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SYSTEMATIX INSTITUTIONAL EQUITIES

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Institutional Equities

Hindustan Unilever

19 October 2023

Volume growth disappoints, but sharp margin improvement drives earnings beat

RESULT UPDATE

Sector: FMCG **Rating:** HOLD
CMP: Rs 2,548 **Target Price:** Rs 2,760

Stock Info

Sensex/Nifty	65,629/ 19,625
Bloomberg	HUVR IN
Equity shares (mn)	2350
52-wk High/Low	Rs 2,769/2,393
Face value	Rs 1
M-Cap	Rs 5,986bn/US\$ 73bn
3-m Avg value	US\$ 47mn

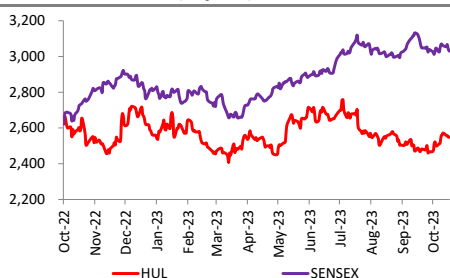
Financial Snapshot (Rs mn)

Y/E Mar	FY23	FY24E	FY25E
Sales	605,800	639,802	697,513
PAT	102,090	111,208	124,739
EPS (Rs)	43.4	47.3	53.1
PE (x)	58.7	53.8	48.0
EV/EBITDA (x)	35.0	32.1	28.9
P/BV (x)	10.9	10.7	10.5
EV/Sales	8.2	7.7	7.1
RoE (%)	20.5	21.9	24.0
RoCE (%)	25.7	27.5	29.8
NWC (days)	-14	-11	-11
Net gearing (x)	(0.1)	(0.1)	(0.1)

Shareholding Pattern (%)

	Jun 23	Mar 23	Dec 22
Promoter	61.9	61.9	61.9
-Pledged	-	-	-
FII	14.5	14.4	14.3
DII	11.5	11.5	11.5
Others	12.2	12.2	12.3

Stock Performance (1-year)



Hindustan Unilever (HUVR) delivered an earnings beat despite a soft volume performance led by sharp margin improvement. Revenue growth fell short of expectations at 3.6% YoY while EBITDA/ Adj. PAT growth stood strong at 9.4%/ 14.2% YoY respectively. Volume growth at 2.5% was lower than the market volume growth of 8% (2-yr CAGR at 3% vs 1% for industry) given decline in segments like tea, HFD and detergent bars indicating resurgence of competition from smaller players and continued impact on consumption of cumulative inflation. A continued cool-off in material inflation (esp. crude and palm-related) led to sharp gross margin expansion of 692bps to 52.7% albeit EBITDA margin expansion was moderate at 129bps to 24.2% given 420bps increase in ad spends and 160bps increase in other expenses given higher investments and royalty increase.

We expect gross margin recovery to continue, with commodity inflation continuing to moderate and premiumization and scale leverage playing out. But EBITDA margin improvement will be tempered by the 80bps phased increase in royalty and a continued uptick in ad spends. The benefits of aggressive price cuts in soaps and laundry and pick-up in ad-spends should take a couple more quarters to start showing up in volumes, while pricing should get into the negative zone in near-term, translating to a soft below-trend revenue growth for FY24. We expect a rural recovery led by lower inflation, low base and better farm income expectations while urban demand especially in food categories should take some more time to see the benefits of innovation and market development. We expect volume growth to be the sole driver for revenue growth in near-term. Margins, however, can recover significantly from the FY23 lows.

Management expects a gradual rural demand recovery and some tailwinds from the festive season. It also highlighted the 25% cumulative industry pricing over last 2-3 years having a protracted impact on demand, which might take a couple more quarters to normalize with pricing falling to 3% at industry level. With competitive intensity rising, the company would need to maintain higher A&P spends and also take further price cuts if needed, which will moderate the EBITDA flow-through of expected gross margin expansion. Looking beyond a soft FY24, laundry category still retains strong premiumization and share gain potential while BPC segment should also recover with a pick-up in disposable income levels and company efforts on premiumization. Foods and HFD category, however, is expected to continue to see sluggish demand for the foreseeable future.

Valuation and View: We are building in revenue/EBITDA/PAT growth of 7.3%/9.9%/10.5%, respectively, over FY23-25E. We maintain our HOLD rating on the stock, given the weak near-term growth outlook. After adjusting our estimates to factor in lower FY24 growth, we reduce our target price to Rs 2,760 from Rs 2,890 based on 52x FY25E earnings, a 5% discount to its five-year average valuation multiple. However, in the long-term, we expect above-industry growth going ahead led by continued premiumization and strategic initiatives by the company. Nevertheless, the strong operational performance can drive some positive reaction on the stock in light of the recent underperformance. Key monitorables would be the timing of industry demand recovery, commodity price trends and competitor actions.

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Investors are advised to refer disclosures made at the end of the research report.

