



TM

Hindustan Unilever

19 January 2023

In line quarter; surprise royalty increase to offset the tailwinds from positive management commentary

RESULT UPDATE

Sector: FMCG **Rating:** BUY
CMP: Rs 2,650 **Target Price:** Rs 2,950

Stock Info

Sensex/Nifty	60,858/ 18,108
Bloomberg	HUVR IN
Equity shares (mn)	2350
52-wk High/Low	Rs 2,741/1,902
Face value	Rs 1
M-Cap	Rs 6,227bn/US\$ 76bn
3-m Avg value	US\$ 44mn

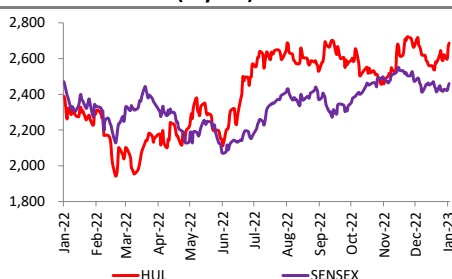
Financial Snapshot (Rs mn)

Y/E Mar	FY23E	FY24E	FY25E
Sales	596,577	659,012	732,314
PAT	99,104	118,547	133,512
EPS (Rs)	42.2	50.4	56.8
PE (x)	64.0	53.5	47.5
EV/EBITDA (x)	35.8	30.0	26.6
P/BV (x)	11.7	11.4	11.1
EV/Sales	8.3	7.5	6.7
RoE (%)	20.0	23.4	25.7
RoCE (%)	25.5	29.7	32.5
NWC (days)	-32	-32	-32
Net gearing (x)	(0.1)	(0.1)	(0.2)

Shareholding Pattern (%)

	Dec 22	Sept 22	Jun 22
Promoter	61.9	61.9	61.9
-Pledged	-	-	-
FII	14.3	14.1	13.3
DII	11.5	11.7	12.2
Others	12.2	12.3	12.6

Stock Performance (1-year)



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Hindustan Unilever (HUVR) delivered an in-line performance with revenue/EBITDA/PAT growth of 16%/8%/13% YoY respectively. Volume growth of 5% was a marginal positive surprise given industry volume decline of 4%. A combination of growth leverage, cost controls and calibrated price hikes limited the decline in EBITDA margin to 180bps. With a 11% pricing impact against a material inflation of 18% in 3Q, gross margin dipped 460bps YoY, albeit it was a 170bps QoQ improvement. We expect gross margin to see a gradual normalization, with commodity inflation continuing to moderate and premiumization and scale leverage playing out. But EBITDA margins improvement will be tempered by the 80bps phased increase in royalty and an uptick in ad spends. We expect a rural recovery led by lower inflation, low base and better farm income expectations while urban demand especially in personal care and HFD categories should also see the benefits of innovation and market development. Hence, we expect volume growth trends to improve over the next couple of quarters.

Management commentary on the demand front seems to be getting more constructive over the past couple of quarters, especially on the rural side where things are getting much better after the June-July lows with worst of inflation likely behind us. Even on the margin front, gross margins seem to have bottomed out in 2Q and should gradually be built back which should help drive a recovery in ad spends as well. We expect cost savings and scale benefits to offset the impact of the royalty rate increase, which albeit a negative surprise still remains below that of other MNC peers. HFD category is set for a growth recovery post aggressive market development once inflation subsides, laundry category still retains strong premiumization and share gain potential while BPC segment has also started recovering with some recovery in disposable income levels.

Valuation and View: We are building in revenue/EBITDA/PAT growth of 11%/16%/16%, respectively, over FY23-24E. Our target price of Rs 2,950 is based on 55x 1HFY25E earnings, in line with its five-year average valuation multiple. We maintain our BUY rating on the stock, given expectations of above-industry growth, continued premiumization and strategic initiatives by the company. Despite the increase in royalty which could be a near-term overhang, we find HUVR as a better bet than multiple mid-cap FMCG peers to play the impending rural recovery and a pick up in FMCG consumption across categories. Key downside risks to our call would be a delayed demand recovery, a reversal in recent commodity price trends and irrational competition.

