Sharekhan
by BNP PARIBAS

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Stock Update

Hindustan Unilever Ltd

In-line Q2; Focus remains on achieving consistent volume growth

Consumer Goods	Sharekhan code: HINDUNILVR	Result Update

Summary

- In Q2FY2022, HUL's reported numbers were in-line with our expectation with revenue growing by 11%, while PAT growth stood at ~6% to Rs. 2,187 crore (affected by 46 bps decline in OPM to 24.6%). Miss on volume growth at 4% versus expectation of 5-7%.
- Business fundamentals remained strong with three-fourth of portfolio gaining market share and saw improvement in penetration. Calibrated price aided in sequential margin improvement.
- Recovery in out-of-home/discretionary categories, onset, and intensity of winter and improvement in rural demand would be key growth drivers in Q3. OPM to remain at 24-25%.
- The stock has corrected by ~11% from its recent high and is currently trading at 53.0x/45.4x its FY2023/FY2024 EPS. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 3,185.

Hindustan Unilever Limited's (HUL) Q2FY2022 operating performance was in-line with expectation with domestic revenue, growing by 11% to Rs. 12,724 crore, while PAT growth was moderate at 6% to Rs. 2,187 crore due to a 46 bps decline in OPM at 24.6%. Domestic volume growth stood at 4%, lower than expectation of 5-7%. Home care and beauty and personal care registered double-digit growth of 15% and 10%, respectively. Foods business growth stood at 7% on base of high teens growth. Rural demand has seen some moderation in the past few months, while urban demand has picked up due to improving mobility. OPM to remain at 24-25% in the near term.

Key positives

- Business fundamentals remain strong with 75% of product portfolio gaining market share and witnessed improvement in category penetration.
- Home care category registered 15% growth with fabric wash registering double-digit growth led by strong performance in the premium portfolio.
- Skin care and colour cosmetics registered high double-digit growth with overall improvement in mobility. Discretionary category reached pre-COVID level sales.

Key negatives

- Domestic volume growth stood at 4% versus expectation of 5-7% growth.
- Rural demand has softened for the past few weeks of the quarters.

Management Commentary

- Recovery in the out-of-home/discretionary categories, onset of winter, and improvement in rural sales will drive revenue growth in the near term.
- Focusing on achieving steady volume growth of 7-8% in the medium term through its strategy of growing core with premiumisation, market development through new launches, cluster base approach through WIMI strategy, and distribution expansion.
- Raw-material inflation will keep pressure on gross margin in the near term. Calibrated price hikes, improving mix, and cost-saving initiatives would help OPM to sustain at 24-25%.

Revision in estimates – We have broadly maintained our earnings estimates for FY2023 and FY2024 in view of in-line operating performance and management confidence of consistent and profit-led earnings growth in the medium term.

Our Call

View – Maintain Buy with an unchanged PT of Rs. 3,185: HUL's Q2 performance was in-line with our as well as street's expectation. With a strong brand portfolio, strong team with a great focus supported by R&D, and agile distribution and supply chain, HUL's management is focusing on enhancing the shareholder's value in the next decade. The stock has corrected by ~11% from its recent high and is currently trading at 53x and 45x its FY2023 and FY2024 earnings, respectively, factoring in near-term headwinds. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 3,185.

Key Risks

Any sustained slowdown in rural demand or significant increase in key input prices from current levels would act as a key risk to our earnings in the near term.