2QFY24 Result highlights

- Revenue/EBITDA/Adj.PAT growth of 3.6%/9.4%/14.2% YoY respectively led by 2.5% volume growth, flattish pricing growth and soft growth across categories especially foods.
- Overall revenue growth of 3.6% YoY was a result of 3.3% growth in home care, 4.5% in BPC and 2.6% in foods.
- Overall gross margin grew 692bps to 52.7% driven by softening of RM inflation; EBITDA margin rose 129bps to 24.2% despite rise (+420bps) in A&P spends, higher other expenses (+160bps) while employee costs remained flat (-17bps).
- Due to decline in inflationary pressures, EBIT margin grew 145bps for home care and 211bps for BPC while margin for foods declined 112bps.

Management presentation highlights

- **Margins** – Softening of RM inflation led to 427bps decline in COGS, coupled with price cuts in certain categories. There was a 420bps increase in A&P spends, 160bps rise in other expenses, while a decline of 17 bps in other expenses.
- **Segment performance** - Home care was up 3.3%, BPC by 4.5% and foods by 2.6%; Margins in the home care segment stood at 18.7% (+145bps YoY), personal care stood at 27.2% (+211bps YoY) and Foods & Refreshments was 18.7% (-112bps YoY).
- **Home care** – Segment witnessed single digit growth (3.3%) and mid-single digit volume growth. Fabric Wash had mid single digit volume growth with premium portfolio outperforming. Household care volumes grew in high single digit led by dishwash. Further price cuts were taken in Fabric Wash and Household Care. Brand and marketing investments were increased to protect competitive position. Launched Vim Pure range and Comfort Intense Fabric Conditioner.
- **BPC** – Business delivered 4.5% growth led by mid-single digit volumes. Skin Cleansing grew in low single digit volumes with Lux and Hamam outperforming. Further price reductions were taken in soaps. Skin Care and Color Cosmetics grew double digit driven by focused interventions in new demand spaces and channels. Hair care delivered high single digit growth with Clinic Plus and Indulekha continuing to outperform. Oral care grew in mid single digit led by Closeup. Launched new range of Vaseline moisturizers, Lakme serums and cosmetics, Pond's serum, Indulekha Anti-Dandruff Oil and Shampoo.
- **Foods** – F&R revenue grew 2.6%, volume declined in mid single digit. Tea delivered steady growth as the category continued to witness consumers downgrading. Coffee grew in double-digits. HFD delivered mid-single digit price led growth. Food and ice cream grew in mid-single digit on a high base. Strong growth was witnessed in food solutions, Mayonnaise and Peanut butter. Launched Horlicks Strength Plus, Slow Churn ice cream and new blends of Lipton Green Tea.
- **Outlook** – Management expects to witness tailwinds from a better festive season. Rural recovery is likely to remain gradual. Assuming commodities remain at current level, company expects marginally negative price growth in the coming quarters.

Q&A takeaways

- **FMCG industry growth** – FMCG market pricing growth stood at 3% vs 8% in June quarter; consumers are yet to witness deflation which is reflecting in the slow volume recovery. FMCG industry rural volume growth during 2QFY24 stood at 8% vs 6% decline in 2QFY23. On 2 year CAGR, rural volumes have declined by 1%, however this is better compared to 4% decline in 1QFY24.
- **Factors driving rural growth ahead** – Moderating inflation, growth in real rural wages, increased government investment in rural.
- **Pricing** – Company has taken price corrections in skin cleansing, laundry, soap, detergent; company expects the Nielsen's 3% price growth during the quarter to become marginally negative in the coming quarter given that there is no commodity inflation. When there is inflation company gradually increases price, when commodity cost comes down company takes price cuts immediately to remain competitive.
- **One off credit in BPC** – Company received a one off credit of Rs 50 mn due to favourable resolution of an indirect tax litigation. Excluding the one-off, sales growth would be 3%, price growth being flat. PAT growth would be 7%, with net profit declining marginally YoY.
- **A&P allocation** – A&P allocation is based on principal of share of voice to be ahead of share of market, and focus on innovative advertisements; 1/3 rd of the ad spends are into digital media while 2/3rd into traditional media.
- **Distribution** – Company reaches 3 mn outlets directly, of which 2.3 mn outlets are covered by distributor network/
- **New demand spaces** – Company sees opportunities in beauty and packaged food category. Company also believes that new channels of shopping such as ecommerce will drive growth.
- **Increasing competition from smaller players** – In tea, small players grew 1.4x vs large established players, while in detergent bars small players grew 6x compared to large brands. Downgrading in tea category was due to commodity inflation and decoupling of loose tea which is plain tea and premium tea. The plain tea had seen more price moderation because of a better crop compared to premium tea. Earlier premium tea had witnessed high inflation compared to plain tea. Thus the price gap between premium and plain tea has widened which has led to downgrading. In HUL's portfolio, more traction towards Taza was witnessed over premium tea.
- **HFD and coffee** – 2/3rd of the F&R business lies in HFD and tea; HFD growth has been price led while volumes have declined due to inflation in dairy; coffee too witnessed 60-70% inflation over last 2 years and hence saw decline in volumes and a price led growth. When commodity price rises and then declines, in such a scenario volume recovery is gradual. In HFD, company is witnessing positive signs with region wise customization of communication, stabilized assortment and incentives on SKUs. Company believes it has huge opportunity in the premium, science based supplements for adults and women under HFD.
- **Growth strategy** – 1) 19 brands (+Rs 1bn brands) will be the first engine of growth and the company will make sure their execution in 16 defined clusters is carried out; 2) company sees market development opportunity in home care with fabric conditions, liquids; 3) leverage big brands in beauty and packaged food; 4) winning across channels – GT, MT, ecommerce; 5) Cost control through Symphony program