Result highlights

- Revenue/EBITDA/PAT growth of 16.3%/8%/13% YoY respectively led by 5% volume growth and strong growth in the home care business.
- Overall revenue growth of 16.3% YoY was the result of 31.6% growth in home care, 10.5% in BPC and 6.8% in foods.
- Overall gross margin fell 463bps to 47.5%, given 18% commodity inflation vs 11% blended price hikes; EBITDA margin was down 182bps to 23.2%, with significant savings in other expenses and employee costs offsetting higher A&P spends.
- Due to inflationary pressure, EBIT margin declined 138bps for home care, 271bps for BPC and 77bps for foods.

Management presentation highlights

- **Margins** - Inflation led to 346bps increase in COGS, despite calibrated pricing actions. There was a 120bps decline in A&P spends, 58bps drop in employee cost and 103bps decline in other expenses.
- **Segment performance** - Home care was up 32%, BPC by 11% and foods by 7%; Margins in the home care segment stood at 19.2% (-138bps YoY), personal care stood at 25.1% (-271bps YoY) and Foods & Refreshments was 17.9% (-77bps YoY).
- **Home care** – Segment witnessed double digit volume growth. Fabric Wash and Household Care grew in high double digits. Liquids portfolio continued to deliver strong results driven by effective market development activities. Price hikes were taken in Fabric Wash and Household Care portfolios to partly offset the input cost inflation.
- **BPC** – Skin Cleansing delivered strong double-digit growth with mid-single digit volume growth. Price cuts were taken in soaps due to decline in palm oil prices. Hair Care grew in high single-digit led by strong performance in Clinic Plus. Oral care delivered steady performance led by Close-up. Delayed winter impacted growth in Skin Care, however non-winter portfolio delivered double digit growth.
- **Foods** – Foods grew in high-teens with double digit volume growth led by Jams, Ketchup and Unilever Food Solutions. Ice cream business grew in double digit. Tea business witnessed mid-single digit volume growth. Coffee grew in double digits while HFD grew in mid-single digit.
- **Material inflation** - Net material inflation is now at 18% vs 22% in 2QFY23. Net price vs cost difference stood at 7% during the quarter.
- **New Royalty and Central Services arrangement with Unilever group** – Royalty and Central services fees will increase from c. 2.65% to c. 3.45% of turnover for a period of 5 years. This increase will be effected in a staggered manner over a period of 3 years.
- **Outlook** – As YoY inflation is still at elevated levels, management expects growth to be price-led. With current easing in inflationary pressures company expects recovery in consumer demand.

Q&A takeaways

- **FMCG industry growth** – During 3QFY23, FMCG market grew 8%YoY, higher compared to 2QFY23. Sept & Oct'22 witnessed double digit growths due to high sales during festive season. Delayed winter impacted sales of hand and body care products, facial moisturizer and other skin care products. According to Neilsen data, FMCG volumes declined 4% during 3QFY23. However, HUL reported 5% volume growth.
- **Urban vs Rural growth** – Urban performed better compared to rural during the quarter. However, rural growth in 3QFY23 was better compared to 2QFY23. HUL witnessed value growth in rural in last 5 months.
- **Price hikes/reduction** – HUL hiked prices in fabric wash and HFD category due to milk, soda ash and barley inflation. However, took price cuts in tea and soaps.
- **Horlicks impacted by milk inflation** – In HFD company focused on driving revenue and cost synergies followed by market development and category penetration. However, inflation in milk prices have impacted discretionary

spending (Horlicks) to some extent. Food solutions business grew 2x compared to pre-covid level.

- **Strategy for detergents bars, powder and solutions** – Company's strategy has been to move consumers from bars to solution wash. Strategy focuses on shifting consumers from mass powders to specialists like liquids, matics. Company witnessed 40% volume growth in Home care category.
- **Skin Care growth outlook** – In case inflation stabilizes, company expects skin category (discretionary) to grow driven by improvement in disposable income and GDP.
- **Royalty and Central Services arrangement** – This arrangement grants HUL the right to use Unilever's owned trademarks, technology, corporate logo, procure raw materials and access to central services provided by Unilever. 3.45% consists of 1.95% royalty for trademark and technology of Unilever and 1.5% for services.
- **Margin outlook** – Margin improvement will come through premiumization and leverage scale benefits (in case inflation stabilizes around current levels).
- **Tax rate** – Effective tax rate for the quarter stood at 26%. For FY23E, company expect the ETR to be 24%.
- **Long term growth outlook** – In past decade, growth was driven by topline and substantial margin improvement. In the coming decade, company expects double digit EPS to be driven mainly by topline growth and modest margin improvement which will be led by mix improvement, premiumization and leveraging scale benefits.