Valuation (standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	46,546	52,706	59,359	67,506
OPM (%)	24.3	24.4	26.0	26.4
Adjusted PAT	8,136	9,178	11,280	13,186
Adjusted EPS (Rs.)	34.6	39.1	48.0	56.1
P/E (x)	73.5	65.2	53.0	45.4
P/B (x)	12.6	12.7	12.2	11.3
EV/EBIDTA (x)	52.4	46.1	38.3	32.8
RoNW (%)	29.3	19.4	23.4	25.9
RoCE (%)	36.5	25.2	31.1	34.3

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. 2,546**	
Price Target: **Rs. 3,185**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

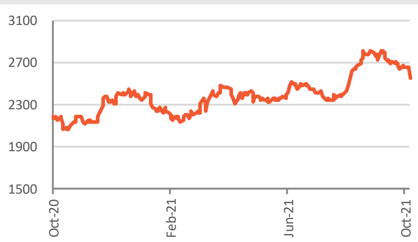
Company details

Market cap:	Rs. 5,98,312 cr
52-week high/low:	Rs. 2,859 / 2,044
NSE volume: (No of shares)	14.7 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Free float: (No of shares)	89.5 cr

Shareholding (%)

Promoters	61.9
FII	16.0
DII	10.5
Others	11.66

Price chart



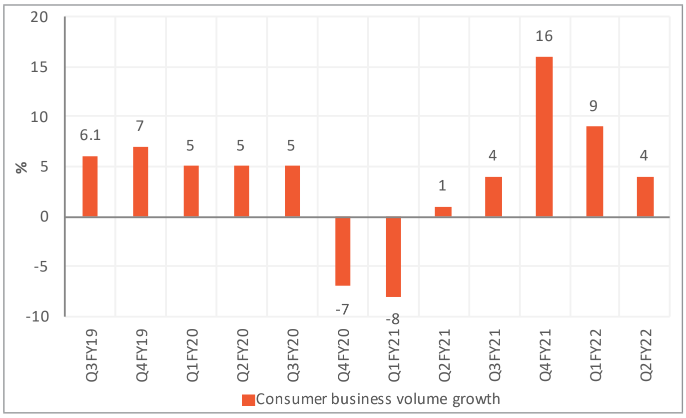
Price performance

(%)	1m	3m	6m	12m
Absolute	-9.1	7.1	6.2	16.9
Relative to Sensex	-14.6	-9.7	-23.2	-35.7

Sharekhan Research, Bloomberg

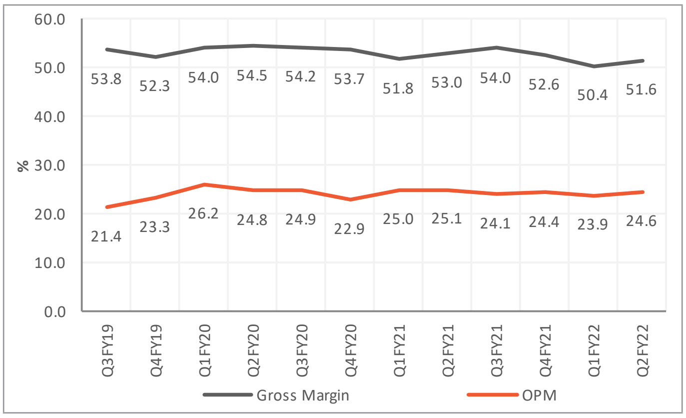
Standalone revenue grew by 11% y-o-y; Volume growth at 4% y-o-y: Revenue grew by 11.2% to Rs. 12,724 crore as against our expectation of Rs. 12,741 crore and marginally ahead of consensus estimates of Rs. 12,718 crore. Sequential revenue growth is at 6.8%. Domestic consumer business' volumes rose by 4%, lower than our as well as street expectation of 5-7%. Revenue of the home care segment, personal care segment, and foods business grew by 16%, 10% and 7% y-o-y, respectively. Gross margin contracted by 142 bps y-o-y to 51.6% mainly on account of higher input prices (including a sharp increase in palm oil, LAB, and packaging cost). Operating profit grew by 9.2% y-o-y to Rs. 3,132 crore. OPM fell by 46 bps y-o-y to 24.6%, largely in-line with street expectation of 24.5% and slightly better than our expectation of 24.2%. This along with lower other income led to 7.7% y-o-y growth in PBT to Rs. 2,954 crore. Adjusted PAT grew by 5.7% to Rs. 2,187crore, marginally higher than our expectation of Rs. 2,167 crore.