Exhibit 1: Quarterly performance

YE March (Rs mn)	2QFY24	2QFY23	1QFY24	YoY (%)	QoQ (%)
Net Revenues	152,760	147,510	151,480	3.6	0.8
Cost of materials	43,780	48,580	46,950	(9.9)	(6.8)
(% of sales)	28.7	32.9	31.0		
Purchase of stock in trade	28,430	31,360	28,930	(9.3)	(1.7)
(% of sales)	18.6	21.3	19.1		
Gross Profit	80,550	67,570	75,600	19.2	6.5
Gross margin (%)	52.7%	45.8%	49.9%		
Employee cost	7,080	7,090	6,510	(0.1)	8.8
(% of sales)	4.6	4.8	4.3		
Selling & admin	17,200	10,410	14,810	65.2	16.1
(% of sales)	11.3	7.1	9.8		
Others	19,330	16,300	19,070	18.6	1.4
(% of sales)	12.7	11.1	12.6		
EBITDA	36,940	33,770	35,210	9.4	4.9
EBITDA margin (%)	24.2	22.9	23.2		
Other income	2,830	1,150	1,850	146.1	53.0
PBIDT	39,770	34,920	37,060	13.9	7.3
Depreciation	2,690	2,480	2,570	8.5	4.7
Finance cost	720	250	470	188.0	53.2
PBT	36,360	32,190	34,020	13.0	6.9
Tax	9,140	8,350	8,930	9.5	2.4
ETR (%)	25.1	25.9	26.2		
Adjusted PAT	27,220	23,840	25,090	14.2	8.5
PATAMI margin	17.8	16.2	16.6		
Exceptional item	(50)	2,320	(370)		
Reported PAT	27,170	26,160	24,720	3.9	9.9
No. of shares (mn)	2,350.0	2,350.0	2,350.0		
Adj EPS (Rs)	11.6	10.1	10.7		

Source: Company, Systematix Institutional Research

Exhibit 2: Segmental performance

YE March (Rs mn)	2QFY24	2QFY23	1QFY24	YoY (%)	QoQ (%)
Segment revenue					
Home care	53,120	51,430	54,250	3.3%	-2.1%
Personal care	58,090	55,610	56,010	4.5%	3.7%
Foods & Refreshments	38,510	37,550	37,970	2.6%	1.4%
Others	3,040	2,920	3,250	4.1%	-6.5%
Net Sales	152,760	147,510	151,480	3.6%	0.8%
Segment EBIT					
Home care	9,950	8,890	9,910	11.9%	0.4%
Personal care	15,810	13,960	14,720	13.3%	7.4%
Foods & Refreshments	7,200	7,440	6,810	-3.2%	5.7%
Others	1,290	1,000	1,200	29.0%	7.5%
Total EBIT	34,250	31,290	32,640	9.5%	4.9%

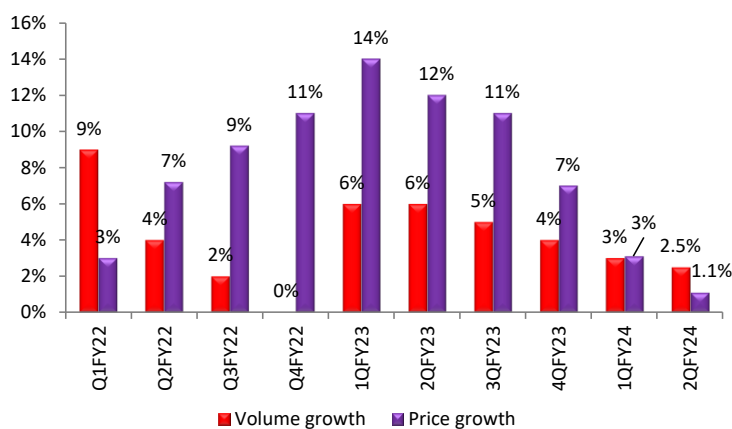
Source: Company, Systematix Institutional Research

Exhibit 3: Change in estimates

(Rs mn)	Old estimates		Revised estimates		Variation (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Net sales	648,079	712,758	639,802	697,513	-1%	-2%
EBITDA	161,372	179,472	154,192	170,891	-4%	-5%
EBITDA margin	24.9%	25.2%	24.1%	24.5%		
Adj. PAT	117,051	130,593	111,208	124,739	-5%	-4%

Source: Company, Systematix Institutional Research

Exhibit 4: Volume growth at 2.5%, pricing growth flattish



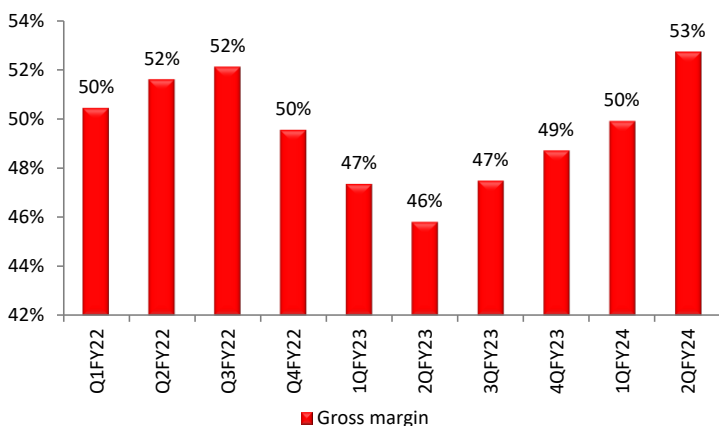
Source: Company, Systematix Institutional Research

