Sharekhan by BNP PARIBAS

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Stock Update

Hindustan Unilever

Winter products to make Q3 glow

Consumer Goods | Sharekhan code: HINDUNILVR | Company Update

Summary

- We retain a Buy on HUL with a revised PT of Rs. 2790 (rolling it over to FY23E estimates). A strong product portfolio, wide distribution reach and sturdy balance sheet make HUL an evergreen pick in the FMCG space.
- For Q3FY2021, we expect HUL's core business volumes to grow by 6-7% as against 1% in Q2FY2021 driven by strong demand for winter products and sustained higher sales of personal wash products.
- Gross margins to remain under pressure led by higher input prices. However, judicious price hikes in key SKUs (soaps and tea) and a better revenue mix would ease pressure on gross margins in the coming quarters.
- Rural demand outpacing urban demand, improving growth prospects of health food drinks segment and expected recovery in discretionary demand remain key growth drivers in the near term.

Hindustan Unilever (HUL) 80% of core business portfolio (including health, hygiene and nutrition) portfolio registered underlying sales growth of 10% in Q2FY2021. This was driven by strong sales on platforms such as e-Commerce and general trade channels coupled with higher demand in rural markets. Discretionary portfolio (that contributes 15% of domestic revenues) and out-of-home portfolio registered a 25% drop in revenues during the quarter affecting overall revenue growth of core business (excluding the HFD portfolio). We believe that higher demand for winter-care products (including Vaseline and ponds) would result in strong recovery in the skin-care category. This along with sustained strong demand for personal wash products such as soaps and handwash would lead to an ~10% growth in the beauty and personal care category in Q3FY2021 compared to flat sales in Q2FY2021. Higher demand for household care products and benefits of price cuts in the fabric wash space would help home care to post mid-single digit revenue growth in Q3. Overall we expect HUL's core business volumes to grow by 6-7% in Q3FY2021 as compared to a just 1% volume growth in Q2FY2021. Gross margins will remain under pressure in Q3FY2021 with the expected drop of 122 bps in the gross margins to 52.4% due to surge in the palm oil, raw tea and other key input prices. However judicious price hikes in soaps and tea portfolio coupled with a correction in the domestic raw tea prices from its high would ease out pressure on the gross margins in the coming quarters. With leadership position in more than 90% of the portfolio and presence in more than eight million stores, HUL is well poised to achieve good growth in the coming years. Improving penetration in 70% of the portfolio, over 50product launches and sustained focus on new products launches coupled with improving growth prospects of acquired health food drinks business would help HUL to achieve a 10-12% revenue growth in FY2022/23 and the OPM would gradually inch-up to 27% in FY2023.

Our Call

View: Retain Buy with revised PT of Rs. 2,790: Rural demand outpacing urban demand, improving growth prospects for health food drinks and an expected recovery in discretionary categories remain key growth drivers in the near term. We expect HUL revenues and PAT to grow at a CAGR of 13% and 21% over FY2020-23 (including the acquired business of GSK Consumers). This along with a strong cash generation ability and strong dividend payout makes it better pick in the large cap FMCG space. We maintain our Buy recommendation on the stock with revised price target of Rs. 2,790 (rolling it over to FY2023E earnings). The stock is currently trading at 46.8x its FY2023E EPS.

Key risk

Any intensified competition in high penetrate categories or increase in key input prices such as palm oil/tea/packaging cost would act as a key risk to our earning estimates.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E*	FY22E*	FY23E*
Revenue	38,224.0	38,785.0	45,464.9	50,964.5	56,490.1
OPM (%)	22.6	24.8	25.3	26.5	27.2
Adjusted PAT	6,199.4	6,885.8	8,440.2	10,639.4	12,140.6
Adjusted EPS (Rs.)	28.7	31.9	35.9	45.3	51.7
P/E (x)	84.2	75.8	67.3	53.4	46.8
P/B (x)	68.2	65.0	11.7	11.2	10.5
EV/EBIDTA (x)	59.7	53.8	47.6	40.3	35.1
RoNW (%)	84.2	87.8	29.8	21.5	23.1
RoCE (%)	113.2	105.2	39.1	28.5	30.7

Source: Company; Sharekhan estimates
**FY21, FY22 and FY23 estimates include the HFD business of GSK Consumer*

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 2,417**	
Price Target: **Rs. 2,790**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

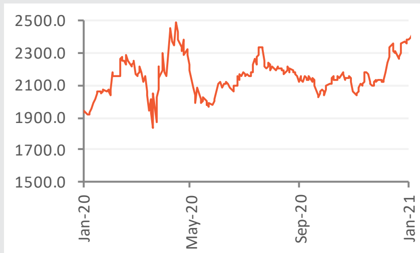
Company details

Market cap:	Rs. 5,67,888 cr
52-week high/low:	Rs. 2,614 / 1,756
NSE volume: (No of shares)	23.1 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Free float: (No of shares)	89.5 cr