Consumer business volume growth



Source: Company, Sharekhan Research

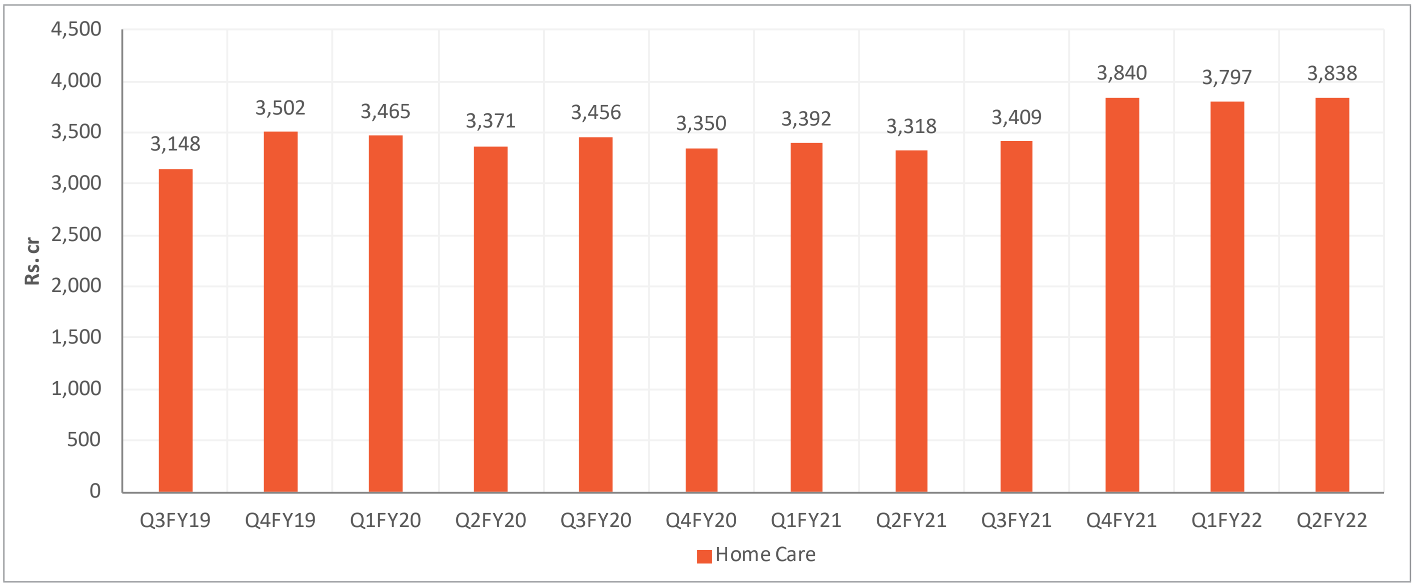
Margins remained under pressure



Source: Company, Sharekhan Research

Homecare – Market share gains and penetration-led growth: The homecare business continued to deliver strong performance, registering y-o-y revenue growth of 16% to Rs. 3,838 crore on a high base, led by penetration and market share gains. Fabric wash reported high teens growth, led by strong performance in the premium portfolio. Liquid wash products registered double-digit growth on good traction. Vim registered single-digit growth due to high base. The company continues to gain market share in the detergent/laundry category. Surf Excel easy wash continued to register strong growth. Management expects input cost inflation to continue for the near term and, hence, calibrated price increases will be undertaken to partly mitigate the impact of high input costs. Purifiers reported double-digit growth led by acceleration in e-Commerce. PBIT margin of the homecare business contracted by 147 bps y-o-y to 19%.

