Sharekhan by BNP PARIBAS

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Stock Update

Hindustan Unilever Ltd

Well strategies to achieve double digit growth in new decade

Consumer Goods | Sharekhan code: HINDUNILVR | Company 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. 2,809**	
Price Target: **Rs. 3,185**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 6,59,941 cr
52-week high/low:	Rs. 2,825 / 2,001
NSE volume: (No of shares)	23495.9 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	17.8	19.2	27.8	31.8
Relative to Sensex	10.7	7.3	13.7	-20.9

Sharekhan Research, Bloomberg

Summary

- We maintain Buy on Hindustan Unilever Limited (HUL) with a revised PT of Rs. 3,185. Leadership position in 80% portfolio, strong earnings visibility with well-defined strategies, and a healthy balance sheet with sturdy cash flows make it the best pick in the FMCG space.
- The company is focusing on winning the next decade by achieving double-digit earnings growth by achieving sustained volume growth in core categories of home care and personal care, scaling up the foods and refreshment business coupled with gradual improvement in OPM.
- Growing the core through premiumisation, market development through new launches, cluster based approach through WIMI strategy, and distribution expansion remain key growth drivers in the medium to long run.
- Resilient demand in rural India would lead to better volume growth in the coming quarters. Raw-material pressure is under control with raw tea prices correcting from its high and price hikes undertaken across the portfolio in Q2FY2022. OPM likely to be at 24-25%.

Hindustan Unilever Limited's (HUL) management has maintained its thrust on achieving double-digit earnings growth and has sustained improvement in cash flows, creating long-term value for shareholders over the next decade. Structural growth story of the Indian consumption market is intact with low per capital consumption, low penetration in most categories and rural consumption is 1/3rd of overall consumption markets, all of which provides ample opportunities. The company is focusing on converting opportunities in growth through growing core premiumisation, market development, and cluster base approach.

- **Well-defined strategies for each category:** HUL has a leadership position in 80% of its product portfolio with excellent product development strategy and strong distribution backing. The company's key business categories have well-defined growth strategies with beauty and personal care (BPC) focusing on building differentiated and purposeful products under core brands and playing on naturals, home care (HC), focusing on automation of laundry and large opportunities in surfaces provided by the pandemic and food and beverages (F&B) focusing on building nutrition portfolio to reduce India's protein deficiency and scale in north and west.
- **Aiming for double-digit earnings growth:** The company is focusing on winning the next decade by achieving double-digit earnings growth by achieving sustained volume growth in the core categories of home care and personal care, scaling up the foods and refreshment business coupled with gradual improvement in OPM. We expect HUL's revenue and PAT to post a CAGR of 14% and 18% over FY2021-FY2024 with structural growth story intact and digital leading the channel growth.
- **Raw-material pressure under control; OPM to be at 24-25%:** Management has indicated that raw-material pressure is under control with all key inputs such as palm oil, crude derivatives and packaging cost not seeing significant jump in prices. Raw tea prices have corrected from their high and are stabilising. The company took another round of price hike across products. OPM is expected to remain at 24-25% with synergistic benefit from GSK Consumer's nutrition business to support profitability.

Our Call

View: Maintain Buy with a revised PT of Rs. 3,185: HUL delivered resilient performance in a tough decade with revenue and PAT posting a CAGR of 9% and 14%, respectively, with 1,000 bps expansion in OPM. 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. HUL remains one of our top picks in the FMCG space. We maintain our Buy recommendation on the stock with a revised PT of Rs. 3,185. We have introduced FY2024 financials through this note. The stock is trading at 57.4x/49.1x its FY2023/ FY2024 EPS.

Key risk

Any disruption in consumer demand due to frequent lockdowns and significant increase in key input prices from current levels would act as a key risk to our earnings in the near term.