Shareholding (%)

Promoters	61.9
FII	14.5
DII	10.8
Others	12.7

Price chart



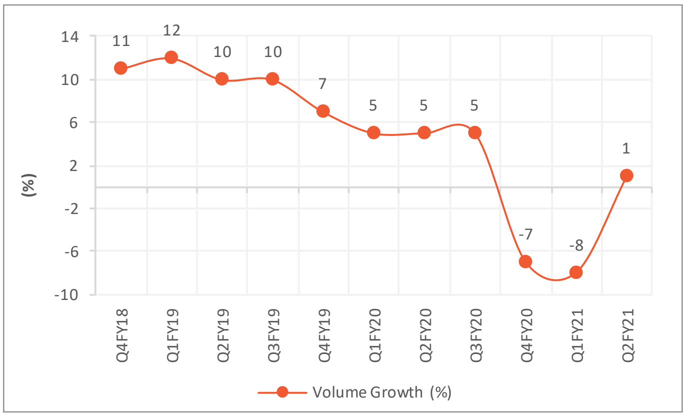
Price performance

(%)	1m	3m	6m	12m
Absolute	4.8	12.7	10.3	19.7
Relative to Sensex	3.9	-8.9	-14.4	1.4

Sharekhan Research, Bloomberg

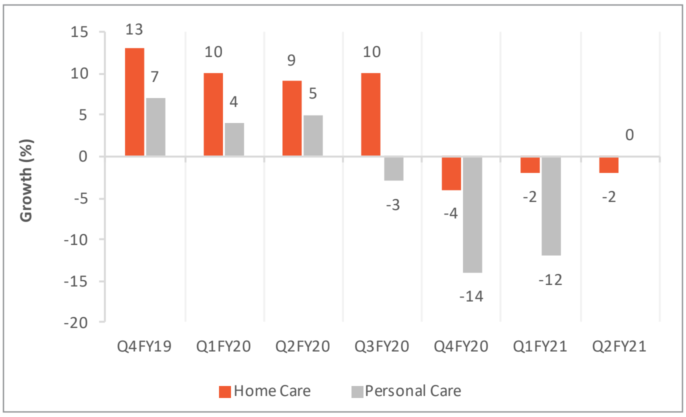
Financials in charts

Volume growth recovered in Q2FY21



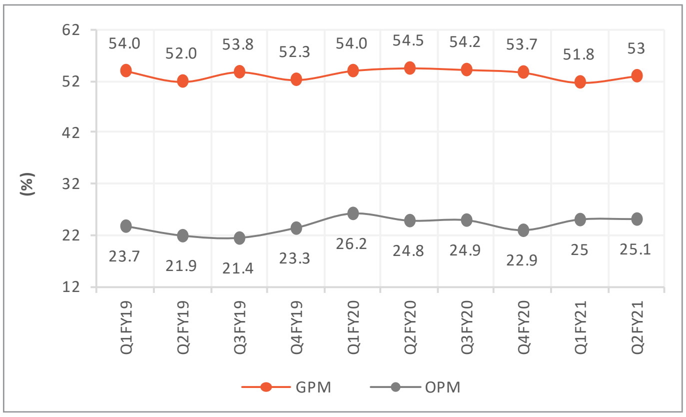
Source: Company, Sharekhan Research

Trend in segmental growth



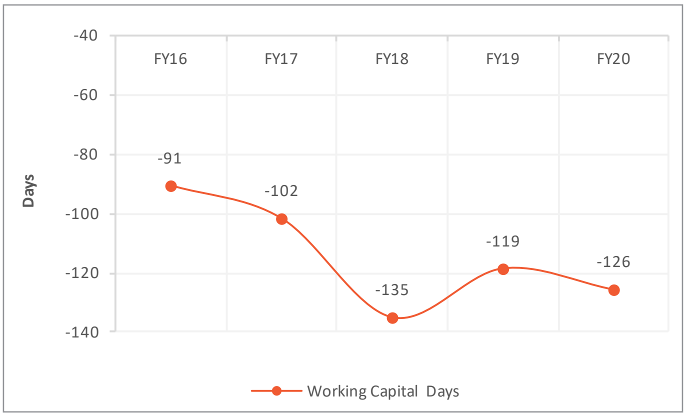
Source: Company, Sharekhan Research

Trend in gross margins and OPM



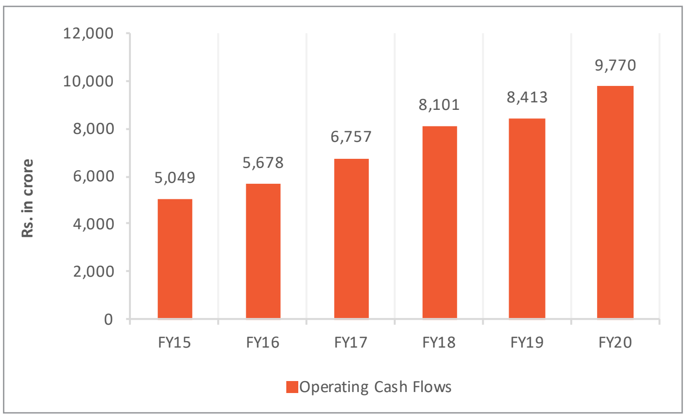
Source: Company, Sharekhan Research

Negative working capital



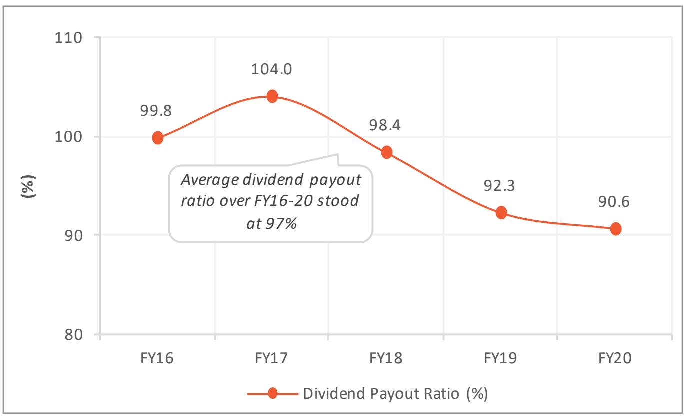
Source: Company, Sharekhan Research

Strong operating cash flows



Source: Company, Sharekhan Research

Cheery dividend payout



Source: Company, Sharekhan Research

Outlook and Valuation

■ **Sector View – Steady revenue growth momentum to sustain; margin pressure to firm up**

