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Hindustan Unilever Limited

Demand recovery fuels Q3

Consumer Goods	Sharekhan code: HINDUNILVR	Result Update

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. 2,391**	
Price Target: **Rs. 2,790**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

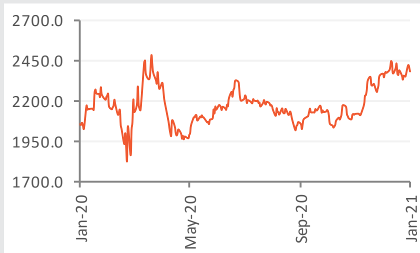
Company details

Market cap:	Rs. 5,61,779 cr
52-week high/low:	Rs. 2,614 / 1,756
NSE volume: (No of shares)	21.9 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Free float: (No of shares)	89.5 cr

Shareholding (%)

Promoters	61.9
FII	14.9
DII	10.7
Others	12.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.1	9.9	7.7	16.0
Relative to Sensex	0.0	-7.1	-17.3	0.8

Sharekhan Research, Bloomberg

Summary

- Hindustan Unilever Limited's (HUL) Q3FY2021 operating performance was largely in-line with expectation with 21% growth in revenue (core business growth of 7%) and OPM at 24.1% (operating profit grew by ~17% and adjusted PAT grew by 15.6%).
- Volume growth in domestic business improved to 4% from 1% in Q2FY2021 (was in-line with street expectation of 4%-5%).
- 80% of essential portfolio grew by 10%, discretionary recovered to almost 100%. Rural India continues to grow in double digits. Management is optimistic of delivering better performance in Q4 because of improved demand environment.
- We broadly maintainour estimates for FY2022/FY2023. HUL remains one of our top picks in the large-cap space. We maintain Buy with an unchanged PT of Rs. 2,790.

Hindustan Unilever Limited's (HUL) Q3FY2021 standalone operating performance was in-line with expectation.Revenue and operating profit grew by 21% and 17% to Rs. 11,862crore and Rs. 854crore,respectively (OPM stood at 24.1%). The decline in other income led to 15.6% growth in adjusted PAT to Rs. 1,952.1crore (our expectation was Rs. 2,048.2crore). Organic revenue growth stood at 7% with volume growth of 4% (better than 1% volume growth achieved in Q2). About 80% of the domestic portfolio (health, hygiene, and nutritional) continues to perform well and registered 10% revenue growth in Q3 (largely volume-led growth). Discretionary portfolio recovered to 100% from 45% decline in June quarter, while out-of-home recovered to 85% of pre-Covid level from 33% in Q1. On the category front,the home care category registered 2% decline in revenue, while beauty and personal care (BPC) category registered 9% growth with strong traction in winter products, personal wash, and oral care growing in double digits each and the colours andcosmetics segment seeing strong sequential recovery. Foodsandrefreshment (F&R) business registered strong 19% growth. Health food drinks (HFD) brands - Horlicks and Boost registered double-digit growth, with supply issues getting sorted during the quarter. Rural demand staying ahead of urban demand, improving penetration of nutritional portfolio, and new product launches remain key revenue drivers in the near term. Higher input prices (such as raw tea and palm oil) would continue to put pressure on gross margins. Calibrated price hikes in the key portfolio (5% price hike in soaps and mid-single digit price hike in tea portfolio), improvement in revenue mix, and focus on cost efficiencies are likely to mitigate the impact of higher input prices. Synergistic benefits from integration of the nutritional business would flow in FY2022 and would provide support to overall profitability. The company is focusing on categories such as naturals and hygiene to build a strong portfolio for various channels (including e-commerce) to deliver sustainable volume-led profitable growth in the medium term.

Key positives

- 86% of domestic portfolio is gaining penetration and market share.
- Second consecutive of quarter double-digit growth delivered by the oral care segment.
- Innovation strategy continues with 18 new product launches in various categories.

Key negatives

- Out-of-home segment (5% of revenues) declined by 15%.
- OPM decreased by 87 bps to 24.1% due to higher input prices and higher investment behind brands.

Our Call

View- Retained Buy with unchanged PT of Rs. 2,790: HUL's management is optimistic about better growth in the coming quarters because of improving demand environment, gaining market share in key categories, and new products gaining good traction. 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's revenue and PAT to register a CAGR of 13% and 21% over FY2020-FY2023 (including the acquired business of GSK Consumers). This along with a strong cash-generation ability and dividend payout makes it a better pick in the large-cap FMCG space. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 2,790. The stock is currently trading at 47x its FY2023E EPS.