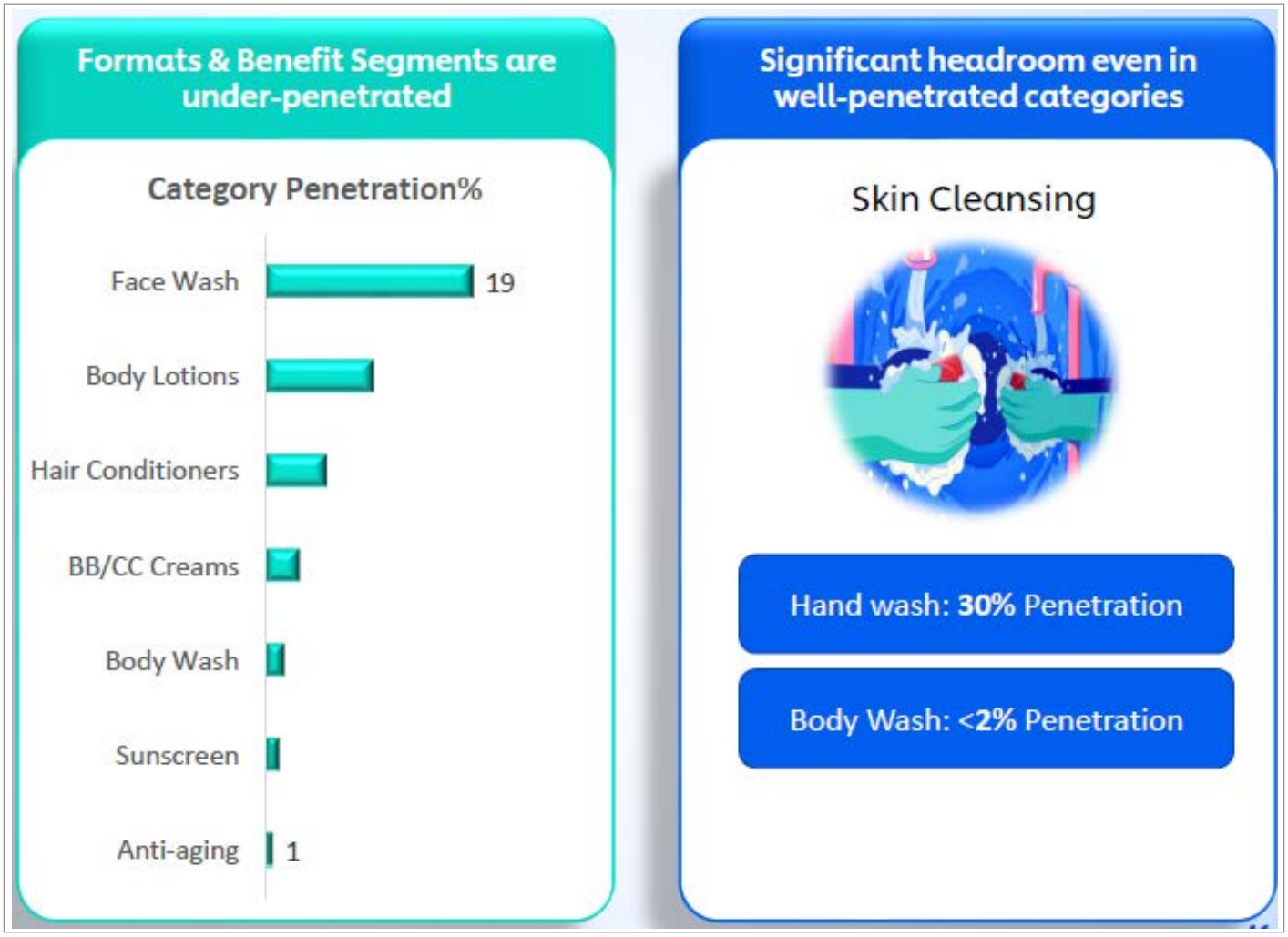
Valuation (standalone) Rs cr

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	46,546.0	53,078.2	59,823.6	68,040.1
OPM (%)	24.3	24.7	26.0	26.5
PAT	8,135.6	9,577.0	11,489.7	13,445.8
EPS (Rs.)	34.6	40.8	48.9	57.2
P/E (x)	81.1	68.9	57.4	49.1
P/B (x)	13.9	13.9	13.3	12.3
EV/EBIDTA (x)	57.8	50.0	41.9	35.8
RoNW (%)	29.3	20.2	23.6	26.0
RoCE (%)	36.5	26.4	31.3	34.5

Source: Company; Sharekhan estimates

Beauty and Personal Care (BPC) – The beauty and personal care segment is highly under-penetrated in India with many product categories having very less penetration. Hand wash, face wash, and body wash categories have penetration of 30%, 19%, and <2%, respectively, thereby providing significant headroom for growth.