Exhibit 5: Revenue grew 3.6% YoY and 0.8% QoQ



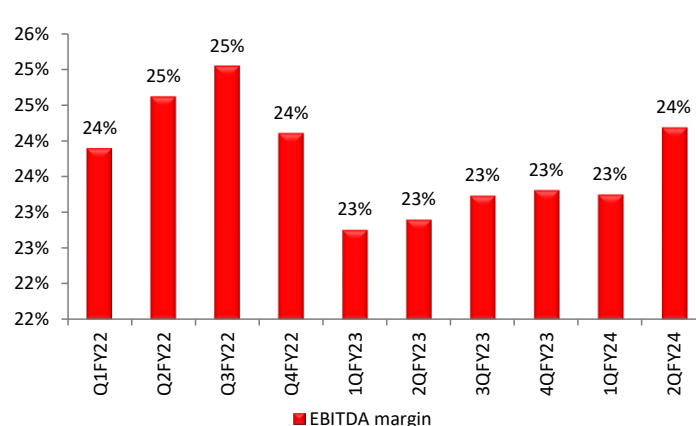
Source: Company, Systematix Institutional Research

Exhibit 6: Gross margin continues to improve post 2QFY23 lows

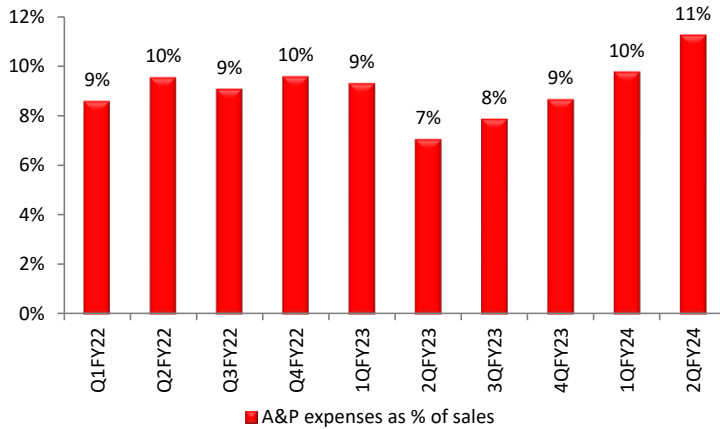


Source: Company, Systematix Institutional Research

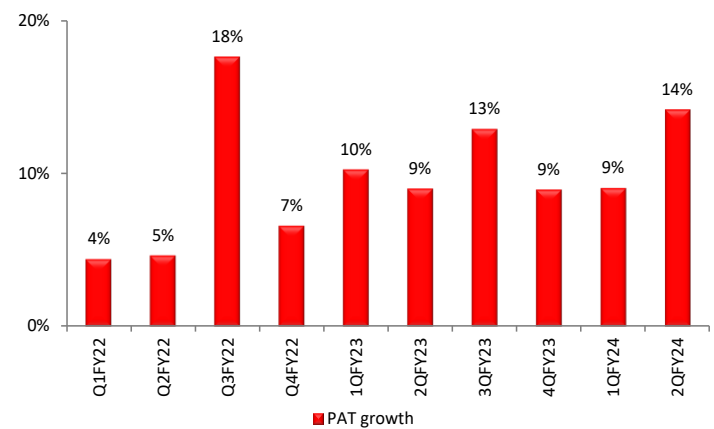
Exhibit 7: EBITDA margin impact limited due to leverage benefits



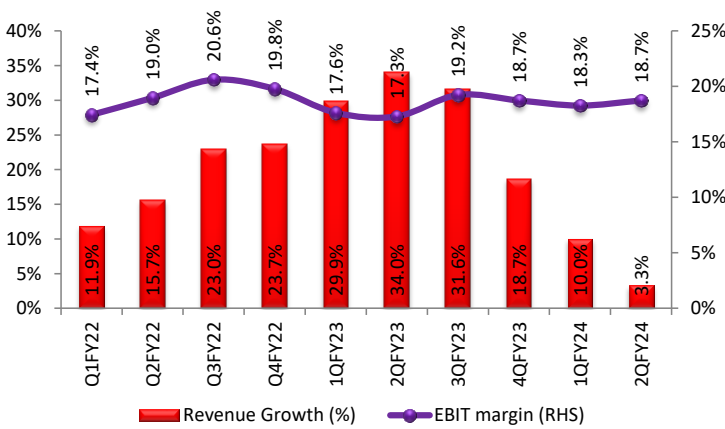
Source: Company, Systematix Institutional Research