Exhibit 1: Quarterly performance

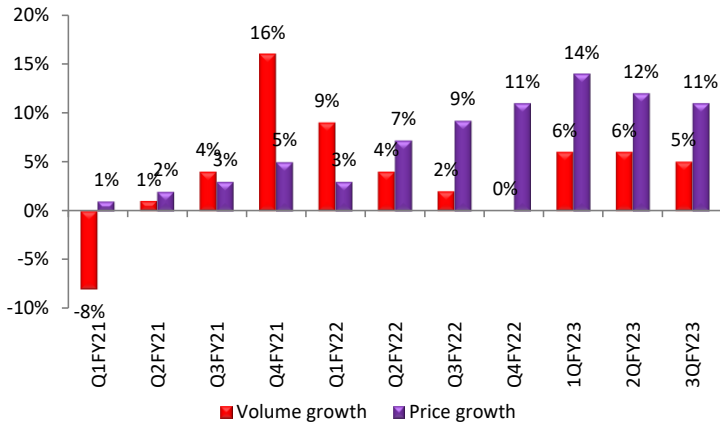
YE March (Rs mn)	3QFY23	3QFY22	2QFY23	YoY (%)	QoQ (%)
Net Revenues	152,280	130,920	147,510	16.3	3.2
Cost of materials	51,050	39,360	48,580	29.7	5.1
(% of sales)	33.5	30.1	32.9		
Purchase of stock in trade	28,920	23,330	31,360	24.0	(7.8)
(% of sales)	19.0	17.8	21.3		
Gross Profit	72,310	68,230	67,570	6.0	7.0
Gross margin (%)	47.5%	52.1%	45.8%		
Employee cost	6,760	6,570	7,090	2.9	(4.7)
(% of sales)	4.4	5.0	4.8		
Selling & admin	12,000	11,890	10,410	0.9	15.3
(% of sales)	7.9	9.1	7.1		
Others	18,180	16,980	16,300	7.1	11.5
(% of sales)	11.9	13.0	11.1		
EBITDA	35,370	32,790	33,770	7.9	4.7
EBITDA margin (%)	23.2	25.0	22.9		
Other income	2,280	910	1,150	150.5	98.3
PBIDT	37,650	33,700	34,920	11.7	7.8
Depreciation	2,600	2,550	2,480	2.0	4.8
Finance cost	260	250	250	4.0	4.0
PBT	34,790	30,900	32,190	12.6	8.1
Tax	8,720	7,810	8,350	11.7	4.4
ETR (%)	25.1	25.3	25.9		
Adjusted PAT	26,070	23,090	23,840	12.9	9.4
PATAMI margin	17.1	17.6	16.2		
Exceptional item	(1,020)	(660)	2,320		
Reported PAT	25,050	22,430	26,160	11.7	(4.2)
No. of shares (mn)	2,350.0	2,350.0	2,350.0		
Adj EPS (Rs)	11.1	9.8	10.1		