Penetration across product categories

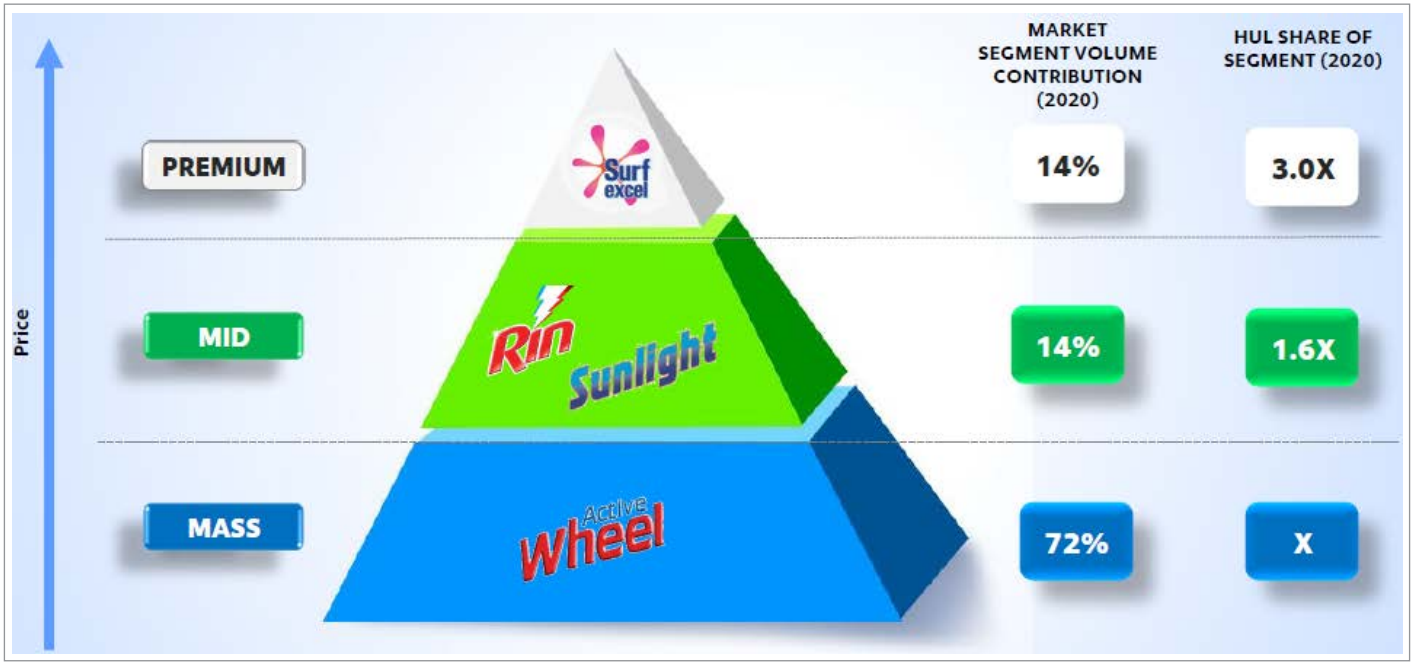


Source: Company presentation

Evolution of the BPC segment is supported by rise of digital and ecommerce, led by recent trends like premiumisation, holistic wellness, and nature-based beauty with growing focus on science and technology to develop new products and categories. The BPC segment's contribution is 40% of total sales of the company. HUL's key priorities for the BPC segment include driving the core, premiumisation, and market development, focus on digital and ecommerce, and people and plant positive beauty. To grow the core portfolio, HUL plans to focus on building purposeful brands and extend to newer formats, drive penetration in rural India by going deep and building access, design to win in many Indias (WiMI strategy) through differentiated products in different regions, and locally relevant advertisement to connect and attract consumers in a better way. HUL is the market leader in hair conditioners and colour cosmetics. The company aims to develop the market further through activities such as category education, engaging category experts, online sampling, medical marketing, and premiumise the category by democratising key trends and building new formats. HUL plans to design and create products specifically for the ecommerce platform such as sheet masks, skin and hair serums, and hair masks. The digital channel and ecommerce will help HUL stay ahead of the game with the help of influencer marketing and D2C. HUL's strategy is to create a people and planet positive business and aims to become 100% plastic free by FY2025.

Home Care (HC) – Long-term growth drivers in the HC segment include automation of laundry, change in palette of wardrobe, more surfaces and benefits in dish and surface cleaning and change in consumer access channels. There is huge opportunity for premiumisation as mass market is 72% of the volume.

