Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Hindustan Unilever Ltd

Q1 misses mark; volume growth to pick-up gradually

Consumer Goods	Sharekhan code: HINDUNILVR
Reco/View: Buy ↔	CMP: **Rs. 2,702**
Price Target: **Rs. 3,050** ↔	

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 23.4

Updated July 08, 2023

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

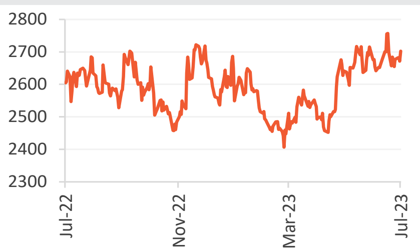
Company details

Market cap:	Rs. 6,34,942 cr
52-week high/low:	Rs. 2,769/2,393
NSE volume: (No of shares)	14.3 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Free float: (No of shares)	89.5 cr

Shareholding (%)

Promoters	61.9
FII	15.0
DII	11.6
Others	11.54

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.0	8.2	2.0	3.8
Relative to Sensex	-5.7	-5.1	-9.0	-18.2

Sharekhan Research, Bloomberg

Summary

- HUL's Q1FY2024 numbers missed ours as well as the street's expectation, with revenue/PAT growing by 6% and 9% y-o-y, respectively (and volumes rising by just 3%). OPM improved 49 bps y-o-y to 23.2%.
- Price growth will be flat or marginally slip if raw material prices remain low. Volume growth will gradually pick up with expected recovery in demand going ahead (especially in the rural market).
- Focus remains on healthy gross margin expansion with input cost staying moderated. A large part of savings will be invested in higher ad-spends given increased competitive intensity.
- Stock trades at 58x/50x its FY2024E/FY2025E earnings. New leadership is confident of achieving consistent and profitable growth in the medium term. We retain Buy with an unchanged PT of Rs. 3,050.

Hindustan Unilever (HUL)'s Q1FY2024 performance missed our as well as street expectation with revenues/PAT growing by 6%/9% y-o-y, respectively, with domestic y-o-y volume growth standing at 3%. The miss was largely led by lower-than-expected revenue growth, which missed our as well as street expectation by 2-3%. Decline in input prices led to 246 bps y-o-y improvement in the gross margins to 49.9% while OPM improved by 49 bps y-o-y to 23.2% as large part of gross margins savings was invested in higher ad-spends and incremental impact of increase in royalty charges. Management expects volume growth to gradually pick up, which will drive revenue growth in the quarters ahead. Market share gains in key categories, pick up in rural demand and market development activities will be key volume growth drivers in the coming quarters.

Key positives

- Over 50% of portfolio (including household care & laundry) registered mid-to-high single-digit volume growth in Q1FY24.
- ~75%+ portfolio continues to gain market share.
- Gross margin rose 256 bps y-o-y to 49.9% due to lower input prices.

Key negatives

- Skin-cleansing category registered low single digit volume growth while Health Food Drink (HFD) category registered marginal decline in volumes.

Management Commentary

- FMCG market is in a transition phase as the companies are passing on benefit of decline in the input prices to consumers in some of the key categories. Hence dealers/distributors are maintaining little lower inventory and would focus on finishing high price inventory lying with them. The transition phase will take two quarters to settle. On the other hand, consumer demand is expected to pick-up with price inflation moderating.
- Rural growth stood in low single digits due to a low base of Q1FY2023. Government doing higher capex investment resulting in higher non-farming income, lowering of inflation and higher government spends on rural development will improve rural growth ahead. Erratic monsoon could be a spoilsport for rural demand.
- Overall, in the next two-three quarters, revenue growth will be pre-dominantly driven by volume growth (two-thirds contribution to growth) while price-led growth will moderate (one-third contribution to growth).
- The company will continue to focus on healthy gross margin expansion due to benign input prices in the near term. Due to competitive intensity in some of the key categories, HUL will maintain higher advertisement and promotional spends in the coming quarters. OPM expansion will be lesser compared to gross margin expansion.
- New leadership is focusing on driving more opportunities in the skin care category and foods business through impactful innovations and improving the growth prospects of the HFD category, which is yet to see meaningful improvement in the performance since the acquisition.

Revision in estimates - We have fine-tunned our earnings estimates for FY2024 by reducing the revenue growth for next two quarters and expanding the gross margin expectation, while we have broadly maintained earnings estimates for FY2025. We will keenly monitor the recovery in rural demand in the coming quarters to make any material changes in the estimates going ahead.

