Sharekhan by BNP PARIBAS

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Hindustan Unilever

Normalcy returns; 90% portfolio performing well

Consumer Goods	Sharekhan code: HINDUNILVR	Company Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 2,135**	
Price Target: **Rs. 2,550**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

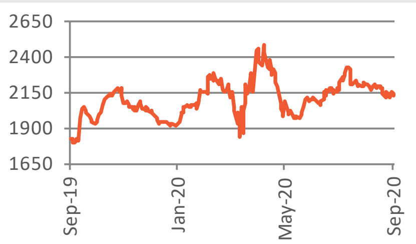
Company details

Market cap:	Rs. 501,611 cr
52-week high/low:	Rs. 2,614/1,756
NSE volume: (No of shares)	53.7 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Free float: (No of shares)	89.5 cr

Shareholding (%)

Promoters	61.9
FII	14.8
DII	8.3
Others	15.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.4	1.3	9.9	17.0
Relative to Sensex	-5.1	-12.3	1.2	12.6

Sharekhan Research, Bloomberg

Summary

- Hindustan Unilever (HUL) operations restored to 100% from June onwards (from 70-90% in April-May) and the momentum continued in the subsequent months.
- Company rebuilt supply chain, launched 50 products; rationalised of SKUs to supply relevant products and enhanced capacity of sanitisers (by 120x) and handwash (by 6x) to capture growing demand.
- HUL focuses on improving profitability through cost-savings; synergistic benefits from integration of GSK Consumer's nutrition business would come into play.
- Stock has correct ~9% in recent times and is trading at 46.7x is FY22E (discount to its last three-year average multiples of ~53x); we maintain a Buy recommendation on the stock with an unchanged PT of Rs. 2,550.

Hindustan Unilever (HUL) has restored its operations to 100% from June onwards (from 70% in April and 90% in May) and maintain momentum in the subsequent months. Supply chain and distribution network is back to normal, with company focusing on manufacturing key SKUs of high-demand products. HUL is currently producing just 40% of SKUs manufactured during pre-COVID levels and plan is to manufacture just 80% of relevant SKUs of pre-COVID levels. About 50% of the general trade business is coming from lower-price point SKUs or key access packs. In view of strong demand, capacities of sanitisers and handwash have been increased by 120x and 6x, respectively. The company fast-tracked its innovation route, which manufactured over 50 new products and packs to cater to evolving consumer needs. About 90% of the product portfolio has been made relevant to cater to the demand during COVID-19 times. Contextual communications and building relevance through propositions/activations helped HUL get strong traction to new launches. The company has also focused on digitalising the general trade by covering 2.3 lakh outlets under its digital platforms. Order value and SKUs ordered are 2x higher through digital platforms. Share of e-Commerce sales is also increasing which has better margins than general trade. All these initiatives aided the company to achieve volume share gains in 97% of business while 90% of business is achieving good growth. An adverse mix and COVID-related costs dragged down Q1FY2021 operating margins to 25%. However, cost-saving initiatives and unlocking synergies from smooth integration of GSK Consumer's nutrition business would help in achieving better margins in the coming quarters.

Our Call

View: Retain Buy with unchanged price target of Rs. 2,550 - With the business attaining normalcy and strategies in place to gain market share in the uncertain times would help HUL post better operating performance in Q2FY2021. Recovery in the rural demand (50% of HUL domestic sales), strong demand for essential products (85-90% of HUL domestic portfolio), and strong traction in new launches are some of the key growth drivers in the near term. HUL's strong cash generation ability remains key in the uncertain environment. The stock has corrected by ~9% in recent times and trading at 46.7x its FY2022E EPS (discount to its last three-year average multiples of ~53x) providing good opportunity to enter into the stock. We maintain our Buy recommendation on the stock with unchanged price target of Rs. 2,550.

Key Risks

Frequent lockdowns, intensity of spread of Coronavirus in tier-II and tier-III town intensifies and significant increase in the key input prices would act as a key risk to our earnings in the near term.