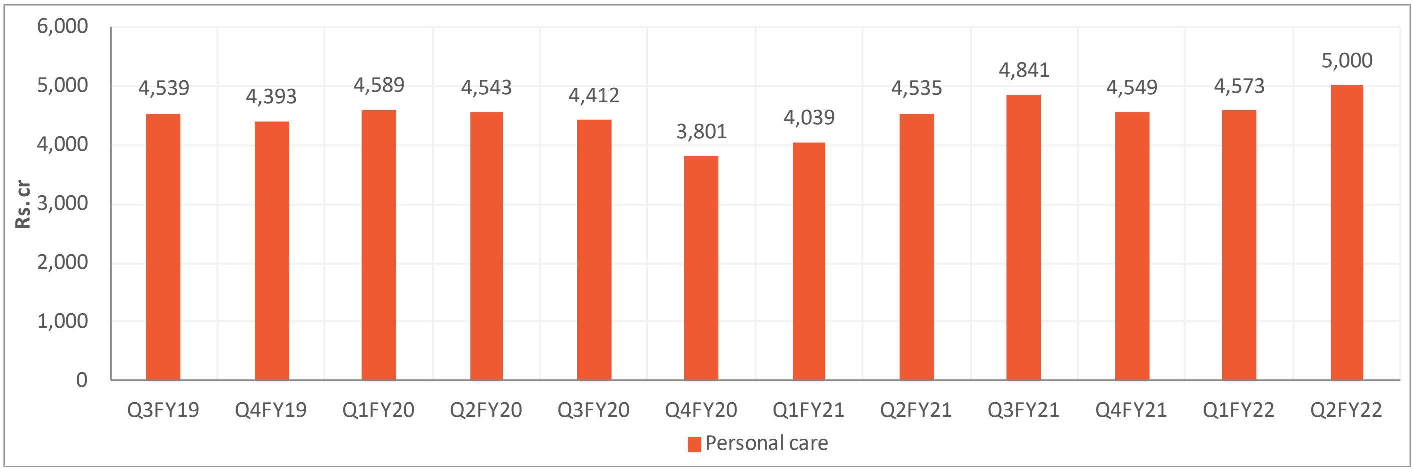
Quarterly trend in revenues of home care



Source: Company; Sharekhan Research

Beauty and personal care (BPC) – Skin Care, colour cosmetics, and hair care deliver double-digit growth: The BPC business grew by 10% y-o-y to Rs. 5,000 crore, led by double-digit growth in skin care, hair care, and colour cosmetics segments. The soaps portfolio registered moderate growth on a high base of previous year. Dove and Pears grew sequentially, while Lifebouy maintained its leadership position in the domestic market. Beauty and premium brands reported double-digit growth due to improved mobility in urban markets. The hand hygiene portfolio declined against an exceptionally high base. VWash reported another strong quarter. Price hikes undertaken in a calibrated manner helped reduce the impact of high vegetable oil prices, which remained elevated. Purposeful communications and impactful innovations aided strong performance of the hair care portfolio. Improvement in mobility, skin care, and colour cosmetics reported strong double-digit growth. PBIT margin of the BPC business declined by 148 bps y-o-y at 27.8%. Pepsodent was relaunched during the quarter with a superior product.