Source: Company, Systematix Institutional Research

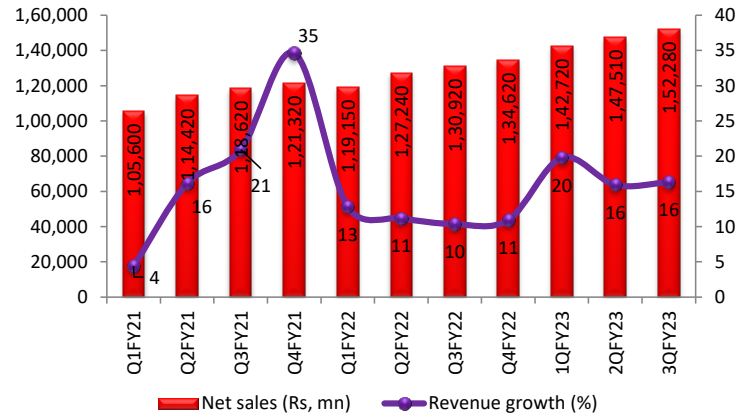
Exhibit 2: Segmental performance

YE March (Rs mn)	3QFY23	3QFY22	2QFY23	YoY (%)	QoQ (%)
Segment revenue					
Home care	55,180	41,930	51,430	31.6%	7.3%
Personal care	57,180	51,750	55,610	10.5%	2.8%
Foods & Refreshments	37,000	34,660	37,550	6.8%	-1.5%
Others	2,920	2,580	2,920	13.2%	0.0%
Net Sales	152,280	130,920	147,510	16.3%	3.2%
Segment EBIT					
Home care	10,610	8,640	8,890	22.8%	19.3%
Personal care	14,370	14,410	13,960	-0.3%	2.9%
Foods & Refreshments	6,610	6,460	7,440	2.3%	-11.2%
Others	1,180	730	1,000	61.6%	18.0%
Total EBIT	32,770	30,240	31,290	8.4%	4.7%

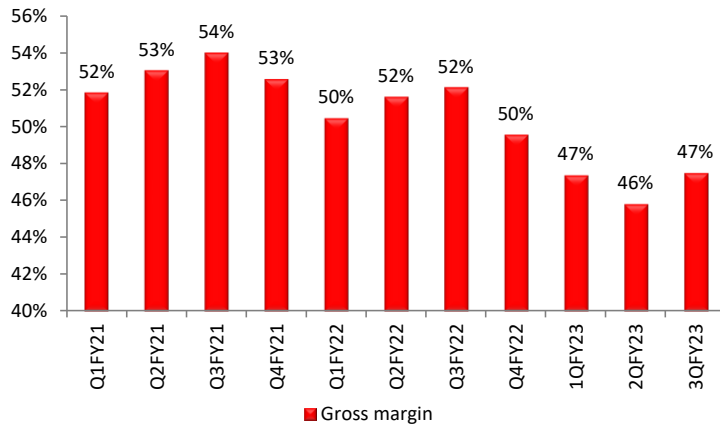
Source: Company, Systematix Institutional Research

Exhibit 3: Strong growth in both volumes and value

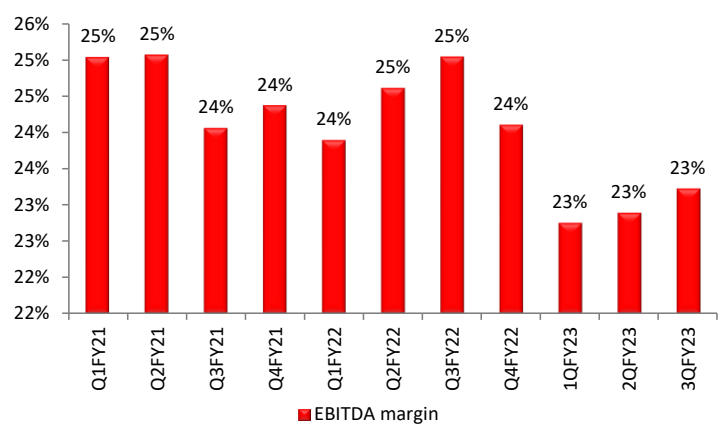
Source: Company, Systematix Institutional Research

Exhibit 4: Growth trajectory picks up to touch normalized levels

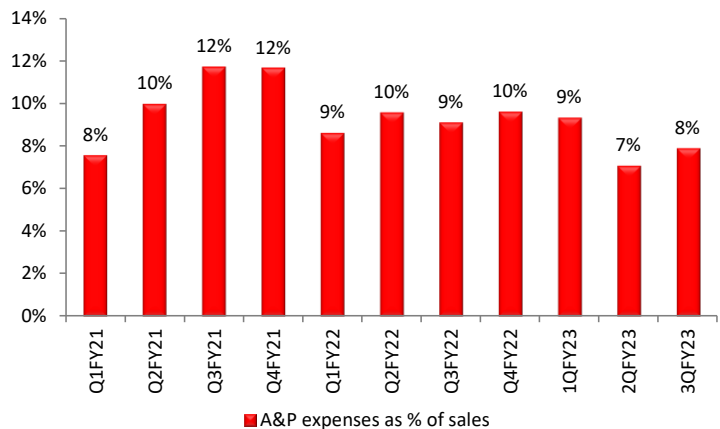
Source: Company, Systematix Institutional Research