Portfolio geared to drive premiumisation



Source: Company presentation

The HC segment contributes 31% to the company's overall sales. HUL's strategy for the HC segment includes growing the core, market development, win channels of future, and pioneer a clean future. For the growth of its core brands, the company aims to create superior products and build purposeful brands. Detergent liquids and fabric conditioners have 2x higher realisation per wash and are GM accretive as compared to powders. Market penetration for these products is also low at <15%. HUL aims to encash this opportunity by developing market of such future categories. HUL plans to improve market share in modern trade and e-commerce through better discovery and higher realisations. To develop a clean future, HUL is working on reducing carbon across product lifecycle, biodegradability and water efficiency and 100% renewable or circular feedstock without deforestation.

Foods and Refreshment (F&R) – Various products in the foods and refreshment segment have lower penetration in India such as coffee (27%), health food drinks (25%), soups (7%), and green tea (2%), which provide a huge growth opportunity. The F&R segment contributes 29% to total sales of HUL. For the F&R segment, HUL has adopted a multi-pronged strategy to continue winning in the upcoming decade. Indian diet is deficient in protein and micro nutrients, thus HUL's nutrition portfolio comprising Horlicks and Boost is designed to address unbalanced nutrition. HUL plans to introduce high science-based innovations around lifestyle diseases and to address rampant life stage issues with products such as Women's plus, Protein plus, and NutriJoy. For its tea portfolio, the strategy is to premiumise as loose tea is currently 30% of market, WiMI strategy with differentiation across brands, packs and formulation and market development of green tea where penetration is very low at 2%. In coffee, HUL plans to focus on market development in north, where penetration level is 17% and premiumisation in south, where penetration is 87%. In the foods category, the idea is to transform the portfolio through on-trend innovations such as restaurant-like food at home (Knorr), making protein delicious (peanut butter), and making host food tastier (Mayonnaise). India has a very low per capital consumption of ice creams (1x) when compared to countries such as US (21x), Turkey (7x), China (6x) and it is expected to post a CAGR of 15% between 2018-2028. In ice creams, the idea is to accelerate OOH consumption through increased cold cabinet penetration (from 1x in 2015 to 12x in 2025) and any-time anywhere availability.

Ice-cream opportunity in India

Source: Company presentation

HUL also plans to leverage Unilever Food Solutions (UFS) with an addressable market of Rs. 25 billion to tap the upper end of seasonings/value-added sauces. UFS is expected to maximise on the eating out trend led by portfolio cross-selling and branded presence. With the chef's digitally connected to UFS, HUL is creating a digital route to market. HUL is one of the largest buyers of agri commodities and aims to do good for consumers, farmers and environment through its Farm to Fork business model.

Nutrition portfolio – A key pillar for future growth: Health food drinks penetration in India is the lowest at ~20%. Value offering through low price sachet packs and better communication is helping nutritional products to gain good traction in rural markets. With the merging of GSK Consumer's distribution reach, the overall direct reach for nutrition portfolio has doubled in the recent past. E-commerce contribution has grown 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, 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 term of margins and are further expected to add around 300-400 bps in the coming years.

Focus on achieving competitive growth across categories – HUL is focusing on achieving competitive growth across categories through its well-defined strategies of growing the core through premiumisation, building new categories for future, cluster base approach through WIMI strategy, and distribution expansion. The company is aiming for market development portfolio to grow ahead of the premium portfolio and premium portfolio to grow ahead of core category portfolio, which will help to achieve competitive growth across categories will maintain the leadership positioning.

Modest margin expansion in the medium to long term – HUL's OPM expanded by 1,000 bps to 25% over the past decade, led by operating efficiencies and premiumisation strategy. The company is targeting modest margin expansion over the next decade, led by cost-saving initiatives, premiumisation, and nutritional synergies. The company is striving cost savings by designing products at least possible cost, operating efficiencies across value chain, reduce distance through reduction in travel per tonne, media spends creating

value through better reach, and zero-based budget with every additional cost challenged. Acquisition of nutrition business has already clocked 1000 bps of synergistic benefits. It is likely to add around 300-400 bps in the coming years. This along with agile supply chain and distribution and help of data analytics would enable HUL to achieve sustained improvement in OPM. Large part of margin expansion will be utilised for improving the growth prospects of key categories. Thus, the company expects modest margin expansion in the near future.