Exhibit 8: A&P spends have picked up year on year & sequentially

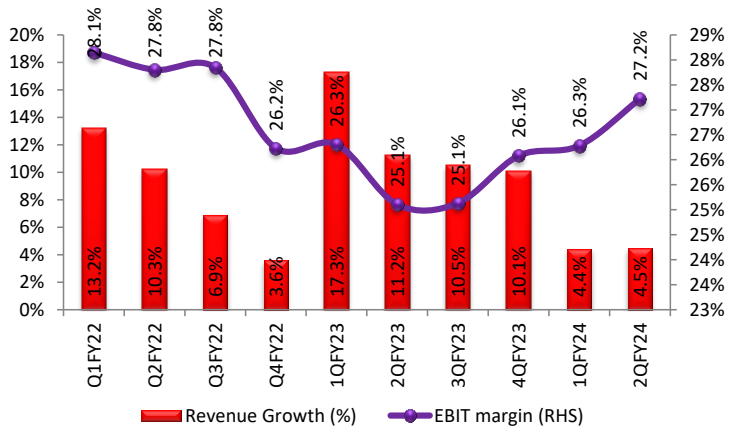
Source: Company, Systematix Institutional Research

Exhibit 9: PAT growth stood at 14%

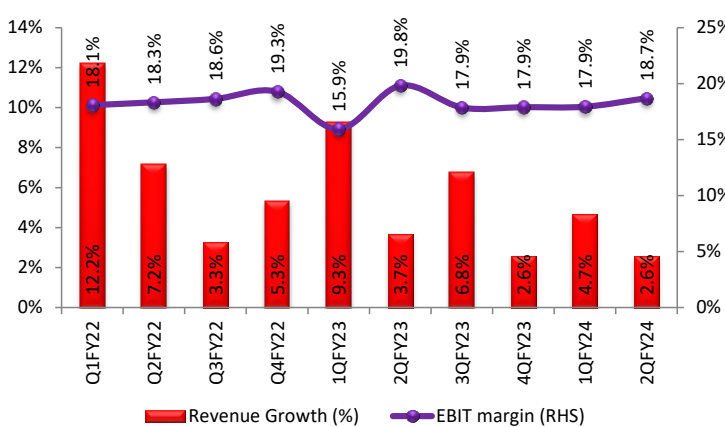
Source: Company, Systematix Institutional Research

Exhibit 10: Home care sees 3.3% growth, with volume uptick

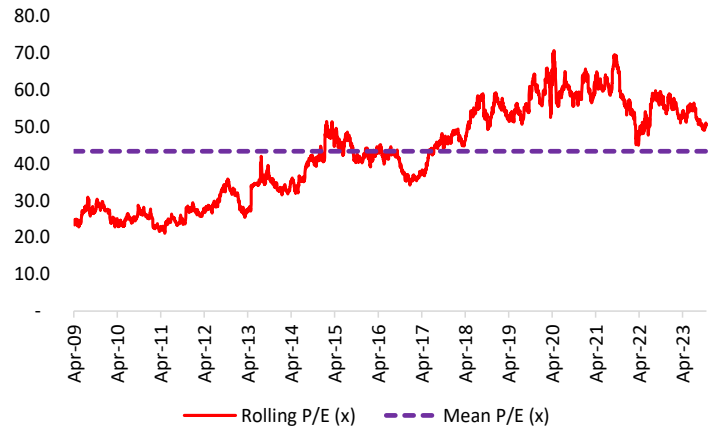
Source: Company, Systematix Institutional Research

Exhibit 11: BPC registered 4.5% growth, led by volumes

Source: Company, Systematix Institutional Research

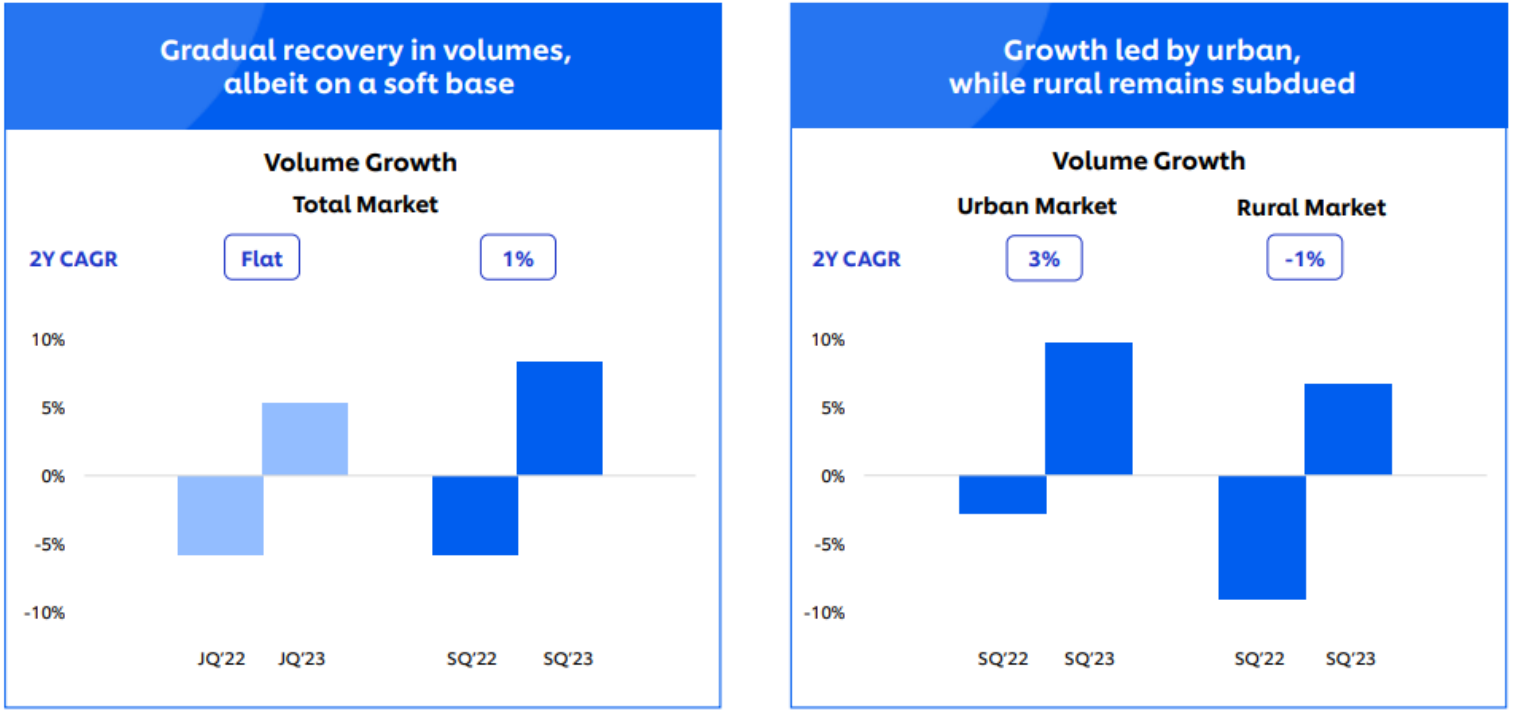
Exhibit 12: F&R growth at 2.6%, led by pricing in HFD