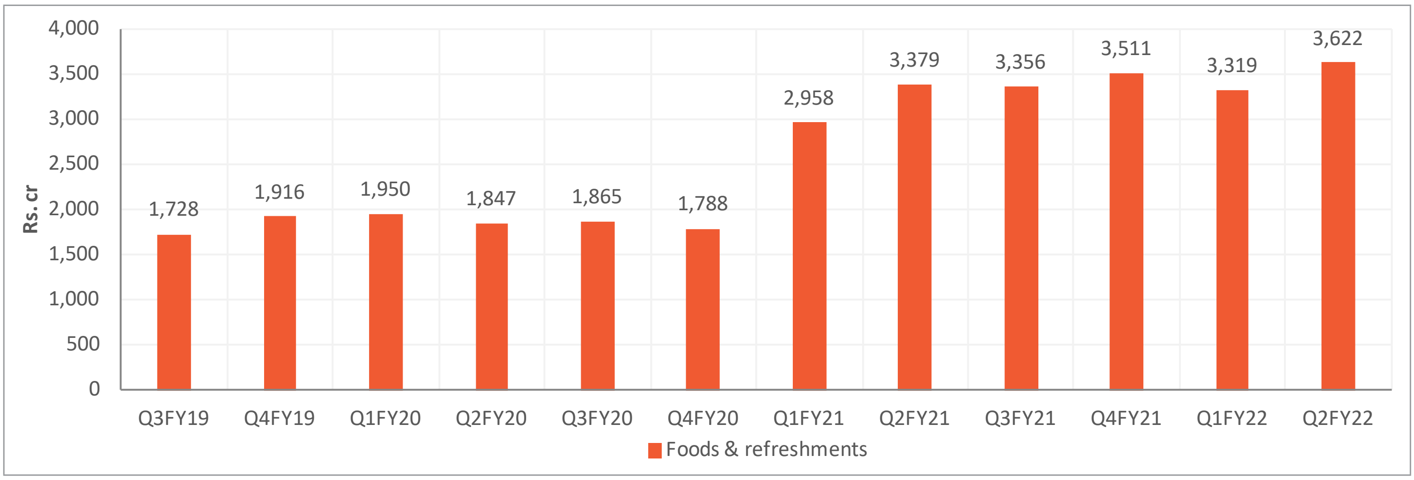
Quarterly trend in revenues of BPC business



Source: Company; Sharekhan Research

Foods and Refreshments (F&R) – Good performance on a high base: F&R business registered revenue growth of 7% y-o-y to Rs. 3,622 crore. Tea grew on a very strong base and further strengthened its market leadership, while coffee performed well. Health Food Drinks (HFD) volumes grew in double digits, with penetration gains on a sequential basis. Category growth stood at 19% over the normal base of September 19 quarter. Go-to market integration is more than 85% completed. HFD products effective coverage is 1.9x the pre-integration level coverage. Penetration improvement will continue, which will help HFD category to scale up in the coming quarters. Ice creams portfolio reported strong recovery due to effective communications and innovations. The F&R segment's EBIT margin expanded by 179 bps y-o-y to 18.3%. During the quarter, HUL launched 'Horlicks Diabetes Plus'.

Quarterly trend in revenues of F&R business



Source: Company; Sharekhan Research

Key conference call highlights

- **Cautiously optimistic on demand revival:** Management is cautiously optimistic on demand revival with overall recovery in the macro environment and improvement in mobility. Urban demand has seen strong revival with out-of-home and discretionary products seeing strong recovery in demand. Rural demand was resilient for most part of the quarter. However, last few weeks have softened a bit. Management is keenly monitoring demand trends in rural India. It is confident of achieving better demand in urban markets.
- **Focus on calibrated price hikes and better mix to reduce margin pressure:** Management has indicated that raw-material inflation will continue to put pressure on margins in the near to medium term. The company is following calibrated price mechanism and has undertaken price increase of 6.5% in the portfolio. Calibrated price hike, improvement in revenue mix, and operational efficiencies would help the company maintain its OPM of 24-25% in the near term.
- **Digital remains key focus area:** More than 15% of HUL's domestic sales are generated through the digital platform. Shikhar app, which narrows the gap between the company and retailers, has now covered more than 6.5 lakh outlets. On the other hand, the company has accelerated its presence on the e-commerce platform by increasing the assortment of products. The company expects sales through digital channels will further enhance in the coming quarters.
- **Integration of the nutrition business:** With merging of GSK Consumer distribution reach, go-to-market integration has been 85% completed. Consumer connect has improved beyond 5 million households. E-commerce contribution has grown by 2x. The company has launched Boost nationally and premium plus portfolio is activated across key markets. Further, the company is focusing on unlocking markets such as North and South while focusing on nutritional base premium products and scaling up the chocolate portfolio. Overall, the nutritional portfolio is expected to grow in double digits. Synergistic benefits already added 1,000 bps in terms of margins and are further expected to add around 300-400 bps in the coming years.
- **Other key highlights of the conference call**
  - Effective tax rate for FY2022 is expected at 25%.
  - In-line with its assortment strategy, the company has increased the availability of access packs in general trade and large/multiple packs in modern trade. Effective coverage has increased by 1.2x compared to Q1FY2022 and assortment in stores stand at 1.4x compared to Q1FY2022.
  - The company has declared interim dividend of Rs. 15 per share.

