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Stock Update

Hindustan Unilever Ltd

Mixed quarter; eyeing competitive volume growth

Consumer Goods	Sharekhan code: HINDUNILVR	Result Update

Summary

- Hindustan Unilever's (HUL) Q1FY2022 performance was mix, with revenue rising by 13% driven by a 9% domestic volume growth; raw material inflation hit OPM that was tad lower than our expectation, at 23.9%
- After a disrupted May 21, demand recovered in June 21 to March 21 levels. Rural growth outpaced urban growth. HUL saw penetration improve for 80% of product portfolio and market share rise for two-thirds of portfolio.
- HUL aims to clock competitive volume growth by having customer-relevant portfolio assortment and ensuring strong back-end support. Likely correction in the raw material inflation, better product mix and synergies from GSK acquisition would drive up OPM in the medium term.
- Stock has underperformed broader indices in the past year and currently trades at 48x FY2023E EPS. We maintain a Buy on the stock with a PT of Rs. 2,790.

Hindustan Unilever's (HUL's) Q1FY2022 performance was mix with double digit revenue growth but profitability was affected by higher raw material prices. The company's revenues grew by 13% y-o-y to Rs. 11,915 crore (in-line with our expectation of Rs. 11,714.3 crore) and OPM stood at 23.9% as against our expectation of 24.4%. Double-digit revenue growth was driven by a 9% rise in domestic volumes. Realisation growth was slightly lower at 4% as the company opted for few promotional activities which were not undertaken in the base quarter. The company hiked prices by 3% in Q1FY2022 that took cumulative price hikes to 5-6%. As expected, gross margins decreased by 156 bps y-o-y mainly on account of higher raw material prices (including palm oil, raw tea and packaging cost). The OPM declined by 131 bps y-o-y to 23.9% and the operating profit grew by 6.9% y-o-y to Rs. 2,847 crore. Adjusted PAT grew by 3% y-o-y due to 57% decline in other income. Home care, beauty & personal care (BPC) and the foods & refreshment (F&R) businesses grew by 12-13% y-o-y. The key highlighting factors of the quarter were rural demand outpacing urban demand (1.04x:1.00) with about 80% of HUL's products gaining penetration, while two-thirds of the product portfolio continuing to gain market share. The e-commerce channel continued to gain strong traction and ~10% of revenues came from the digital platform. The back-end remains key for the company with the supply chain remaining agile, debottlenecking aiding higher production, effective coverage reaching 0.9x of pre-COVID levels and product assortment in stores improving to 0.8x of pre-pandemic levels. About 50% of go-to-market integration has been achieved for the newly-acquired GSK Consumer's nutrition business, direct coverage has risen 1.4x and customer connect has reached 0.5 million customers from a market development perspective. Resilient rural demand (aided by another year of good monsoon), recovery in demand for out-of-home categories with improvement in mobility, relevant product additions and sustained improvement in penetration of key categories remain near-term growth drivers. The company continues to focus on achieving competitive volume growth with strategies in place in the near to medium term. Rising input prices would keep margins under stress for a quarter or two. However, the management is of the opinion that raw material inflation has peaked and is likely to correct in the coming quarters. Further, a better product mix with a recovery in discretionary categories, calibrated price hikes and operational efficiencies along with integration benefits would help the margins improve in the medium term. HUL is eyeing a moderate margin improvement every year.

Key positives

- 80% of domestic portfolio has witnessed improvement in penetration.
- Contribution of digital platform to revenues improved to 10%.
- Rural demand remained resilient despite higher disruption in the hinterland during the second wave of COVID-19; rural growth stayed ahead of urban growth.

Key negatives

- Higher input prices led to 156 bps y-o-y and 211 bps sequential decline in gross margins.
- Other income was down by 57% due to lower treasury gains resulting in just a 3% growth in adjusted PAT.