Source: Company, Systematix Institutional Research

Exhibit 13: Currently trades at 50.4 1-yr fwd P/E

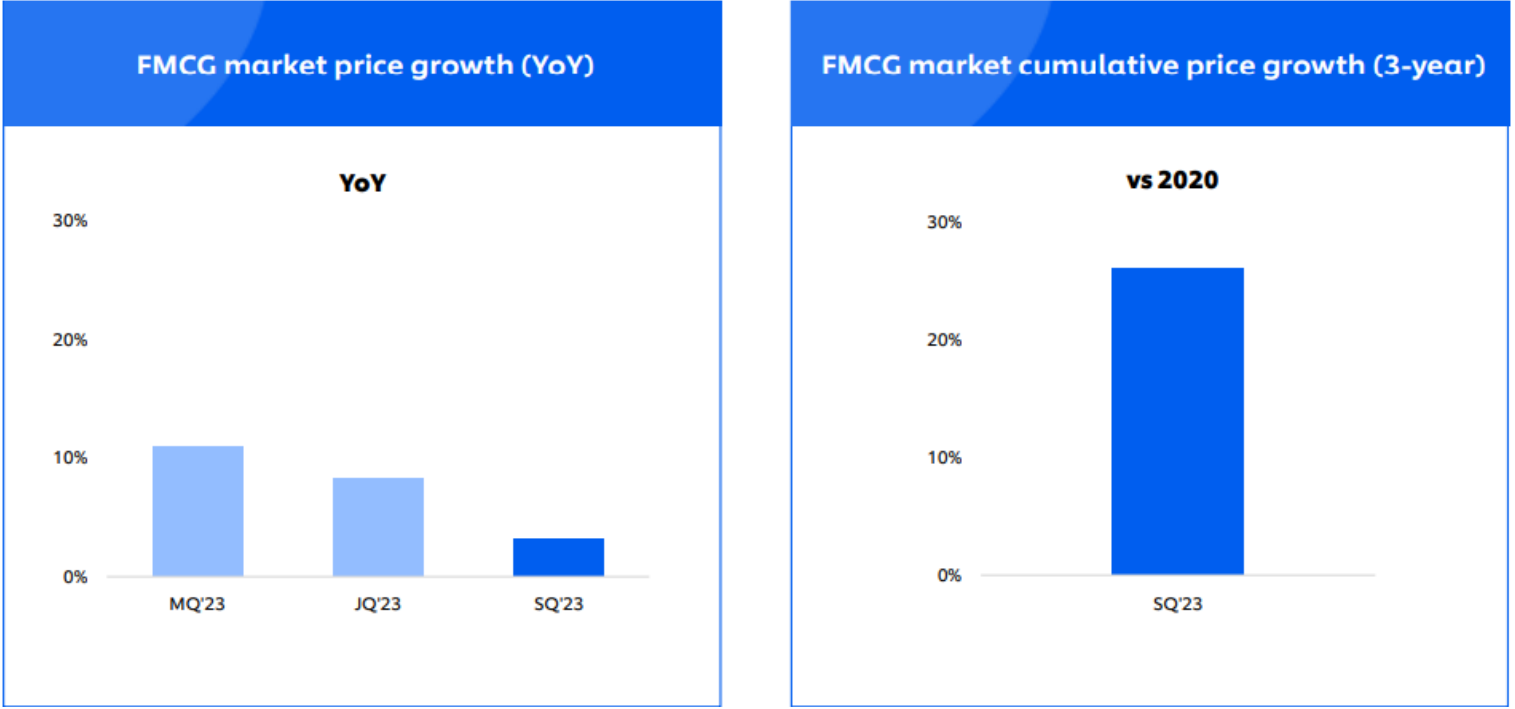
Source: Bloomberg, Systematix Institutional Research