Our Call

View: Maintain Buy with an unchanged PT of Rs. 3,050: Though Q1 performance was miss on expectation, the outlook for coming quarters is relatively better with an expected gradual recovery in the volume growth. Recent correction in key input prices augurs well for margins, while improvement in rural sentiments will play key role in volume growth recovery. Leadership position in a few high-penetrated categories, thrust on innovation and market development to remain competitive and drive consistent earnings growth make it a good pick from a long-term perspective. The stock is currently trading at 57.8x and 49.6x its FY2024E and FY2025E earnings, respectively. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 3,050.

Key Risks

Sustained slowdown in rural demand led by erratic monsoon or persistent volatility 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	FY22	FY23	FY24E	FY25E
Revenue	51,193	59,144	64,419	73,349
OPM (%)	24.4	23.0	23.7	24.3
Adjusted PAT	8,845	10,024	10,986	12,802
Adjusted EPS (Rs.)	37.6	42.7	46.7	54.5
P/E (x)	71.8	63.4	57.8	49.6
P/B (x)	13.0	12.6	12.3	11.5
EV/EBIDTA (x)	50.3	46.2	41.0	35.0
RoNW (%)	18.4	20.3	21.5	23.9
RoCE (%)	23.6	25.6	28.2	31.9

Source: Company; Sharekhan estimates

Weak Q1 – miss on estimates

Standalone revenue grew by 6.1% y-o-y to Rs. 15,148 crore in Q1FY2024 against our and average street expectation of Rs. 15,508-15,517 crore. Domestic sales volumes grew by 3% y-o-y which is below our as well as street expectation of 5-6% volume growth. Revenues of the home care (HC) segment grew by 10% y-o-y (mid single-digit volume growth) while beauty & personal care (BPC) segment revenues grew by 4.4% y-o-y (mid single-digit volume growth) and food & refreshments segment (F&R) registered a growth of 4.7% y-o-y (flat volume growth). More than 75% portfolio gained market share in Q1. Gross margins improved by 256 bps y-o-y to 49.9% aided by softening of raw material prices, while OPM is higher by 49 bps y-o-y at 23.2% due to increased advertising & promotion (A&P) expenses. OPM came in-line with our and street average expectation of 23.4%. HC/BPC/F&R reported margins of 18.3%/26.3%/17.9%, respectively. Operating profit grew by 8.4% y-o-y to Rs. 3,521 crore. In line with operating profit growth, adjusted PAT grew by 8.8% y-o-y to Rs. 2,499 crore, below our expectation of Rs. 2,584 crore and street average expectation of Rs. 2,612 crore.

Home Care (HC) – Mid-single digit volume growth; margins slightly higher y-o-y

The segment grew by 10% y-o-y to Rs. 5,425 crore, with volume growth in mid single-digit. Both fabric wash and household care grew in double-digit led by focused market development actions and premiumisation. Fabric wash continued to gain market share and registered double-digit growth balanced between price and volume. Household care registered double-digit volume-led growth driven by outperformance in the dishwash category. New launches during Q1 include Comfort In Wardrobe Premium Fragrance Hangers and Vim Shudhham Cleaning Spray and Gel. PBIT margin of the HC segment increased by 64 bps y-o-y to 18.3%.

Beauty and personal care (BPC) – Volume-led growth; margins maintained y-o-y

The BPC segment reported 4.4% y-o-y growth to Rs. 5,601 crore. Revenue growth was largely volume-led with the segment registering mid single-digit volume growth in Q1. Skin care and colour cosmetics grew in double-digits on the back of strong performance in the premium portfolio. Hair care delivered mid-single digit volume-led growth driven by Tresemme, Indulekha and Clinic Plus. Innovations and future formats continued to do well in Q1. Skin cleansing had a modest volume-led growth with Lux and Hamam continuing to outperform. Further price reductions were taken in soaps portfolio in Q1. Market development actions in bodywash continued to yield good results. As per the management, skin cleansing consumption is expected to grow up with levers like playing the portfolio smartly, premiumisation and new formats scaling up. Oral care delivered strong double-digit growth led by Closeup. New launches during Q1 include Dove Men+ Care range, Indulekha Soap and Pond's Anti Pigmentation Serum. PBIT margin of the BPC segment stood flat at 26.3%. Price reduction in select categories and higher A&P spends led to stable margin y-o-y, though raw material prices fell.