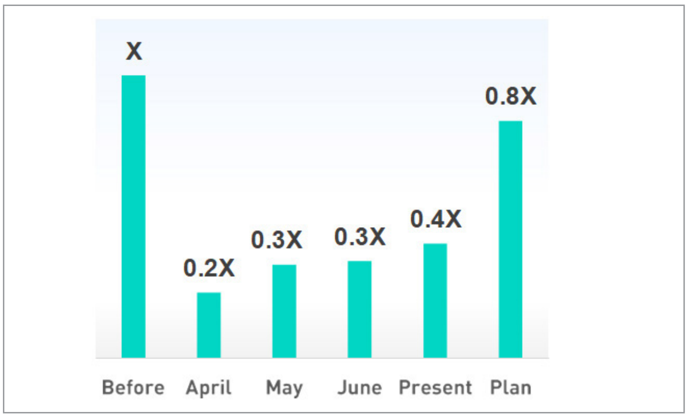
Valuations (Standalone) Rs cr

Particulars	FY19	FY20	FY21E*	FY22E*	FY23E*
Revenue	38,224.0	38,785.0	46,032.1	51,316.8	56,865.8
OPM (%)	22.6	24.8	25.4	26.5	27.3
Adjusted PAT	6,199.4	6,885.8	8,568.4	10,729.4	12,240.6
Adjusted EPS (Rs.)	28.7	31.9	36.5	45.7	52.1
P/E (x)	74.4	67.0	58.5	46.7	41.0
P/B (x)	60.2	57.4	10.3	9.9	9.2
EV/EBIDTA (x)	52.7	47.5	41.2	35.1	30.5
RoNW (%)	84.2	87.8	30.2	21.6	23.2
RoCE (%)	113.2	105.2	39.7	28.6	30.8
RoCE (%)	22.1	22.2	19.2	22.1	22.8

Source: Company; Sharekhan estimates
** FY21, FY22 and FY23 earnings estimates include the merger of GSK Consumer Healthcare*

Operations back to 100%; production of sanitizers and hand wash increased significantly: Post the relaxation on restrictions, HUL had scaled back its operations at ~70% of its capacity in April,20 and improved further to 90% in May,20 and June (mid-single-digit revenue growth in June). The company has been ramping up the production of its essential category products such as hand sanitisers, where production was increased by 120x and that of hand wash was increased by 6x. The company increased the pace of innovation and launched 50+ relevant products during the pandemic which got good traction in the domestic market.

Portfolio prioritization



Number of SKUs produced

Capacity unlocks

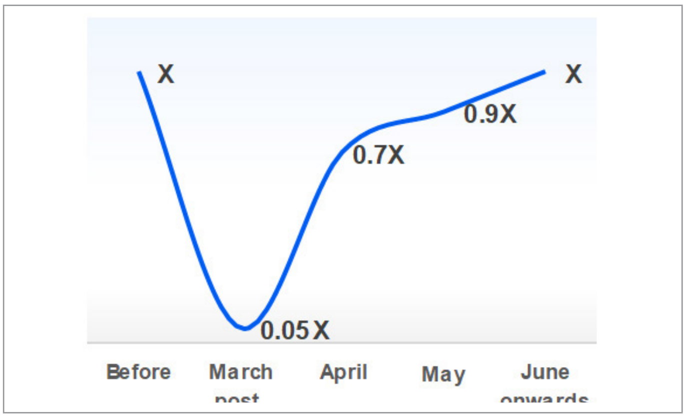
Sanitizer ~120X | Handwash ~6X

97% of business is gaining value market share; 90% of business registering growth: About 90% of HUL's product portfolio is under the health, hygiene & nutrition segment, which is performing well and registering good growth due to better traction in the domestic market. 97% of the business is gaining volume market share, which is better than 86% of business gaining volume market in Q1FY2021. SKUs had been reduced to 20% of pre-COVID levels in April which gradually came back to 40% currently. HUL will gradually ramp-up the SKUs to 80% of pre-COVID levels which is expected to stay at the same level going ahead. The focus is on prioritising availability of right product and right quantity in key markets. About 50% of general trade business is coming from lower price points SKUs or key access packs.