Our Call

View – Retain Buy with an unchanged target price of Rs. 2,790: We have reduced our earnings estimates by 3% to factor in lower-than-earlier-expected OPM while we have maintained estimates for FY2023. Strengthening of core brands, creating categories of future through market development, driving premiumisation by straddling product pyramid and focusing on creating bigger brands and better tapping of emerging trends are some key long-term growth strategies. HUL's stock price has underperformed broader indices in the past one year with return of just 6% compared with 39-40% returns given by Sensex/Nifty. The stock is currently trading at 48.2x its FY2023E earnings. In view of long-term growth prospects and comfortable valuations, we maintain our Buy recommendation on the stock with an unchanged price target of Rs. 2,790.

Key Risks

Any disruption in the consumer demand due to frequent lockdowns, increase in intensity of virus in tier two and three towns and significant increase in key input prices from the current levels would act as a key risk to our earnings in the near term.

Valuation (standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	38,785.0	46,546.0	53,078.2	59,823.6
OPM (%)	24.8	24.3	24.7	26.2
Adjusted PAT	6,885.8	8,135.6	9,577.0	11,599.8
Adjusted EPS (Rs.)	31.9	34.6	40.8	49.4
P/E (x)	74.6	68.7	58.3	48.2
P/B (x)	64.0	11.8	11.7	11.2
EV/EBIDTA (x)	53.0	48.9	42.2	35.0
RoNW (%)	87.8	29.3	20.2	23.8
RoCE (%)	105.2	36.5	26.4	31.6

Source: Company; Sharekhan estimates

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. 2,379**	
Price Target: **Rs. 2,790**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

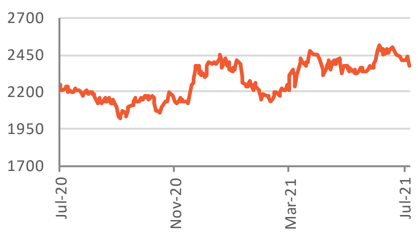
Company details

Market cap:	Rs. 5,58,967 cr
52-week high/low:	Rs. 2,532 / 2,001
NSE volume: (No of shares)	1.2 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Free float: (No of shares)	89.5 cr

Shareholding (%)

Promoters	61.9
FII	15.6
DII	10.8
Others	11.73

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.5	1.2	-1.2	5.8
Relative to Sensex	-4.9	-8.7	-9.3	-32.7

Sharekhan Research, Bloomberg

Standalone revenue grew by 13% y-o-y; OPM contracted by 131 bps: Revenues grew by 12.8% to Rs. 11,915 crore as against our expectation of Rs. 11,714 crore and consensus estimates of Rs. 12,078 crore. Revenues were almost flat sequentially. Domestic consumer business' volumes rose by 9%, beating expectations of 6-8%. Revenues of the home care segment, personal care segment and foods business grew by 12%, 13% and 12% y-o-y respectively. Gross margins decreased by 156 bps y-o-y to 50.4% mainly on account of higher input prices (including sharp increase in palm oil, tea and crude prices). Operating profit grew by 6.9% y-o-y to Rs. 2,847 crore. OPM fell by 131 bps y-o-y to 23.9% largely in-line with street expectation of 24% and slightly lower than our expectation of 24.4%. This along with lower other income on account of lower treasury yields led to 4.4% y-o-y growth in PBT. Adjusted PAT grew by 3% to Rs. 1,962 crore. Reported PAT (after exceptional item) grew by 8.5% y-o-y to Rs. 2,061 crore.

Homecare – Double-digit growth in fabric wash and household care: The homecare business reported y-o-y revenue growth of 12% to Rs. 3,797 crore on back of double-digit growth in both the segments – Fabric Wash and Household care. Growth in household care was led by *Vim* and strong performance of fabric wash was led by premium products. Various market development initiatives undertaken helped liquids and fabric sensations outperform. Calibrated price increases were undertaken in both the segments which helped to partly mitigate the impact of high input costs. PBIT margin of the homecare business contracted by 134 bps y-o-y to 17.4%. HUL launched a new product - *3 in 1 Smart Shots* under Surf Excel brand's *Matic* range.