Foods and Refreshments (F&R) – Flat volume growth; margins improve y-o-y

The F&R segment delivered 4.7% y-o-y revenue growth to Rs. 3,797 crore, with volume growth near flat. The tea category saw a modest volume-led growth as the category continued to witness consumers downgrading due to higher inflation in premium teas versus loose tea. Coffee grew in mid-single digits led by pricing. Health Food Drinks (HFD) posted price-led growth with both Horlicks and Boost performing well. Management has guided that premium products are growing well, while mass products are impacted due to inflation. Market share and penetration in HFD category is improving with increased awareness. Foods grew in mid-single digit led by strong performance in ketchup and food solutions. Mayonnaise and peanut butter continued to deliver robust growth. The ice cream category grew in mid-single digit on an exceptionally high base of Q1FY23. Unseasonal rains in April hit ice cream consumption in the quarter. New launches during Q1 include Horlicks Millet Biscuits, range of Knorr Chinese Sauces and Bru Cold Coffee. PBIT margin of F&R segment grew by 200 bps y-o-y to 17.9%.

Key concall highlights

- **Rural demand gradually improving:** FMCG demand is recovering gradually. Management indicated that rural growth came in positive (low single-digit volume growth) in Q1FY24, but recovery is slower than expected. Slowdown has bottomed-out, going ahead, recovery would be led by moderating inflation, government maintaining rural expenditure and higher capex spends by the government aiding the non-farm income. However, Erratic monsoon could be a spoil sport for rural demand.
- **Price-led growth to taper off:** Price-led growth will be flat to marginally negative if raw material prices remain at current levels. Sales volume is expected to gradually pick in the coming quarters and will drive revenue growth. As per the management, FMCG market is in transition phase as the companies are passing on benefit of decline in the input prices to consumers in some of the key categories. Hence dealers/ distributors are maintaining little lower inventory and would focus on finishing high price inventory lying with them. Transition phase will take two quarters to settle. Over the long term, 1/3rd growth is likely to be driven by price growth and 2/3rd growth would be driven by volume growth.
- **Raw material inflation cooling:** Management has guided that prices of crude & crude derivative and palm oil have moderated, while prices of coffee, milk, barley are still high y-o-y. Management expects the inflation in these commodities to cool of as well in the the coming months.
- **Competitive intensity to go up further:** Management stated that with inflation reducing, the competitive intensity has risen due to resurgence of small/regional players who had vacated the market during COVID in select categories. To remain competitive, the company plans to step-up it's A&P spends to sustain the volume growth momentum in the coming quarters.
- **Market share improving across categories:** More than 75% portfolio gained market share and improved penetration during Q1, which market shares ahead of pre-COVID period. Management indicated that market share gains in premium products higher.
- **Focus on driving up gross margins:** As per the management, HUL reported 600 bps impact on gross margin in September 22, however, the company recovered 400 bps margins in past 3 quarters, with a large amount of savings (~300 bps) being invested in A&P spends. HUL will focus on improving its gross margin in the coming quarters. OPM expansion will be lesser than gross margin expansion as large part of gross margin savings will be utilised for higher ad spends.
- **Other expenses higher y-o-y:** Other expenses rose 20% y-o-y in Q1FY24 due to increased royalty fees beginning from the quarter, higher spends on building capabilities, restructuring expenses and one-off items in the base quarter.
- **Long-term outlook strong:** The management has guided that market development, innovation, premiumisation, market share gains, improved penetration coupled with strong prospects of India's FMCG sector would drive growth in the long term. In terms of categories, new leadership is focusing on driving more opportunities in the skin care category and foods business through impactful innovations and improving the growth prospects of HFD category, which is yet to see meaningful improvement in the performance since the acquisition.