Aiming for double-digit earnings growth – In the tough business environment hovered by challenges posted by demonetization, GST implementation, and the pandemic, HUL posted resilient performance with revenue and PAT growing by 9% and 14%, respectively, in the last decade. The company is aiming at winning the next decade by achieving double-digit earnings growth by achieving sustained volume growth in core categories of home care and personal care, scaling up the foods and refreshment business coupled with gradual improvement in OPM. Structural growth story of the Indian consumption market with low per capital consumption, low penetration in most categories, and rural consumption is 1/3rd of overall consumption market provide ample opportunities. We expect HUL's revenue and PAT to post a CAGR of 14% and 18% over FY2021-FY2024 with the structural growth story intact and digital leading the channel growth.

Raw-material pressure under control; OPM to be at 24-25% – Management has indicated that raw-material pressure is under control with all key inputs such as palm oil, crude derivatives, and packaging cost not seeing significant jump in prices. Raw tea prices have corrected from their high and are stabilising. The company took another round of price hike across products. OPM is expected to remain at 24-25% with synergistic benefit from GSK Consumer's nutrition business to support profitability.

Oral care will achieve good growth in the coming years – HUL has number two position in the oral care category. Relaunch of close-up and WIMI communication will help the brand to achieve good traction in the coming years. The company is in the process of relaunching Pepsodent in the coming quarters. Overall, the company would like to gain market share in the oral care category.

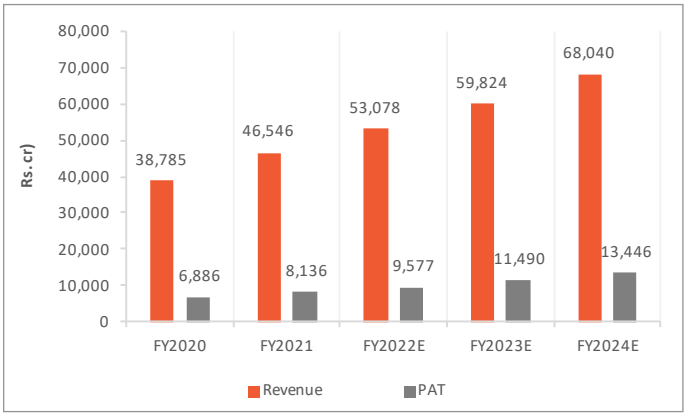
Bottom-of-pyramid portfolio remains key for growth – HUL's management stated that premiumisation will not lead to shifting of focus from the bottom-of-pyramid portfolio in the near future. Contribution of mass product is high in some of the core categories such as detergents which have strong traction for its mass portfolio. The bottom-of-pyramid products provide an opportunity to improve penetration in the tier 3-4 towns. Further, it is aiming at consumer mass products in urban and tier-1 towns to shift to gradually upgrade to premium products in the medium term.

E-commerce will grow faster among the channel – HUL's products are available in 8 million stores (2.5 million outlets are directly reached). The company is planning to go big on emerging channels such as e-commerce, which contribute 9-10% to revenue. It is developing a different product portfolio for its e-commerce platform. The e-commerce channel will be the fastest growing channel for the company. The company is also building Direct-to-Consumer presence by adding more premium brands in the pipeline. However, management reiterated that general trade will remain the top contributing channel for the company. Digital base demand capturing through Shikhar app, transparent pricing, on-time delivery, and access of credit at reasonable cost will continue to help general trade to remain competitive in the channel mix.

R&D remains the key pillar of Reimagine HUL – HUL has three R&D centres in India at Bangalore, Mumbai and Gurgaon and 18 centres across the world. Few of the initiatives of the R&D department include transforming soaps with vegetable fats and oils, affordable and sustainable home care, revolutionary hygiene technologies including immunity, innovating holistic skin glow, and remodelling tea taste and benefits with technology. HUL's R&D strategy is to develop consumer-focused superior products, drive superiority with positive nutrition, develop sustainable products (low carbon products, plant-based, renewable and biodegradable biosurfactants) for a clean future, improve circular packaging with focus on lesser, better or no plastic, develop deep domain expertise and reimagine R&D by developing future-fit R&D capabilities and talent.