Exhibit 14: FMCG volumes picked up sharply in 2Q, led by urban



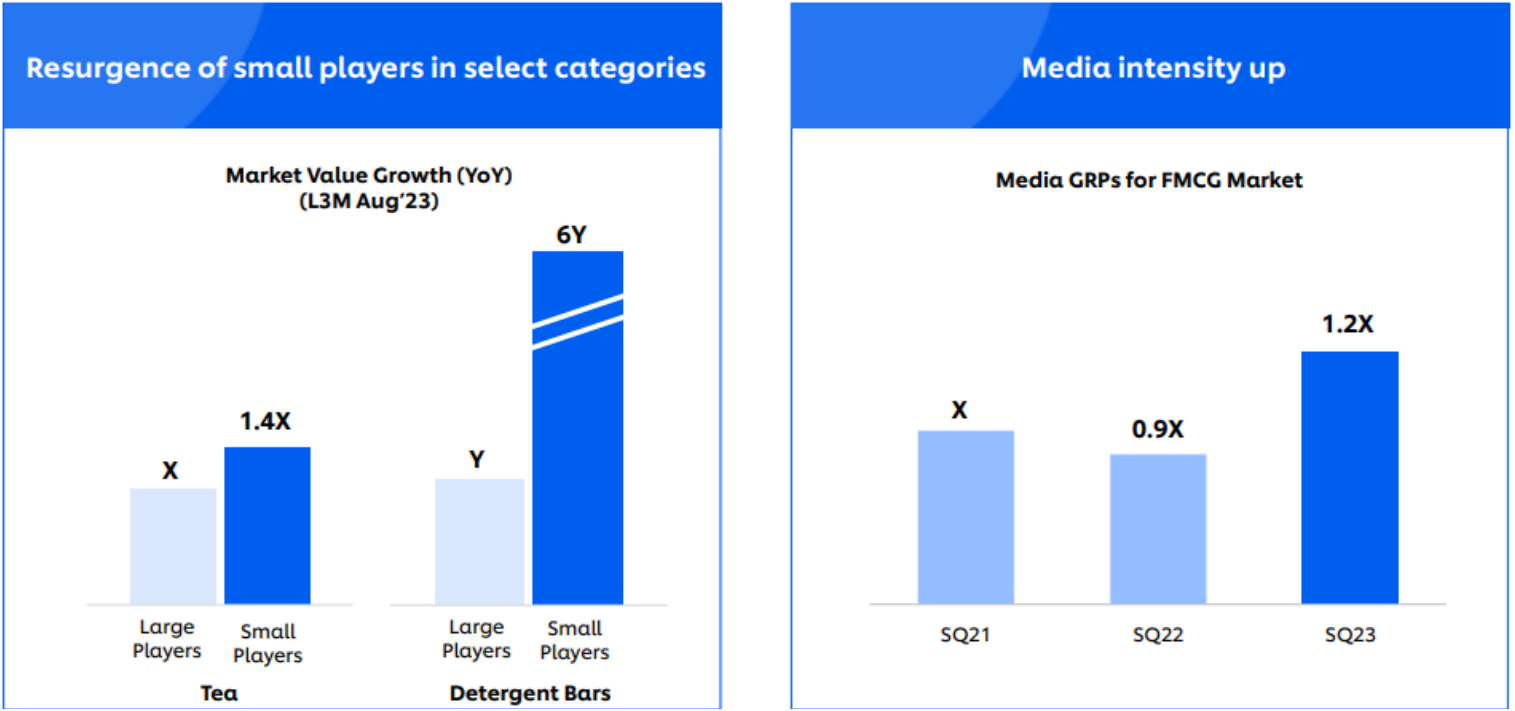
Source: Company, Systematix Institutional Research

Exhibit 15: Market price growth tailing off to 3% albeit remains high on 3 year basis at 25% plus



Source: Company, Systematix Institutional Research

Exhibit 16: Increase in competitive intensity at the mass end and sharp pick up in media intensity



Source: Company, Systematix Institutional Research

FINANCIALS

Profit & Loss Statement

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Net Sales	4,70,280	5,24,460	6,05,800	6,39,802	6,97,513
RM Cost	1,50,270	1,64,240	2,01,370	2,01,538	2,16,229
Purchase of trad. Goods	71,210	93,110	1,15,790	1,10,046	1,13,695
Gross Profits	2,48,800	2,67,110	2,88,640	3,28,219	3,67,589
Employee costs	23,580	25,450	28,540	30,071	32,783
Selling & Admin costs	1,08,960	1,13,090	1,18,610	1,43,956	1,63,916
Total Expenses	3,54,020	3,95,890	4,64,310	4,85,610	5,26,622
EBITDA	1,16,260	1,28,570	1,41,490	1,54,192	1,70,891
Depreciation	10,740	10,910	11,370	11,904	13,066
Other income	4,100	2,580	5,120	7,014	7,716
EBIT	1,09,620	1,20,240	1,35,240	1,49,303	1,65,541
cost	1,170	1,060	1,140	2,280	2,006
PBT	1,08,450	1,19,180	1,34,100	1,47,023	1,63,534
Taxes	26,060	29,870	32,010	35,815	38,795
Adj. PAT	82,390	89,310	1,02,090	1,11,208	1,24,739
Extraordinaries/Exceptional	2,390	440	640	-	-
Reported PAT	80,000	88,870	1,01,450	1,11,208	1,24,739
No. of shares (mn)	2,350	2,350	2,350	2,350	2,350
Adj. EPS	35.1	38.0	43.4	47.3	53.1