Beauty and personal care (BPC) – Strong growth in skin care and hair care: The BPC business grew by 13% y-o-y to Rs. 4,573 crore led by double-digit growth in Hair Care and Skin Care segments. The soaps portfolio grew on a high base and premium segment performed well. The Hand Hygiene portfolio declined against an exceptionally high base. 'VWash' reported another strong quarter and *Color Cosmetics* recovered sharply from last year's weak base. HUL's calibrated approach towards a price hike helped reduce the impact of high vegetable oil prices which remain elevated. The PBIT margin of the BPC business remained flat y-o-y at 28.1% during Q1FY2022. Product launches in the BPC business include 'Pepsodent' mouthwash, new moisturizing gels and body lotions in 'Vaseline' and 'Lakme Lip Crayons'.

Foods & Refreshments (F&R) – Growth driven by in-home consumption: F&R business registered revenue growth of 12% y-o-y to Rs. 3,319 crore. Ketchups, soups and all the tea brands continued to perform well despite a strong base in the prior year. Go-To-Market integration in the nutrition business is progressing well. Health food drinks gained penetration sequentially and reported mid-single digit volume growth. Despite limited mobility, the ice cream portfolio recovered and grew y-o-y from a weak base. The F&R category's EBIT margins declined by 160 bps y-o-y to 18.1%. During the quarter, HUL launched 'Kwality Wall's Cadbury Crackle' frozen desert in partnership with Mondelez International.

Key conference call highlights

- Demand stayed strong in April. However, COVID-19 cases started increasing in May which led to localised lockdown and restrictions being imposed on mobility (mobility index down to 37% in May from 78% in Feb) which led to disruption in demand in May. As cases began to reduce and mobility improved, June witnessed recovery with performance similar to March. Impact was much less in the current quarter as compared to Q1FY2020 as back-end supply chain was functional. Growth was led by rural demand which was stronger than urban demand. Health, hygiene and nutrition portfolio contributed to 85% of the revenue as against 80% a few quarters ago. The management is confident of good performance going ahead as demand is expected to improve with increase in mobility and higher penetration.
- Gross margins were impacted during the quarter due to price inflation of the three key raw materials – Crude oil, tea and palm oil which were up by 30%, 60% and 70% respectively as compared to March 2020. The company undertook price hike to the extent of ~3% across most categories (cumulative price hike stands at 5-6%). Inspite of price hike, realizations continued to be lower due to an increase in promotional activities. With the normalization of promotional activities in the upcoming quarter, realisation is expected to improve. The management expects softening of the raw material prices going ahead as compared to FY2020 levels which will ease out the pressure on the margins but has stated that prices are expected to remain higher than FY2019 levels. Though the company will undertake calibrated price hikes, its focus will be on achieving competitive volume growth through improved market penetration.
- The integration of GSK's consumer business is completed to the extent of 50%, thereby increasing coverage by 1.4x. The management expects to complete 80-90% integration by the end of Q2, which will lead to expansion in coverage by 2x. During the quarter, HUL developed more than 0.5 million contacts through GSK integration. The company expects to earn cost synergies with this integration, which will help to improve the overall profitability of the business. Health food drink penetration in India is low at ~25% and much lower in the rural

markets. People integration is completed, system integration is in verge of complete, Go to market integration will be completed by end of the current fiscal and then company will focus on market development. With low price units of Rs. 2/5 packs and large focus on improving the product reach in the rural markets, the company expect nutrition portfolio to achieve good growth in the coming years.

- The tea portfolio continues to perform well and is growing in double digits led by volume and price led growth. The company has gained markets share (in volume and value terms) in the tea category. Raw material inflation has put stress on the tea category margins.
- Digital channel contributes more than 10% to revenues and contribution has gone up by 2x since Q1FY2021. The company aims in accelerating its e-commerce through various initiatives. *Shikhar* (HUL's online ordering platform) added 50,000 stores to its network during the quarter taking the total number of stores to 5.5 lakhs at the end of Q1FY2022. The contribution from Shikhar has increased by 6x on a y-o-y basis. HUL aims to scale up its online presence through standalone branded sites for its premium brands and also through its multi-brand shopping platform *UShop*.