Fast tracking innovations

50+ product & pack innovations

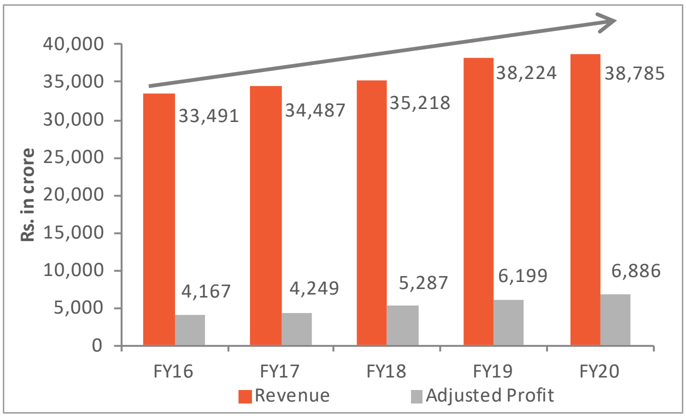
Sequential improvement in operations



100% operations restored

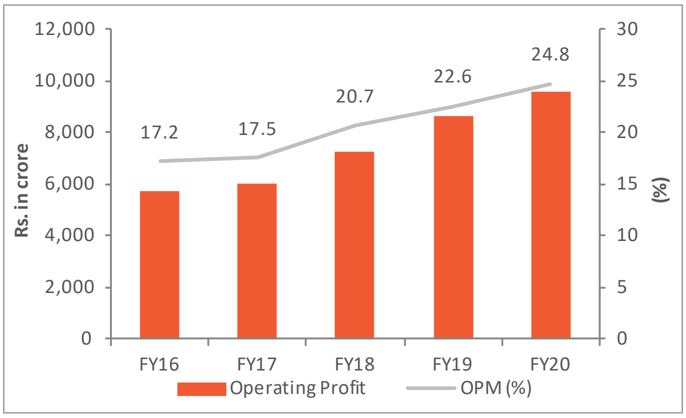
Financials in charts

Trend in Revenues and PAT



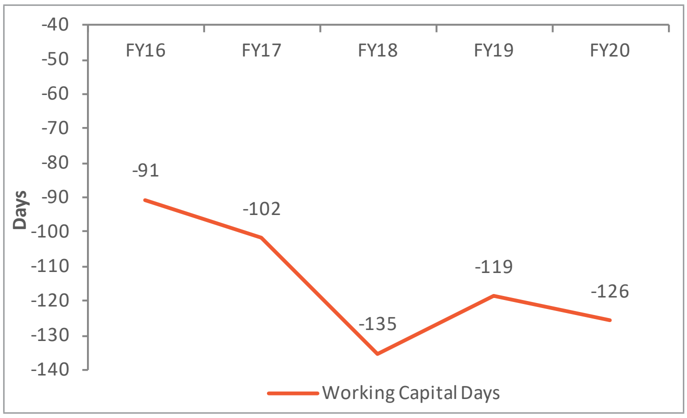
Source: Company, Sharekhan Research

OPM improved consistently



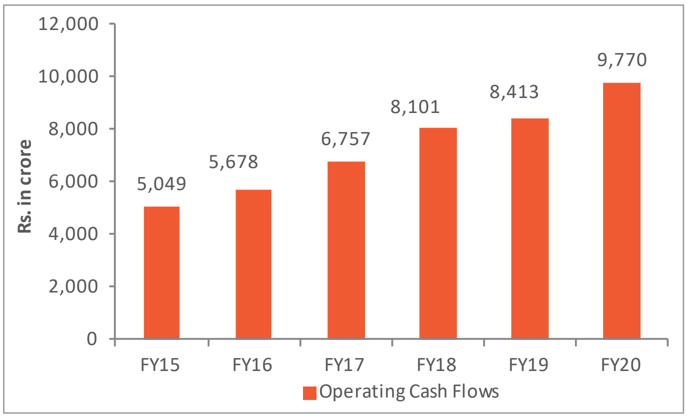
Source: Company, Sharekhan Research

Negative working capital



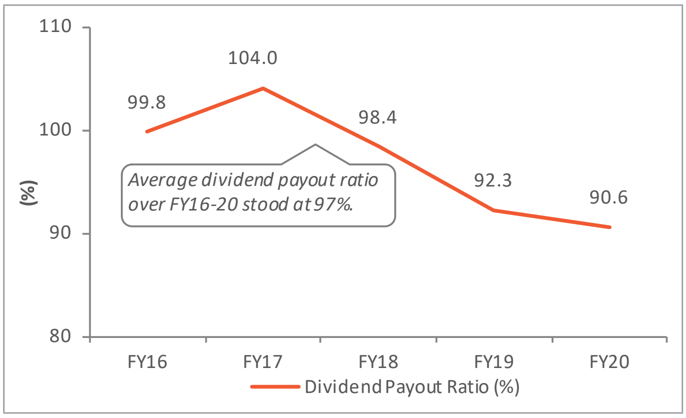
Source: Company, Sharekhan Research

Consistent growth in operating cash flows



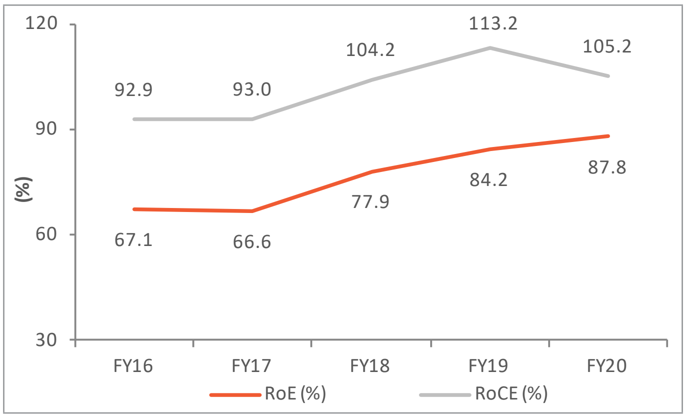
Source: Company, Sharekhan Research

Cheery dividend payer



Source: Company, Sharekhan Research

Strong return profile



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook - Supply chain back to normal; health & hygiene products continues gain good traction

Consumer goods companies saw strong revival in June with production and supply recovering to 90% of pre-COVID levels. With a strong pick in rural demand, general trade seeing normalisation in the business and higher sales through online channels we expect a normalisation in business performance from Q2FY2021. 1) Sustained demand for branded foods, hygiene and HI products; 2) pick-up in rural demand; 3) new launches and 4) focus on expansion of distribution reach are some of the near-term growth catalysts. Most of the key input prices (barring palm oil, raw tea and coffee) have remained benign. This along with cost-saving initiatives would help consumer goods companies to post better margins in the coming quarters.