Results (standalone) Rs cr

Particulars	Q2FY22	Q2FY21	Y-o-Y %	Q1FY22	Q-o-Q %
Net revenue	**12,724.0**	**11,442.0**	**11.2**	**11,915.0**	**6.8**
Total expenditure	9,592.0	8,573.0	11.9	9,068.0	5.8
Operating Profit	**3,132.0**	**2,869.0**	**9.2**	**2,847.0**	**10.0**
Other income	113.0	151.0	-25.2	67.0	68.7
EBITDA	3,245.0	3,020.0	7.5	2,914.0	11.4
Interest	26.0	29.0	-10.3	11.0	136.4
PBDT	3,219.0	2,991.0	7.6	2,903.0	10.9
Depreciation	265.0	249.0	6.4	244.0	8.6
PBT	**2,954.0**	**2,742.0**	**7.7**	**2,659.0**	**11.1**
Tax	767.0	673.1	14.0	696.8	10.1
Adjusted PAT	**2,187.0**	**2,068.9**	**5.7**	**1,962.2**	**11.5**
Adjusted EPS (Rs.)	9.3	8.8	5.7	8.4	11.5
			bps		bps
GPM (%)	51.6	53.0	-142	50.4	116
OPM (%)	24.6	25.1	-46	23.9	72
NPM (%)	17.2	18.1	-89	16.5	72
Tax rate (%)	26.0	24.5	142	26.2	-24

Source: Company; Sharekhan Research

Segmental performance Rs cr

Particulars	Q2FY22	Q2FY21	Y-o-Y %	Q1FY22	Q-o-Q %
Revenue					
Home Care	3,838.0	3,318.0	15.7	3,797.0	1.1
Beauty & Personal Care	5,000.0	4,535.0	10.3	4,573.0	9.3
Food & Refreshments	3,622.0	3,379.0	7.2	3,319.0	9.1
Total	**12,460**	**11,232**	**10.9**	**11,689**	**6.6**
PBIT					
Home Care	728.0	678.0	7.4	662.0	10.0
Beauty & Personal Care	1,390.0	1,328.0	4.7	1,287.0	8.0
Food & Refreshments	664.0	559.0	18.8	600.0	10.7
Total	**2,782**	**2,565**	**8.5**	**2,549**	**9.1**
PBIT margins (%)					
Home Care	19.0	20.4	-147	17.4	153
Beauty & Personal Care	27.8	29.3	-148	28.1	-34
Food & Refreshments	18.3	16.5	179	18.1	25
Total	**22.3**	**22.8**	**-51**	**21.8**	**52**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook – Demand trends will improve ahead

After the second wave disruption in April-May 2021, companies witnessed faster recovery in performance in June-July 2021 with improving mobility, demand for out-of-home categories such as colour cosmetics, beverages and juices, deodorants, and hair colour. Rural demand has softened a bit in the past few weeks due to higher inflationary pressure but is expected to come back with better agri production and government support. Thus, we expect consumer goods companies to post better sales volume in the quarters ahead. Raw-material inflation would sustain in the medium term and would put pressure on the margins of consumer goods companies. However, improving revenue mix and better operational efficiencies would help in mitigating inflationary pressures. Lower penetration in key categories, improving per capita income, shift to branded products, and improving penetration in rural India are some of the key growth drivers for the company in the medium term.