Results (standalone) Rs cr

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Net revenue	**11915.0**	**10560.0**	**12.8**	**12132.0**	**-1.8**
Total expenditure	9068.0	7898.0	14.8	9175.0	-1.2
Operating Profit	2847.0	2662.0	6.9	2957.0	-3.7
Other income	67.0	156.0	-57.1	109.0	-38.5
EBITDA	2914.0	2818.0	3.4	3066.0	-5.0
Interest	11.0	29.0	-62.1	9.0	22.2
PBDT	2903.0	2789.0	4.1	3057.0	-5.0
Depreciation	244.0	242.0	0.8	249.0	-2.0
PBT	2659.0	2547.0	4.4	2808.0	-5.3
Tax	696.8	639.9	8.9	681.8	2.2
Adjusted PAT	**1962.2**	**1907.1**	**2.9**	**2126.2**	**-7.7**
Extra-ordinary items	-98.8	8.1	-	-11.2	-
Reported PAT	**2061.0**	**1899.0**	**8.5**	**2137.4**	**-3.6**
Adjusted EPS (Rs.)	8.4	8.1	2.9	9.0	-7.7
			BPS		**BPS**
GPM (%)	50.4	52.0	-156	52.6	-211
OPM (%)	23.9	25.2	-131	24.4	-48

Source: Company; Sharekhan Research

Segmental performance Rs cr

Particulars	Q1FY22	Q1FY21	Y-o-Y %	Q4FY21	Q-o-Q %
Revenue					
Home Care	3797	3392	11.9	3840	-1.1
Beauty & Personal Care	4573	4039	13.2	4549	0.5
Food & Refreshments	3319	2958	12.2	3511	-5.5
Total	**11689**	**10389**	**12.5**	**11900**	**-1.8**
PBIT					
Home Care	662	637	3.9	812	-18.5
Beauty & Personal Care	1287	1134	13.5	1252	2.8
Food & Refreshments	600	582	3.1	575	4.3
Total	**2549**	**2353**	**8.3**	**2639**	**-3.4**
PBIT margins (%)			**BPS**		**BPS**
Home Care	17.4	18.8	-134	21.1	-371
Beauty & Personal Care	28.1	28.1	7	27.5	62
Food & Refreshments	18.1	19.7	-160	16.4	170
Total	**21.8**	**22.6**	**-84**	**22.2**	**-37**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Demand remains resilient; Margins to improve sequentially

Pre-quarter commentary of most consumer goods companies indicated strong sales recovery from June 2021 with easing of lockdown restrictions in most parts of India. Demand, which started recovering from Q3FY2021, remained resilient in Q1FY2022. With a normal monsoon expected for the third consecutive year, agricultural production is predicted to be better in Kharif season 2021. This will give further boost to rural demand in the coming quarters. We believe that the shift in demand for branded products, rural demand staying ahead of urban demand, gradual recovery in out-of-home categories and product launches remain key catalysts for revenue growth in the near to medium term. On the other hand, prices of key raw materials (including palm oil, copra, and raw tea) have started correcting from their high. The substance of same along with calibrated price hikes would enable consumer goods companies to post better OPM on a sequential basis. Profitability is likely to be better off in H2FY2022. Improving revenue mix and better operational efficiencies remain key margin drivers in the medium term.