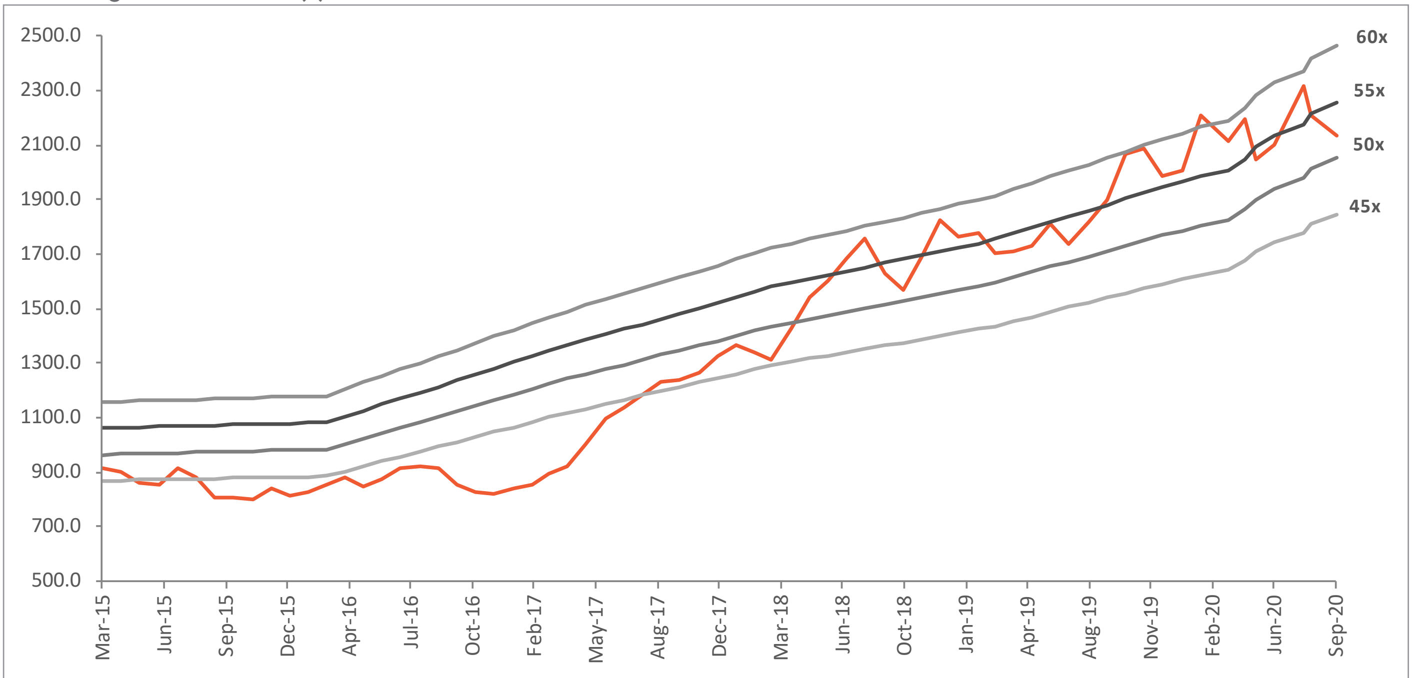
■ Company outlook - About 90% of business will continue to deliver steady performance

Though the current business environment remains uncertain due to sustained spread of corona virus, the management is confident that 90% of business (largely essentials) will continue to perform well. We expect Q2FY2021 performance to be sequentially better compared to Q1FY2021 with most facilities operating at 100% capacity and distribution regaining the momentum. Recovery in rural demand, strong demand for hygiene and nutritional products and market share gains in key categories will be key revenue drivers in the near term. Synergistic benefits from GSK Consumers' merger and cost rationalisation measures will help OPM to improve in the coming quarters.

■ Valuation - Retain Buy with unchanged price target of Rs. 2,550

With the business attaining normalcy and strategies in place to gain market share in the uncertain times would help HUL post better operating performance in Q2FY2021. Recovery in the rural demand (50% of HUL domestic sales), strong demand for essential products (85-90% of HUL domestic portfolio), and strong traction in new launches are some of the key growth drivers in the near term. HUL's strong cash generation ability remains key in the uncertain environment. The stock has corrected by ~9% in recent times and trading at 46.7x its FY2022E EPS (discount to its last three-year average multiples of ~53x) providing good opportunity to enter into the stock. We maintain our Buy recommendation on the stock with unchanged price target of Rs. 2,550.

HUL One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY19	FY20E	FY21E	FY19	FY20E	FY21E	FY19	FY20E	FY21E
Nestle India*	80.3	70.4	59.0	54.8	47.8	41.2	96.9	140.7	125.6
ITC	14.9	16.0	13.8	11.1	11.4	9.6	25.5	23.2	27.0
HUL	67.0	58.5	46.8	47.5	41.2	35.1	105.2	39.7	28.6

Source: Company, Sharekhan estimates

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. HUL reported revenue of Rs. 38,224 crore and OPM of 22.6% in FY2019.

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
SrinivasPathak	Executive Director, Finance & IT and CFO
PradeepBannerjee	Executive Director, Supply Chain
DevBajpai	Executive Director, Legal and Corporate Affairs and Company Secretary

Source: Company

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

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