Exhibit 5: Gross margin impacted due to pricing-inflation gap

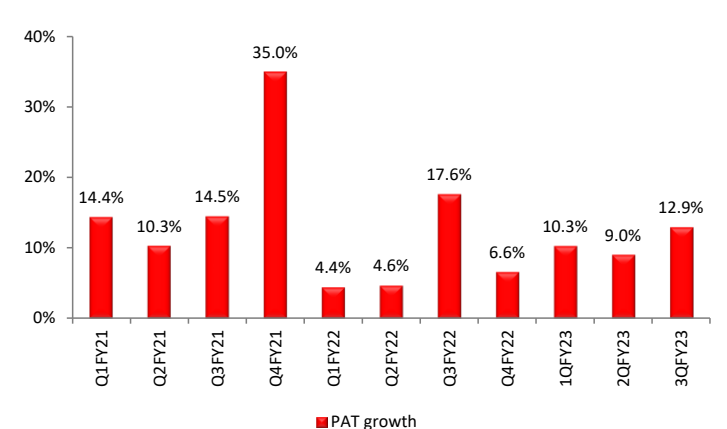
Source: Company, Systematix Institutional Research

Exhibit 6: EBITDA margin impact limited due to leverage benefits

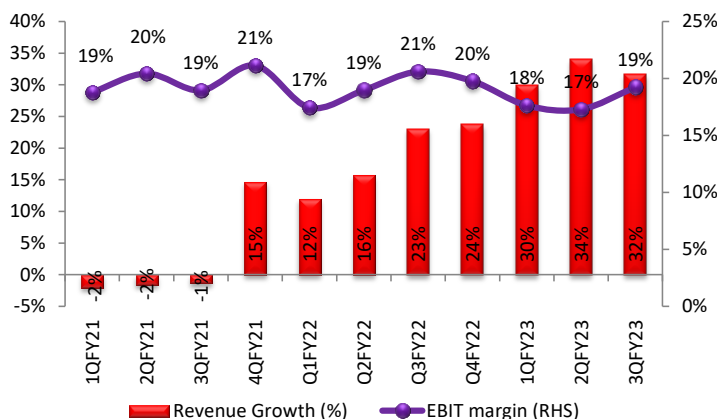
Source: Company, Systematix Institutional Research

Exhibit 7: A&P spends have picked up sequentially

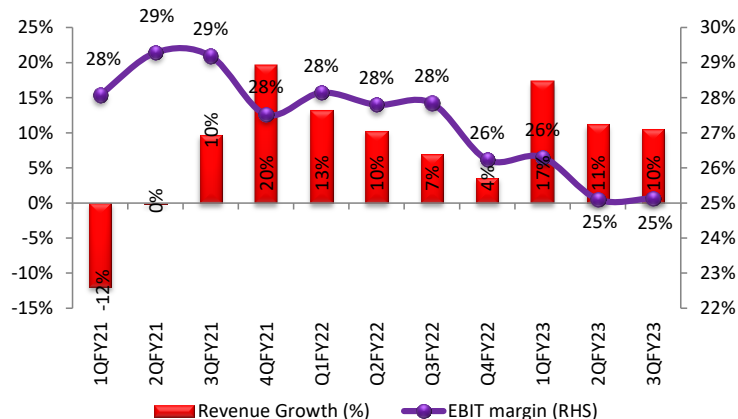
Source: Company, Systematix Institutional Research

Exhibit 8: PAT growth impacted by higher tax rate

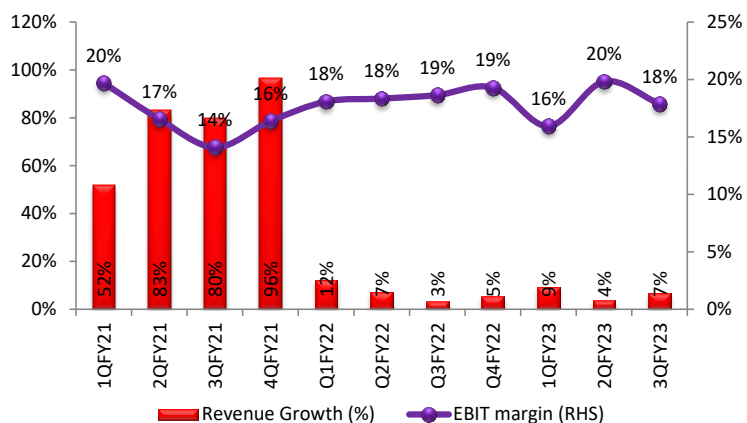
Source: Company, Systematix Institutional Research

