------|
| Buy               | 2024  | 53.94%  | Buy                         | 935   | 50.68%  |
| Neutral           | 944   | 25.16%  | Neutral                     | 442   | 51.64%  |
| Sell              | 784   | 20.90%  | Sell                        | 273   | 37.24%  |

\* Companies in respect of which BofA Merrill Lynch or one of its affiliates 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.

**FUNDAMENTAL EQUITY OPINION KEY:** Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. **VOLATILITY RISK RATINGS**, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. **INVESTMENT RATINGS** reflect the analyst's assessment of a stock's: (i) absolute total return potential and (ii) attractiveness for investment relative to other stocks within its *Coverage Cluster* (defined below). There are three investment ratings: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

| 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%   |

\* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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09 September 2011

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