Results (Standalone) Rs cr

Particulars	Q1FY24	Q1FY23	y-o-y (%)	Q4FY23	q-o-q (%)
Net revenue	**15,148.0**	**14,272.0**	**6.1**	**14,893.0**	**1.7**
Total Raw Material	7,588.0	7,514.0	1.0	7,639.0	-0.7
Employee Expenses	651.0	597.0	9.0	683.0	-4.7
Advertising and promotions	1,481.0	1,328.0	11.5	1,290.0	14.8
Other Expenses	1,907.0	1,586.0	20.2	1,810.0	5.4
Total expenditure	11,627.0	11,025.0	5.5	11,422.0	1.8
Operating Profit	**3,521.0**	**3,247.0**	**8.4**	**3,471.0**	**1.4**
Other income	185.0	137.0	35.0	160.0	15.6
EBITDA	3,706.0	3,384.0	9.5	3,631.0	2.1
Interest	47.0	26.0	80.8	24.0	95.8
PBDT	3,659.0	3,358.0	9.0	3,607.0	1.4
Depreciation	257.0	260.0	-1.2	262.0	-1.9
PBT	**3,402.0**	**3,098.0**	**9.8**	**3,345.0**	**1.7**
Tax	903.0	800.2	12.8	873.0	3.4
Adjusted PAT	**2,499.0**	**2,297.8**	**8.8**	**2,472.0**	**1.1**
Extra-ordinary items	27.0	8.8	-	-80.0	-
Reported PAT	**2,472.0**	**2,289.0**	**8.0**	**2,552.0**	**-3.1**
Adjusted EPS (Rs.)	10.6	9.8	8.8	10.5	1.1
			bps		**bps**
GPM (%)	49.9	47.4	256	48.7	120
OPM (%)	23.2	22.8	49	23.3	-6
NPM (%)	16.5	16.1	40	16.6	-10
Tax rate (%)	26.5	25.8	71	26.1	44

Source: Company, Sharekhan Research

Segmental performance

Particulars	Q1FY24	Q1FY23	y-o-y (%)	Q4FY23	q-o-q (%)
Revenue (Rs. crore)					
Home Care	5,425.0	4,931.0	10.0	5,638.0	-3.8
Beauty & Personal Care	5,601.0	5,364.0	4.4	5,188.0	8.0
Food & Refreshments	3,797.0	3,627.0	4.7	3,794.0	0.1
Others	325.0	350.0	-7.1	273.0	19.0
Total	**15,148**	**14,272**	**6.1**	**14,893**	**1.7**
PBIT margins (%)					
Home Care	18.3	17.6	64	18.7	-46
Beauty & Personal Care	26.3	26.3	-2	26.1	20
Food & Refreshments	17.9	15.9	200	17.9	4
Total	**20.8**	**20.0**	**73**	**20.7**	**2**

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Rural recovery on cards; margin improvement to sustain

Rural demand bottomed out with sales returning to positive growth in Q4FY2023. With price inflation stabilising and a fall in key input prices, managements of most companies are confident of witnessing gradual pick-up in rural demand in the quarters ahead. Moreover, expectation of well spread-out monsoon and government offering some incentives prior to the budget might provide some boost to rural sentiments in the coming quarters. In FY2024, revenue growth is expected to be volume-led growth with companies focusing on passing on the benefits of the decline in input cost to customers in the coming quarters. A decline in input prices will drive gross margins in the coming quarters. Despite higher media spends, OPM would remain high y-o-y in the near term.

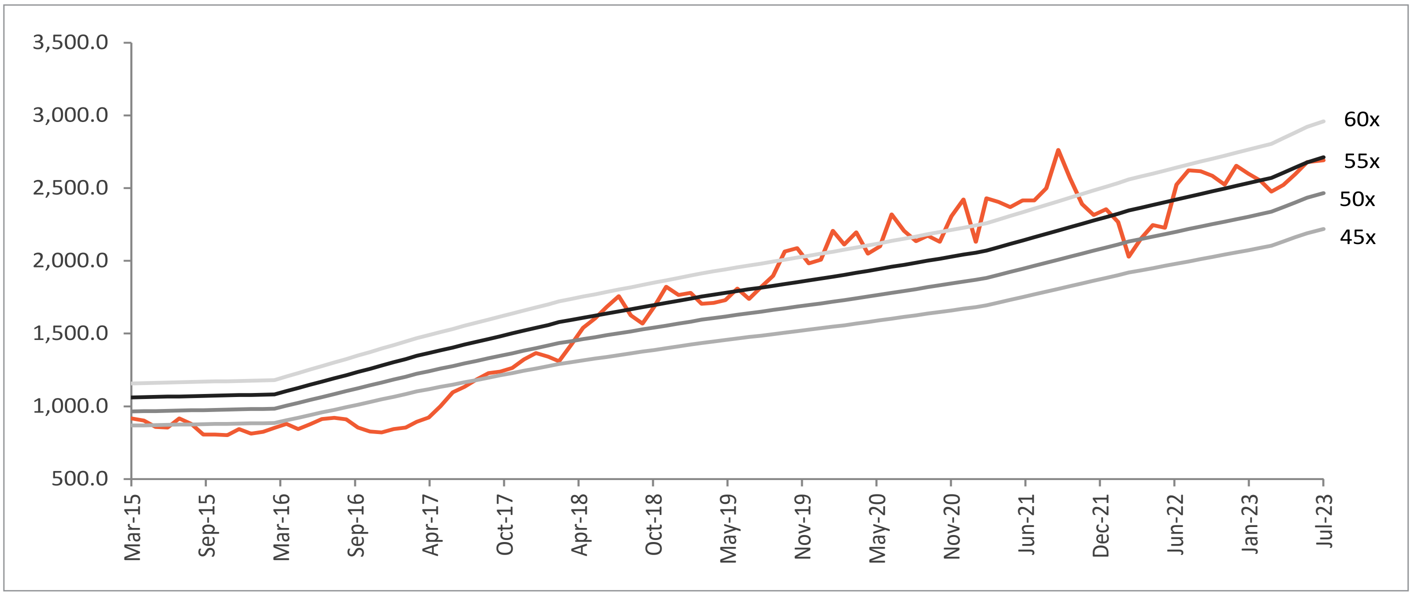
■ Company outlook - Focus remains on achieving competitive volume growth