Key risk

Frequent lockdowns, increasing intensity of virus spread in tier two and three towns,and significant increase in key input prices would act as a key risk to our earnings in the near term.

Valuation (Standalone) Rs cr

Particulars	FY19	FY20	FY21E*	FY22E*	FY23E*
Revenue	38,224.0	38,785.0	46,071.5	51,693.9	57,611.7
OPM (%)	22.6	24.8	24.4	26.7	27.4
Adjusted PAT	6,199.4	6,885.8	7,920.9	10,440.2	11,962.2
Adjusted EPS (Rs.)	28.7	31.9	33.7	44.4	50.9
P/E (x)	83.3	75.0	70.9	53.8	47.0
P/B (x)	67.4	64.3	11.7	11.2	10.5
EV/EBIDTA (x)	59.1	53.3	48.2	39.0	33.9
RoNW (%)	84.2	87.8	28.3	21.3	23.1
RoCE (%)	113.2	105.2	37.1	28.3	30.7

Source: Company; Sharekhan estimates

**FY2021, FY2022 and FY2023 earnings estimates include the merger of GSK Consumer Healthcare*

Standalone revenue grew by 21% y-o-y; OPM declined by 87 bps: HUL's standalone revenue grew by 21% y-o-y to Rs. 11,862 crore with organic business growing by 7% in Q3, better than 3% growth in Q2FY2021. Domestic volume growth stood at 4% y-o-y. The homecare business revenue stood flat, while BPC and foods business revenue grew by 9% and ~19% each on a y-o-y basis. Gross margin declined by 24bps to 54.0% due to higher input costs, including palm oil and raw tea prices. This along with higher investment behind brands led to an87 bps decline in OPM to 24.1%. Operating profit grew by 16.7% y-o-y to Rs. 2,854crore. Lower other income due to lower yields (led by dropped interest rates) resulted in 15.6% growth in adjusted PAT to Rs. 1,952.1crore.

Homecare – Double-digit growth in household care, fabric care remained soft: Revenue of the homecare category stood almost flat, while PBIT margin improved by 75 bps to 18.9%. Household care registered consecutive quarter of double-digit growth with improved penetration across segments. On the other hand,fabric wash continues to see sequential improvement in revenue with mobility improving due to receding scare of virus. Management expects fabric care business to get back to growth by Q1FY2022. New product launches in household care and fabric wash will improve growth prospects of the category in the near term.

Beauty and personal care (BPC) – Strong growth in skin cleansing, oral care, and hair care: Revenue of the BPC category grew by 10% (better than flat sales in Q2) with double-digit growth in skin cleansing, oral care, and hair care portfolios. However, the highlight of the quarter was pickup in winter care portfolio, which resulted in faster recovery in category sales.In the skin cleansing segment, Lifebuoy and Lux continuedto deliver double-digit growth with higher usage of soaps and improving penetration of handwash in the current pandemic environment. The oral care segment saw second consecutive quarter of double-digit growth, led by good recovery in Close Up, while Pepsodent is yet to recover. Hair care portfolio registered strong growth across brands, driven by consumer-focused innovations.The colours andcosmetic segment hasalso seen recovery on a sequential basis with improvement in domestic mobility. PBIT margin of the B&PC category improved by 81bps to 29.2%.

Foods and Refreshments (F&R) – Strong growth across brands sustained, driven by in-home consumption: Revenue of the underlying F&R category grew by 19% y-o-y. On a reported basis (including the HFD portfolio), the category grew by 80% y-o-y. The foods and beverages segments reported double-digit growth, driven by in-home consumption. Both Kissan and Knorr saw strong consumer traction. Double-digit growth was witnessed across brands in tea. Input cost inflation was managed with price hikes. The company's nutrition segment comprising the recently acquired HFD portfolio (Horlicks andBoost) registered double-digit growth with supply issues getting sorted. The company expanded Boost to pan-India. The F&R category's EBIT margin decreased by 381bps to 14.1% due to higher input prices (including raw tea) and highest investment in the packaged foods segment to improve capabilities in the coming years.