We believe that a shift in demand for branded products, rural demand staying of urban demand, gradual recovery in out-of-home categories and new product launches remain key catalysts for revenue growth in the near to medium term. Raw material prices have been rising in the recent past and sustenance of this trend will pressurise gross margins in FY2021. Consumer goods companies ability to pass on the input price increase, sustained benefits of cost-saving initiatives and judicious media spends would determine level the profitability growth in the coming quarters. Structural growth story of domestic consumer goods market is intact with lower per capita consumption of products compared with other international countries, lower penetration in the rural markets and opportunities to launch new differentiated products and gaining market share from small players.

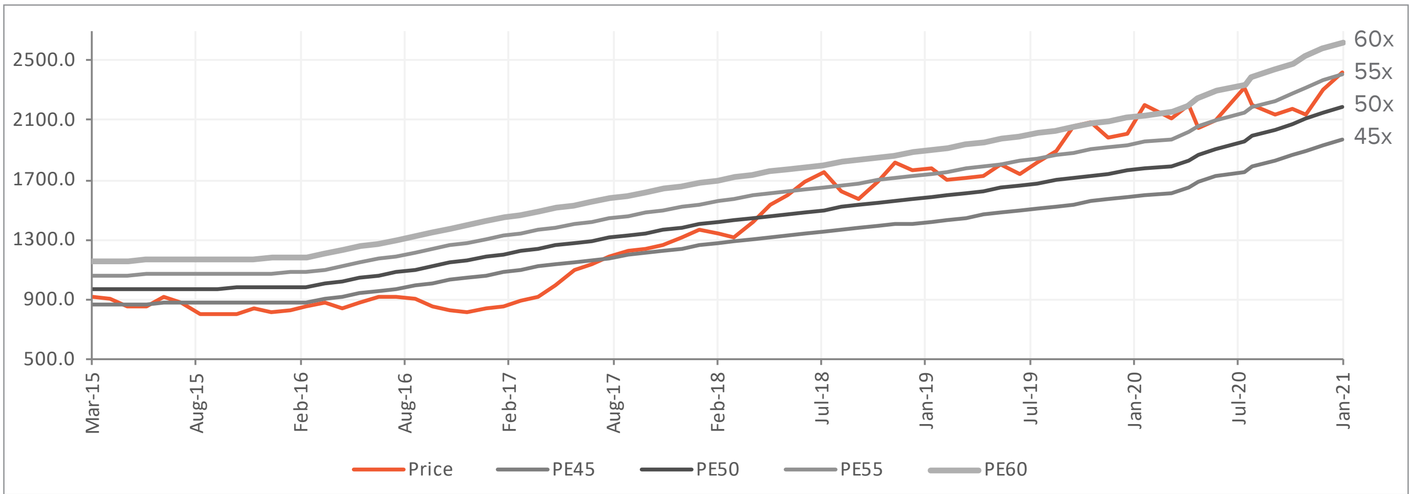
■ **Company Outlook – About 80% of business growing steadily; remaining 20% expected to recover with a lag**