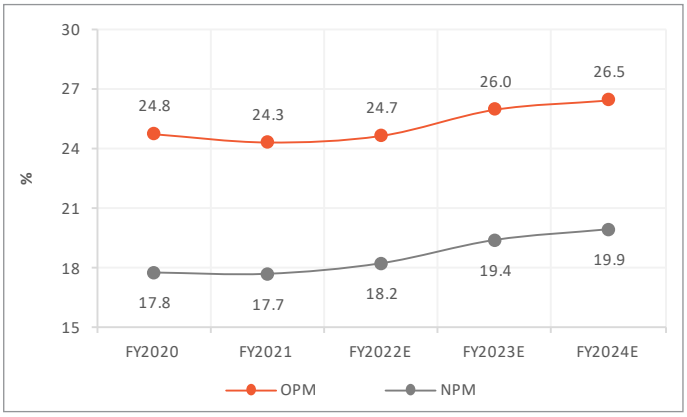
Financials in charts

Steady growth in revenue and PAT (Rs.cr)



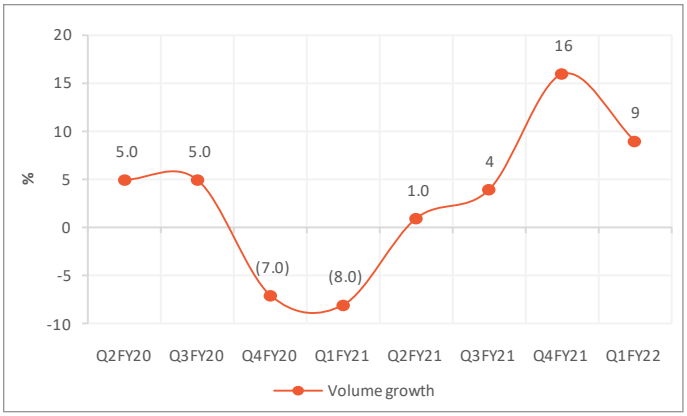
Source: Company, Sharekhan Research

Margins to improve slightly



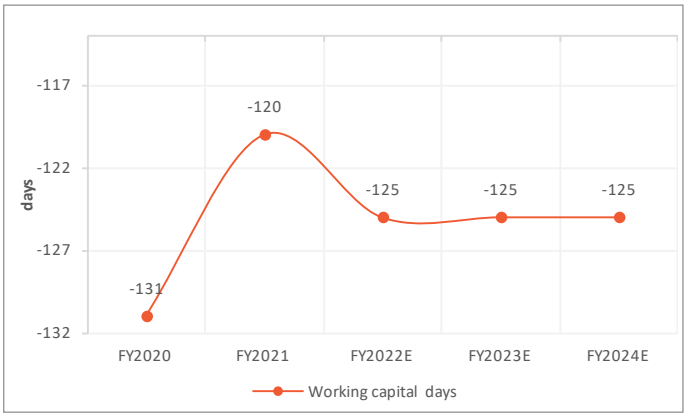
Source: Company, Sharekhan Research

Trend in consumer business volume growth



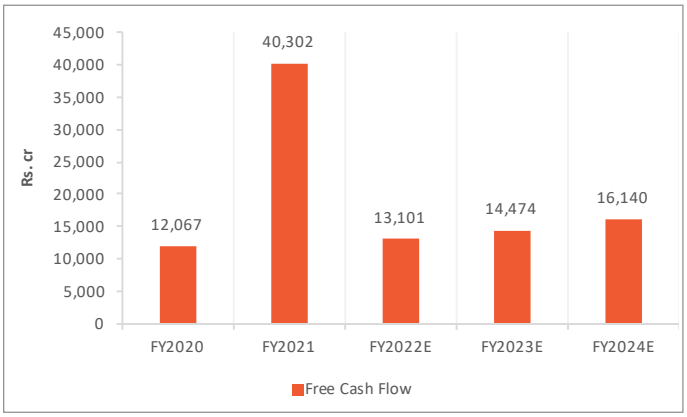
Source: Company, Sharekhan Research

Negative working capital days



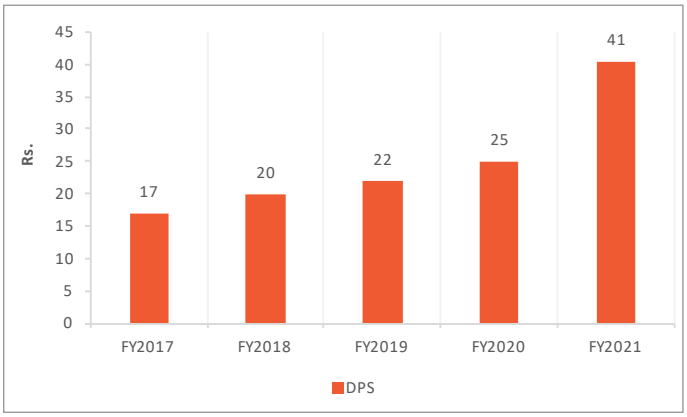
Source: Company, Sharekhan Research

Stable free cash flow generation



Source: Company, Sharekhan Research

Consistent dividend payout



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Demand remains resilient; Margins to improve sequentially