Key Conference call takeaways

- HUL's health, hygiene, and nutrition portfolio, which contributes ~80% to the total revenue grew by 10% in Q3FY2021, driven by demand in essentials and higher in-home consumption. The discretionary portfolio such as skin care, colour cosmetics, and deodorants, whichcontributes ~15% to total revenue,improved sequentially and revenuereached to pre-Covid levels. Out-of-home consumption product portfolio including water, ice cream, and food solutions, which contribute ~5% to the revenue, has seen business recovering to 85% of pre-Covid levels.
- About 86% of the business is gaining volume market share and penetration. Rural geographies are performing better than urban geographies, with rural continuing to grow in double digits, while urban is seeing sequential improvement.

- The winter portfolio remained impacted as traders were cautious of demand and did not fill the inventory pipelines in Q2. However, sequential improvement was seen and the portfolio registered strong traction in Q3. Traction continues in January as well, which will lead to the portfolio deliver good growth in Q4.
- The company took price hike of 5% in soaps portfolio (2.5% in Q2 and 2.5% in Q3) to mitigate the impact of thesharp increase in palm oil prices.
- Oral care registered second consecutive quarter of double-digit growth with Close-up performing well. Traction is improving for Pepsodent brand.. The company is focusing on Naturals as abig long-term opportunity.
- On the acquired nutrition business, the company is focusing on improving its distribution and penetration in FY2022. HUL's distribution reach of 2.5x-3.0x more than the earlier reach of products and strong presence in the rural India provides good opportunity to improve penetration in the near term. The company is focusing on launching small packs and improving the presence at chemists to improve sales in the near term. Boost has beennationally launched and is performing well. Under Horlicks brand, more focus is on launching small packs and introducing premium products to drive growth in the near future.
- In FY2022, there will be rebalancing of portfolio with categories such as sanitizers and personal wash, which will be lower and mitigated by improvement in tractions categories such as detergents and skin care.
- The company made innovations/renovations of 18 new products under various categories. The products will be well distributed on e-commerce and general trade platform. E-commerce sales have grown by 2x compared to last. Modern trade is seeing good recovery on a sequential basis.

Result Snapshot (Standalone) **Rs cr**

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Net revenue	11862.0	9808.0	20.9	11442.0	3.7
Total expenditure	9008.0	7363.0	22.3	8573.0	5.1
Operating Profit	2854.0	2445.0	16.7	2869.0	-0.5
Other income	97.0	140.0	-30.7	151.0	-35.8
EBITDA	2951.0	2585.0	14.2	3020.0	-2.3
Interest	41.0	25.0	64.0	29.0	41.4
PBDT	2910.0	2560.0	13.7	2991.0	-2.7
Depreciation	272.0	232.0	17.2	249.0	9.2
PBT	2638.0	2328.0	13.3	2742.0	-3.8
Tax	685.9	639.7	7.2	673.1	1.9
Adjusted PAT	1952.1	1688.3	15.6	2068.9	-5.6
Extra-ordinary items	31.1	72.3	-57.0	59.9	-48.1
Reported PAT	1921.0	1616.0	18.9	2009.0	-4.4
Adjusted EPS (Rs.)	8.3	7.2	15.6	8.8	-5.6
			Bps		**Bps**
GPM (%)	54.0	54.2	-24	53.0	96
OPM (%)	24.1	24.9	-87	25.1	-101

Source: Company; Sharekhan Research

Segment-wise performance Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Revenue					
Home Care	3409	3456	-1.4	3318	2.7
Beauty & Personal Care	4841	4412	9.7	4535	6.7
Food & Refreshments	3356	1865	79.9	3379	-0.7
Total	**11606**	**9733**	**19.2**	**11232**	**3.3**
PBIT					
Home Care	646	629	2.7	678	-4.7
Beauty & Personal Care	1413	1252	12.9	1328	6.4
Food & Refreshments	473	334	41.6	559	-15.4
Total	**2532**	**2215**	**14.3**	**2565**	**-1.3**
PBIT margins (%)					
Home Care	18.9	18.2	75	20.4	-148
Beauty & Personal Care	29.2	28.4	81	29.3	-10
Food & Refreshments	14.1	17.9	-381	16.5	-245
Total	**21.8**	**22.8**	**-94**	**22.8**	**-102**

Source: Company; Sharekhan Research
**includes the HFD portfolio of GSK Consumer Healthcare*

Outlook and Valuation

■ Sector View – Steady revenue growth momentum to sustain

The domestic FMCG market's growth recovered to 5% in Q3FY2021 from 1% in Q2FY2021. We believe the shift in demand for branded products, rural demand staying ahead 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 the level of profitability growth in the coming quarters. Structural growth story of the domestic consumer goods market is intact with lower per capita consumption of products compared to other international countries, lower penetration in rural markets, and opportunities to launch new differentiated products and gaining market share from small players.