About 80% of HUL's portfolio including (health, hygiene and nutrition) continues to perform well with 10% growth in Q2FY2021. Of the remaining 20%, skin care is witnessing gradual improvement (2/3rd of the portfolio has recovered due to higher demand for winter care products). Out-of-home categories such as Deodorants and Colour cosmetics will take time to recover. With leadership position in more than 90% of the portfolio and presence in more than 8million stores, HUL is well poised to achieve good growth in the coming years. Synergistic benefits from the GSK Consumer merger and cost rationalisation measures will help OPM to improve in the coming quarters.

■ **Valuation – Retain Buy with revised TP of Rs2790**

Rural demand outpacing urban demand, improving growth prospects for health food drinks and an expected recovery in discretionary categories remain key growth drivers in the near term. We expect HUL revenues and PAT to grow at a CAGR of 13% and 21% over FY2020-23 (including the acquired business of GSK Consumers). This along with a strong cash generation ability and strong dividend payout makes it better pick in the large cap FMCG space. We maintain our Buy recommendation on the stock with revised price target of Rs. 2,790 (rolling it over to FY2023E earnings). The stock is currently trading at 46.8x its FY2023E EPS.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Nestle India*	80.6	68.4	59.5	50.5	44.1	38.9	59.8	60.0	56.9
ITC	20.2	16.5	14.5	14.7	11.7	10.1	20.1	25.5	28.6
HUL	67.3	53.4	46.8	47.6	40.3	35.1	39.1	28.5	30.7

Source: Company, Sharekhan Research
**Values for Nestle India are for CY20E, CY21E and CY22E*

About company

HUL is India's largest FMCG company with a strong presence in the homecare and beauty and personal care categories. The company is a subsidiary of Unilever Plc (that holds a 67% stake in HUL), the world's largest consumer goods company present across 190 countries. With over 40 brands spanning 12 distinct categories such as personal wash, fabric wash, skin care, hair care, oral care, deodorants, colour cosmetics, beverages, ice creams, frozen desserts and water purifiers, HUL is part of the everyday life of millions of consumers across India. The company's portfolio includes leading brands such as Lux, Lifebuoy, Surf Excel, Rin, Wheel, Fair & Lovely, Pond's, Vaseline, Lakmé, Dove, Clinic Plus, Sunsilk and Axe. HUL reported revenue of Rs. 38,224 crore and OPM of 22.6% in FY2019.

Investment theme

HUL has a leadership position in highlypenetrated categories such as soaps, detergents and shampoos in India. Sustaining product innovation, entering into new categories, premiumisation and increased distribution network remain some of the key revenue drivers for the company. The merger of GSK Consumer's HFD business will make HUL a formidable play in the HFD segment and will enhance the growth prospects of its relatively small food business. A strong financial background, robust cash generation ability and leadership position in some key categories give HUL an edge over other companies and, hence, justify the stock's premium valuation.

Key Risks

- **Slowdown in the demand environment:** Any slowdown in demand (especially in rural India) would affect sales of key categories, resulting in moderation of sales volume growth.
- **Increased input prices:** Palm oil and crude derivatives such as linear alkyl benzene are some of the key raw materials used by HUL. Any significant increase in the prices of some of these raw materials would affect profitability and earnings growth.
- **Increased competition in highly penetrated categories:** Increased competition in highly penetrated categories such as soaps and detergents would act as a threat to revenue growth.

Additional Data

Key management personnel

Sanjiv Mehta	Chairman and Managing Director
SrinivasPathak	Executive Director, Finance & IT and CFO
PradeepBannerjee	Executive Director, Supply Chain
DevBajpai	Executive Director, Legal and Corporate Affairs and Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Vanguard Group Inc	1.2
2	BlackRock Inc	1.1
3	Nomura Holdings Inc	0.7
4	SBI Funds Management Pvt Ltd	0.7
5	ICICI Prudential Life Insurance Co Ltd	0.4
6	Standard Life Aberdeen PLC	0.4
7	ICICI Prudential Asset Management Co Ltd	0.3
8	J P Morgan Chase & Co	0.3
9	UTI Asset Management Co Ltd	0.3
10	Government Pension Investment Fund	0.2

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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