Exhibit 9: Home care sees 32% growth, with stable margin

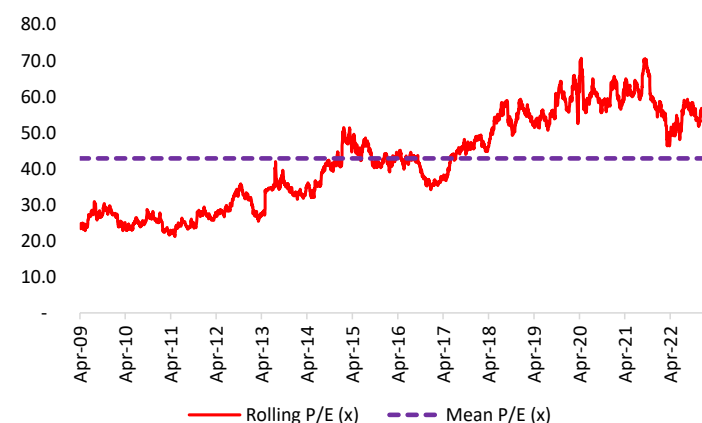
Source: Company, Systematix Institutional Research

Exhibit 10: BPC registers 11% growth, led by skin cleansing

Source: Company, Systematix Institutional Research

Exhibit 11: F&R growth at 13%, led by ice creams, food & coffee

Source: Company, Systematix Institutional Research

Exhibit 12: Currently trades at 55x 1-yr fwd P/E

Source: Bloomberg, Systematix Institutional Research

FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	4,70,280	5,24,460	5,96,577	6,59,012	7,32,314
RM Cost	1,50,270	1,64,240	2,00,748	2,07,589	2,27,017
Purchase of trad. Goods	71,210	93,110	1,14,543	1,21,258	1,29,034
Gross Profits	2,48,800	2,67,110	2,81,286	3,30,165	3,76,263
Employee costs	23,580	25,450	26,846	30,315	33,686
Selling & Admin costs	1,08,960	1,13,090	1,16,631	1,35,756	1,58,180
Total Expenses	3,54,020	3,95,890	4,58,768	4,94,918	5,47,917
EBITDA	1,16,260	1,28,570	1,37,809	1,64,094	1,84,397
Depreciation	10,740	10,910	10,353	11,581	12,771
Other income	4,100	2,580	6,300	6,930	7,623
EBIT	1,09,620	1,20,240	1,33,756	1,59,443	1,79,248
cost	1,170	1,060	1,040	1,144	1,258
PBT	1,08,450	1,19,180	1,32,716	1,58,299	1,77,990
Taxes	26,060	29,870	33,612	39,752	44,478
Adj. PAT	82,390	89,310	99,104	1,18,547	1,33,512
Extraordinaries/Exceptional	2,390	440	-	-	-
Reported PAT	80,000	88,870	99,104	1,18,547	1,33,512
No. of shares (mn)	2,350	2,350	2,350	2,350	2,350
Adj. EPS	35.1	38.0	42.2	50.4	56.8