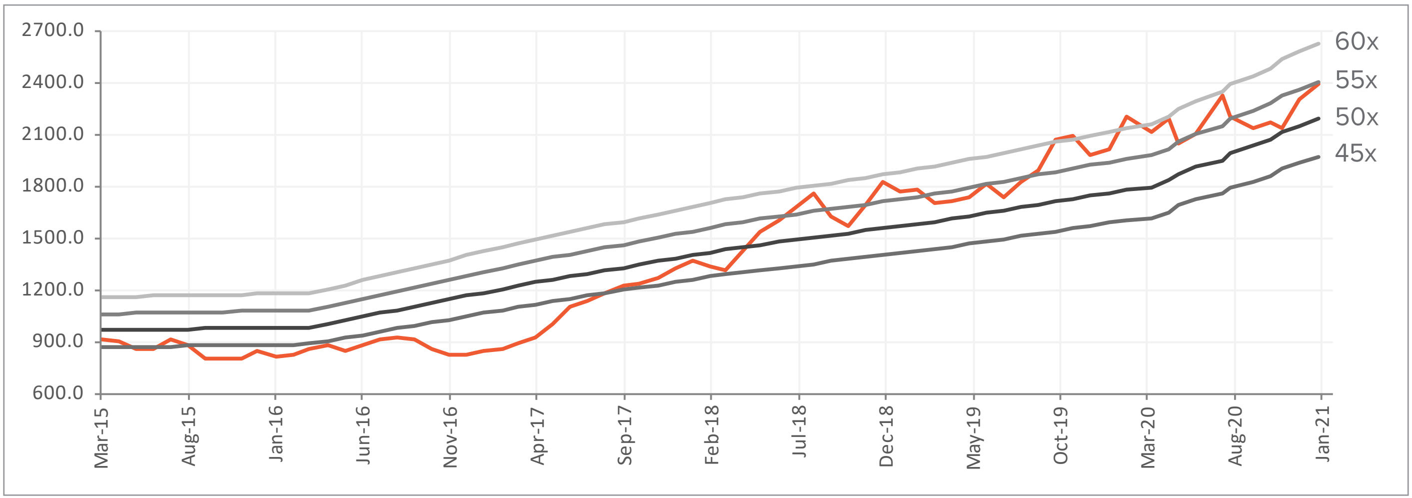
■ Company Outlook – About 80% of business growing steadily; Remaining 20% is in recovery mode

About 80% of HUL's portfolio including (health, hygiene, and nutrition) continues to perform well with 10% growth in Q3FY2021. With discretionary portfolio recovering to pre-Covid levels and out-of-home consumption seeing sequential improvement, we expect steady growth momentum to sustain in the coming quarters. 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. New product launches, premiumisation, gaining market share in key categories and improving penetration in rural markets remain key growth levers in the near to medium term. Synergistic benefits from the merger of GSK Consumer and cost-rationalisation measures will help OPM to better off in FY2022/FY2023.

■ Valuation – Retain Buy with unchanged PT of Rs. 2,790

HUL's management is optimistic about better growth in the coming quarters because of improving demand environment, increasing market share in key categories, and new products gaining good traction. 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's revenue and PAT to post a CAGR of 13% and 21% over FY2020-FY2023, respectively (including the acquired business of GSK Consumers). This along with a strong cash-generation ability and strong dividend payout makes the company a better pick in the large-cap FMCG space. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 2,790. The stock is currently trading at 47x 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*	76.4	64.8	56.4	51.8	45.2	39.8	59.8	60.0	56.9
ITC	20.8	17.0	14.9	15.1	12.1	10.4	20.1	25.5	28.6
HUL	70.9	53.8	47.0	48.2	39.0	33.9	37.1	28.3	30.7

Source: Company, Sharekhan Research
**Values for Nestle India are for CY2019, CY2020E and CY2021E*

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.*

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 *As on July 21, 2020*

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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