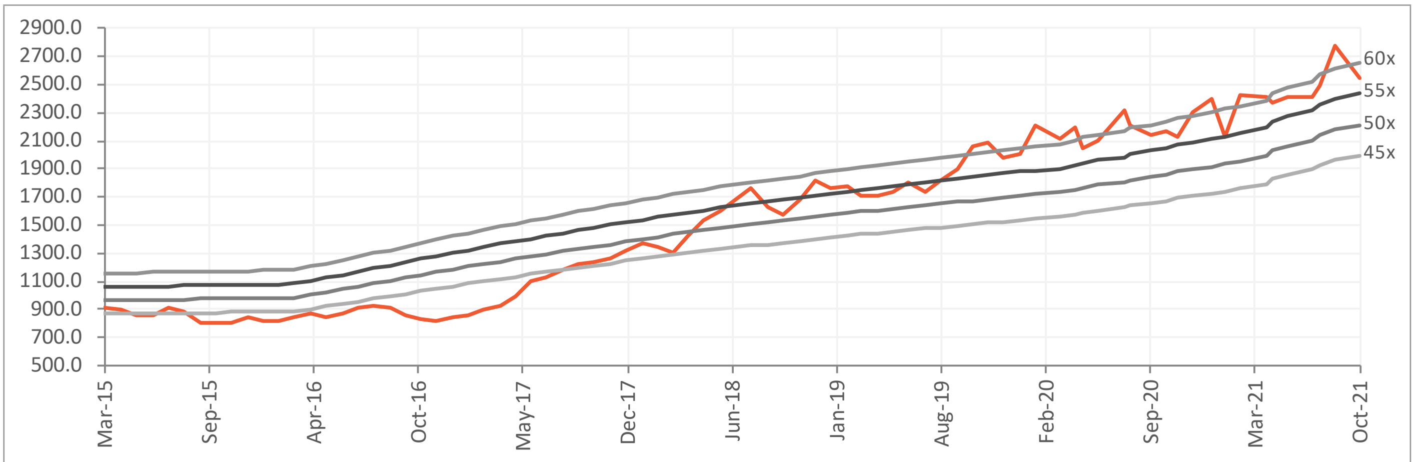
■ Company outlook – Focus remains on achieving competitive volume growth

With a leadership position in more than 80% of the portfolio and presence in more than 8 million stores, HUL is well poised to achieve good growth in the coming years. Recovery in rural demand, improvement in demand for out-of-home categories with improvement in mobility, addition of relevant products in the 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 discretionary categories, calibrated price hikes, and operational efficiencies along with integration benefits would help margins to improve in the medium term. Management is targeting moderate margin improvement every year.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 3,185

HUL's Q2 performance was in-line with our as well as street expectation. With a strong brand portfolio, strong team with great focus supported by R&D, and agile distribution and supply chain, HUL's management is focusing on enhancing the shareholder's value in the next decade. The stock has corrected by ~11% from its recent high and is currently trading at 53x and 45x its FY2023 and FY2024 earnings, respectively, factoring in near-term headwinds. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 3,185.

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	FY22E
Nestle India*	89.7	74.4	63.8	57.9	50.2	43.2	136.4	139.7	141.9
ITC	23.0	20.9	17.6	17.9	14.8	12.6	21.5	26.6	31.1
Godrej Consumer Products	58.4	52.1	43.1	42.9	38.3	32.4	18.3	20.6	22.8
HUL	73.5	65.2	53.0	52.4	46.1	38.3	36.5	25.2	31.1

*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 highly penetrated 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
Ritesh Tiwari	Executive Director, Finance
Willem Uijen	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	Life Insurance Corp of India	3.59
2	Vanguard Group Inc.	1.30
3	BlackRock Inc.	1.28
4	SBI Funds Management Pvt. Ltd.	1.01
5	J P Morgan Chase & Co	0.57
6	ICICI Prudential Life Insurance Co. Ltd.	0.56
7	Norges Bank	0.41
8	Aberdeen PLC	0.40
9	UTI Asset Management Co Ltd.	0.40
10	UBS AG	0.40

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

Sharekhan

by BNP PARIBAS

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