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
PBT	1,06,060	1,18,740	1,32,716	1,58,299	1,77,990
Add: Depreciation	11,340	11,060	10,353	11,581	12,771
Add:	1,170	1,060	1,040	1,144	1,258
Less: taxes paid	(24,800)	(27,810)	(31,852)	(37,992)	(42,718)
Add: other adjustments	(1,130)	(2,570)	-	-	-
Less: WC changes	(1,010)	(10,000)	25,235	6,445	7,679
Total OCF	91,630	90,480	1,37,493	1,39,477	1,56,981
OCF w/o WC changes	92,640	1,00,480	1,12,257	1,33,032	1,49,302
Capital expenditure	(40,990)	(10,940)	(12,000)	(13,000)	(14,000)
Change in investments	22,930	(7,960)	-	-	-
/Dividend reced.	2,780	1,620	-	-	-
Total ICF	(15,280)	(17,280)	(12,000)	(13,000)	(14,000)
Free Cash Flows	50,640	79,540	1,25,493	1,26,477	1,42,981
Share issuances	-	-	-	-	-
Change in borrowings	-	-	-	-	-
Dividends	(88,110)	(75,260)	(89,194)	(1,06,692)	(1,20,161)
payment	(920)	(820)	(1,040)	(1,144)	(1,258)
Others	(4,060)	(4,070)	(61,649)	(61,649)	(61,649)
Total FCF	(93,090)	(80,150)	(1,51,883)	(1,69,485)	(1,83,069)
Net change in cash	(16,740)	(6,950)	(26,390)	(43,008)	(40,087)
Opening cash & CE	32,160	44,710	38,460	64,523	74,050
Closing cash & CE	44,710	38,460	64,523	74,050	86,394

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity capital	2,350	2,350	2,350	2,350	2,350
Reserves and surplus	4,74,390	4,88,260	4,98,170	5,10,023	5,23,374
Net worth	4,76,740	4,90,610	5,00,520	5,12,373	5,25,724
Minority	200.0	260.0	260.0	260.0	260.0
Total Debt	-	-	-	-	-
Other LT liabilities	26,050	26,780	28,655	30,660	32,807
Total sources	5,02,990	5,17,650	5,29,434	5,43,294	5,58,790
Net Block	61,160	61,690	71,690	81,690	91,690
Intangible assets	4,53,270	4,53,040	4,53,270	4,53,270	4,53,270
Net deferred tax	(60,920)	(63,030)	(63,030)	(63,030)	(63,030)
Other assets	10,870	10,380	11,107	11,884	12,716
CWIP	7,450	13,130	13,130	13,130	13,130
Investments	27,090	35,210	35,210	35,210	35,210
Cash	44,710	38,460	64,523	74,050	86,394
Inventories	35,790	40,960	40,861	45,138	50,158
Debtors	17,580	22,360	21,248	23,472	26,082
Other current assets	17,020	18,250	19,153	20,494	21,928
Current Assets	70,390	81,570	81,262	89,103	98,169
Creditors	88,020	90,680	1,14,412	1,26,386	1,40,444
Other CL	23,010	22,120	23,316	25,627	28,315
Current Liabilities	1,11,030	1,12,800	1,37,728	1,52,013	1,68,759
Net Working Capital	(40,640)	(31,230)	(56,465)	(62,910)	(70,589)
Total Uses	5,02,990	5,17,650	5,29,434	5,43,294	5,58,790

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY21	FY22	FY23E	FY24E	FY25E
Yoy growth in Revenue	18.2	11.5	13.8	10.5	11.1
Yoy growth in EBITDA	17.9	10.6	7.2	19.1	12.4
Yoy growth in Net income	18.3	8.4	11.0	19.6	12.6
Effective tax rate	23.2	23.8	24.0	24.0	24.0
EBITDA margin	24.7	24.5	23.1	24.9	25.2
PAT margin	17.5	17.0	16.6	18.0	18.2
ROACE (pre-tax)	35.9	23.6	25.5	29.7	32.5
ROAE	29.5	18.5	20.0	23.4	25.7
Net debt to equity (x)	(0.1)	(0.1)	(0.1)	(0.1)	(0.2)
Inventory days	28	25	25	25	25
Debtors days	14	13	13	13	13
Payable days	68	70	70	70	70
NWC days	(27)	(19)	(32)	(32)	(32)
Per share numbers (Rs)					
Reported earnings	35.1	38.0	42.2	50.4	56.8
Dividend	40.5	34.0	38.0	45.4	51.1
Book Value	202.9	227.1	231.7	237.2	243.4
Valuations (x)					
Price to diluted earnings	77.0	71.1	64.0	53.5	47.5
EV / EBITDA	42.6	38.6	35.8	30.0	26.6
Price to sales	10.6	9.5	8.4	7.6	6.8

Source: Company, Systematix Institutional Research

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