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
PBT	1,06,060	1,18,740	1,33,460	1,47,023	1,63,534
Add: Depreciation	11,340	11,060	11,520	11,904	13,066
Add:	1,170	1,060	1,140	2,280	2,006
Less: taxes paid	(24,800)	(27,810)	(31,400)	(33,815)	(36,795)
Add: other adjustments	(1,130)	(2,570)	(5,230)	-	-
Less: WC changes	(1,010)	(10,000)	(9,580)	(3,641)	2,323
Total OCF	91,630	90,480	99,910	1,23,750	1,44,134
OCF w/o WC changes	92,640	1,00,480	1,09,490	1,27,392	1,41,811
Capital expenditure	(40,990)	(10,940)	(13,870)	(13,000)	(14,000)
Change in investments	22,930	(7,960)	(3,680)	-	-
/Dividend reced.	2,780	1,620	2,610	-	-
Total ICF	(15,280)	(17,280)	(14,940)	(13,000)	(14,000)
Free Cash Flows	50,640	79,540	86,040	1,10,750	1,30,134
Share issuances	-	-	-	-	-
Change in borrowings	-	-	-	-	-
Dividends	(88,110)	(75,260)	(84,740)	(1,00,087)	(1,12,265)
payment	(920)	(820)	(880)	(2,280)	(2,006)
Others	(4,060)	(4,070)	(3,910)	(61,649)	(61,649)
Total FCF	(93,090)	(80,150)	(89,530)	(1,64,016)	(1,75,921)
Net change in cash	(16,740)	(6,950)	(4,560)	(53,266)	(45,786)
Opening cash & CE	32,160	44,710	38,460	46,780	49,627
Closing cash & CE	44,710	38,460	46,780	49,627	55,866

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Equity capital	2,350	2,350	2,350	2,350	2,350
Reserves and surplus	4,74,390	4,88,260	5,00,690	5,11,810	5,24,283
Net worth	4,76,740	4,90,610	5,03,040	5,14,160	5,26,633
Minority	200.0	260.0	2,180.0	2,180.0	2,180.0
Total Debt	-	-	-	-	-
Other LT liabilities	26,050	26,780	30,300	32,421	34,690
Total sources	5,02,990	5,17,650	5,35,520	5,48,761	5,63,503
Net Block	61,160	61,690	69,490	79,490	89,490
Intangible assets	4,53,270	4,53,040	4,57,290	4,53,270	4,53,270
Net deferred tax	(60,920)	(63,030)	(63,330)	(63,330)	(63,330)
Other assets	10,870	10,380	11,030	11,802	12,628
CWIP	7,450	13,130	11,320	11,320	11,320
Investments	27,090	35,210	28,130	28,130	28,130
Cash	44,710	38,460	46,780	49,627	55,866
Inventories	35,790	40,960	42,510	47,328	51,597
Debtors	17,580	22,360	30,790	33,305	36,309
Other current assets	17,020	18,250	21,790	22,930	24,535
Current Assets	70,390	81,570	95,090	1,03,563	1,12,441
Creditors	88,020	90,680	95,740	99,914	1,08,927
Other CL	23,010	22,120	24,540	25,197	27,386
Current Liabilities	1,11,030	1,12,800	1,20,280	1,25,111	1,36,312
Net Working Capital	(40,640)	(31,230)	(25,190)	(21,549)	(23,871)
Total Uses	5,02,990	5,17,650	5,35,520	5,48,761	5,63,503

Source: Company, Systematix Institutional Research

Ratios

YE: Mar	FY21	FY22	FY23	FY24E	FY25E
Yoy growth in Revenue	18.2	11.5	15.5	5.6	9.0
Yoy growth in EBITDA	17.9	10.6	10.0	9.0	10.8
Yoy growth in Net income	18.3	8.4	14.3	8.9	12.2
Effective tax rate	23.2	23.8	22.4	23.0	22.5
EBITDA margin	24.7	24.5	23.4	24.1	24.5
PAT margin	17.5	17.0	16.9	17.4	17.9
ROACE (pre-tax)	35.9	23.6	25.7	27.5	29.8
ROAE	29.5	18.5	20.5	21.9	24.0
Net debt to equity (x)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Inventory days	28	29	26	27	27
Debtors days	14	16	19	19	19
Payable days	68	63	58	57	57
NWC days	(27)	(19)	(14)	(11)	(11)
Per share numbers (Rs)					
Reported earnings	35.1	38.0	43.4	47.3	53.1
Dividend	40.5	34.0	39.0	42.6	47.8
Book Value	202.9	227.1	232.9	238.0	243.8
Valuations (x)					
Price to diluted earnings	72.7	67.0	58.7	53.8	48.0
EV / EBITDA	42.6	38.6	35.0	32.1	28.9
Price to sales	10.6	9.5	8.3	7.8	7.2

Source: Company, Systematix Institutional Research

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