After second wave disruption in April-May 2021, companies witnessed faster recovery in performance in June-July 2021. The rural market is gaining momentum and, with monsoon expected to be normal, rural growth is expected to be stronger than urban growth in the quarters ahead. Further, corporates opening up with full capacity and improving mobility would improve demand for out-of-home categories such as colour cosmetics, beverages and juices, deodorants and hair colour. Thus, we expect consumer goods companies to post better sales volume in the quarters ahead. 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 sequentially. Profitability is likely to be better off in H2FY2022. Improving revenue mix and better operational efficiencies remain key margin drivers in the medium term.

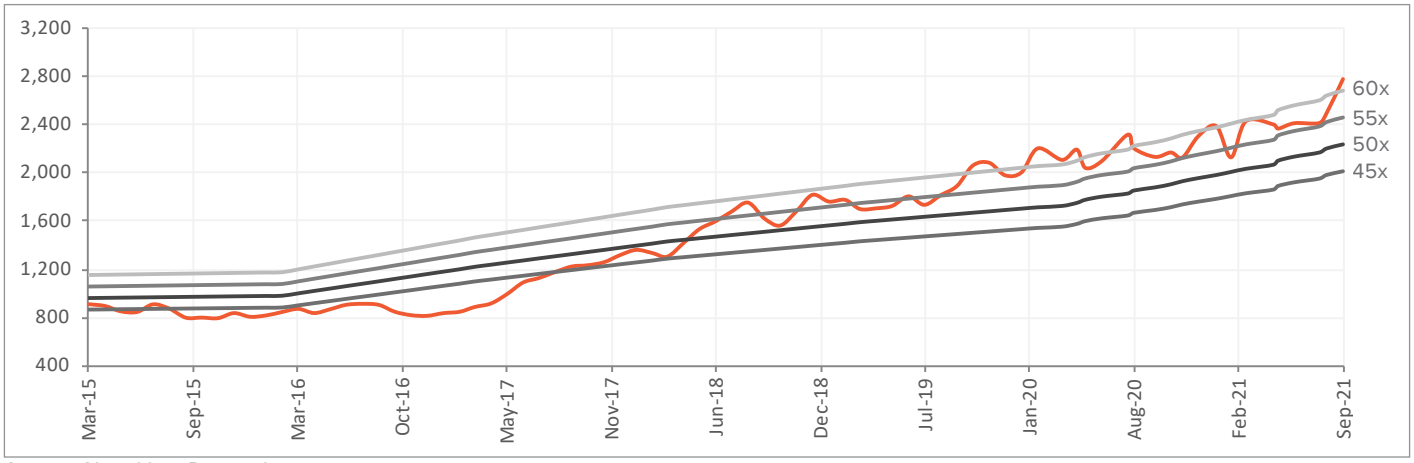
Company Outlook – Focus remains on achieving competitive volume growth

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. Resilient demand in rural India (aided by another year of good monsoon), recovery in demand for out-of-home categories with improvement in mobility, addition of 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 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 a revised PT of Rs. 3,185

HUL delivered resilient performance in a tough decade with revenue and PAT posting CAGR of 9% and 14%, respectively, with 1,000 bps expansion in OPM. 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. HUL remains one of our top picks in the FMCG space. We maintain our Buy recommendation on the stock with a revised PT of Rs. 3,185. We have introduced FY2024 financials in this update. The stock is trading at 57.4x/49.1x its FY2023/FY2024 EPS.

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*	94.6	78.4	67.3	61.1	52.9	45.6	136.4	139.7	141.9
ITC	19.4	17.6	14.8	15.2	12.7	10.7	21.5	26.6	30.7
Godrej Consumer Products	64.2	55.3	46.8	47.1	40.7	35.2	18.3	21.3	22.9
HUL	81.1	68.9	57.4	57.8	50	41.9	36.5	26.4	31.3

*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
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 *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

Sharekhan

by BNP PARIBAS

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