Q1FY24 performance lagged expectations with low single-digit volume growth. However, the company is well poised to achieve good growth in the coming years with a leadership position in over 80% of the portfolio and presence in more than 8 million stores. Recovery in rural demand, improvement in demand for out-of-home categories with better 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. We expect revenue growth in FY2024 will largely be a volume-led growth with input price inflation receding for past few months. Better product mix with a recovery in discretionary categories, calibrated price hikes and operational efficiencies along with integration benefits would help margins to improve in the coming years. However, the recent hike in royalty charges and continued focus on A&P spends will moderate margin expansion.

■ Valuation - Maintain Buy with an unchanged PT of Rs. 3,050

Though Q1 performance was miss on expectation, the outlook for coming quarters is relatively better with an expected gradual recovery in the volume growth. Recent correction in key input prices augurs well for margins, while improvement in rural sentiments will play key role in volume growth recovery. Leadership position in a few high-penetrated categories, thrust on innovation and market development to remain competitive and drive consistent earnings growth make it a good pick from a long-term perspective. The stock is currently trading at 57.8x and 49.6x its FY2024E and FY2025E earnings, respectively. We maintain our Buy recommendation on the stock with an unchanged PT of Rs. 3,050.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
Nestle India*	92.7	73.4	63.4	59.5	49.6	42.8	129.2	135.5	138.9
ITC	32.3	28.3	24.9	24.3	21.0	18.3	32.7	35.3	37.5
Godrej Consumer Products	62.2	47.9	40.9	42.2	35.8	30.5	15.2	16.9	18.1
HUL	63.3	57.8	49.6	46.2	41.0	35.0	25.6	28.2	31.9

*Source: Company, Sharekhan estimates; *Values for Nestle India are for CY22, CY23E and CY24E*

About company

HUL is India's largest FMCG company with presence of more than 90 years. The company is a subsidiary of Unilever Plc (that holds a 62% stake in HUL), the world's largest consumer goods company present across 190 countries. It has a strong portfolio in the homecare and beauty and personal care categories. With over 50 brands spanning 16 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. Out of the company's portfolio of over 50 brands, 19 brands have a turnover exceeding Rs. 1,000 crore per annum (FY23).

Investment theme

HUL has a leadership position in highly penetrated categories such as soaps, detergents, and shampoos in India. The company maintained its leadership position in more than 85% of business (FY23). Sustaining product innovation, entering new categories, premiumisation, and increasing distribution network remain some of the company's key revenue drivers. A strong financial background, robust cash-generation ability, and leadership position in some of the 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

Nitin Paranjpe	Chairman
Rohit Jawa	Chief Executive Officer & Managing Director
Ritesh Tiwari	Executive Director, Finance & IT and Chief Financial Officer
Dev Bajpai	Executive Director, Legal & Corporate Affairs & Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	3.99
2	SBI Funds Management Ltd	1.55
3	Blackrock Inc	1.54
4	Vanguard Group Inc	1.32
5	Republic of Singapore	1.06
6	JP Morgan Chase & Co	0.69
7	ICICI Prudential Life Insurance Co. Ltd	0.51
8	UTI Asset Management Co Ltd	0.45
9	Norges Bank	0.34
10	Abrdn plc	0.33

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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Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

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