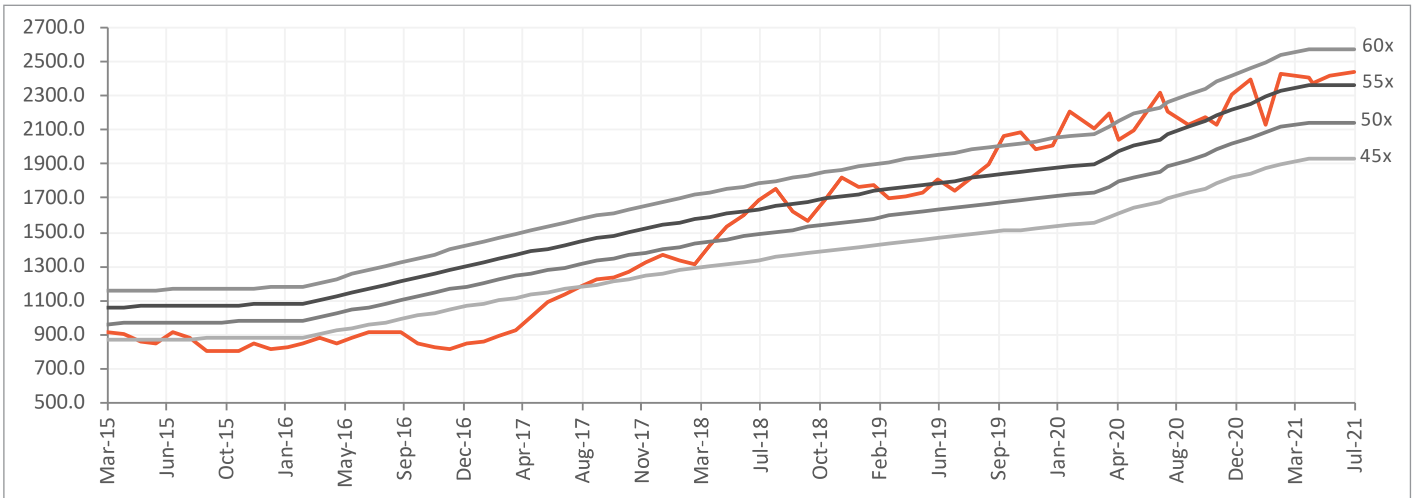
■ Company outlook – focus remains on achieving competitive volume growth

Operating performance was decent in Q1FY2022 with 9% volume growth and OPM coming in flat sequentially at 24%. With a leadership position in more than 90% of the portfolio and presence in more than 8 million stores, HUL is well-poised to achieve good growth in the coming years. Resilient demand in rural India (aided by another year of good monsoon), recovery in demand for out of home categories with improvement in the mobility, adding relevant products in portfolio and sustained improvement in the penetration of key categories remain key growth drivers in the near term. The company continues to focus on achieving competitive volume growth with strategies in place in the near to medium term. Better product mix with recovery in the discretionary categories, calibrated price hikes and operational efficiencies along with integration benefits would help margins to improve in the medium term. The management is targeting moderate margin improvement every year.

■ Valuation – Retain Buy with an unchanged target price of Rs. 2,790

We have reduced our earnings estimates by 3% to factor in lower-than-earlier-expected OPM while we maintained estimates for FY2023. Strengthening of core brands, creating categories of future through market development, driving premiumisation by straddling product pyramid and focusing on creating bigger brands and better tapping of emerging trends are some key long-term growth strategies. HUL's stock price has underperformed broader indices in the past one year with return of just 6% compared with 39-40% returns given by Sensex/Nifty. The stock is currently trading at 48.2x its FY2023E earnings. In view of long-term growth prospects and comfortable valuations, we maintain our Buy recommendation on the stock with an unchanged price target of Rs. 2,790.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Nestle India*	83.3	69.1	58.7	53.7	46.9	40.6	136.4	139.7	142.5
ITC	19.4	17.6	14.8	14.8	12.6	10.5	20.3	25.4	28.2
Godrej Consumer Products	56.2	48.3	40.8	41.3	35.7	30.7	18.3	21.4	23.0
HUL	68.7	58.3	48.2	48.9	42.2	35.0	36.5	26.4	31.6

*Source: Company, Sharekhan estimates; *Values for Nestle India are for CY20, 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*.

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
Srinivas Pathak	Executive Director, Finance & IT and CFO
Pradeep Banerjee	Executive Director, Supply Chain
Dev Bajpai	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 (Old data)

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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