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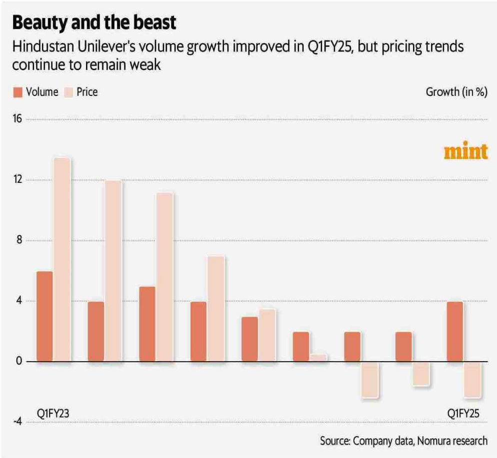
Journalist:	Pallavi Pengonda	Page No:	4

HUL's outlook is improving slowly

Pallavi Pengonda
pallavi.pengonda@livemint.com

The shares of Hindustan Unilever Ltd (HUL) dropped close to 2% on Wednesday, a decline that can be attributed to profit booking given a
1 healthy 11% surge over the past month driven by expectations of favourable announcements in the Union budget.

It should be noted that the commentary of HUL's management while announcing the June quarter (Q1FY25) results on Tuesday after market hours, though not too exciting about business conditions, is largely positive. In a post earnings call, the management said it expects FMCG (fast-moving consumer goods) sector and rural demand to continue improving gradually. Further, forecast of above-normal monsoon and better crop realization augur well, said the management.



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The company's underlying volume growth stood at 4% in Q1, and was much better than the 2% growth seen in each of the previous three quarters. However, pricing growth continued to be under pressure. Pricing slipped about 2% in Q1, marking the third straight quarter of drop in the measure. Thus, HUL's operating revenue growth was just about 2% year-on-year with the personal care business revenue declining by 4.5%.

So, what fuelled volume growth? The fabric wash category in the home care business saw high-single digit volume growth. In the beauty and wellbeing business, hair care clocked double-digit volume growth led by Clinic Plus, Sunsilk and Dove.

A key highlight is that soaps saw low-single digit volume growth vis-à-vis a high-single digit decline in Q4FY24 helped by pricing actions. Meanwhile, the foods and refreshment business experienced flat volume growth and was impacted by a harsh summer season, which weighed on the sales of nutrition drinks (Horlicks and Boost), although the ice cream category saw double-digit volume growth.

HUL said about 55% of its portfolio is gaining share now, and it expects this figure to go back to 60% by the end of 2024. Overall, the company has seen a gain of about 200 basis points (bps) in its market share since March 2021 levels. Further, the premium portfolio contribution is up 300bps over the last three years.

In Q1, gross margin expanded by 155bps year-on-year as total raw material costs declined. However, higher advertising and promotion expenses curtailed operating profit margin (OPM) expansion to 26bps to 23.5%. "While there are margin improvement drivers like operating leverage, improving mix, premiumization, supply chain synergy, etc., higher brand investments will keep OPM range-bound in the near term but will drive modest margin expansion in the medium term," said a report by Nomura Global Markets Research.

POSITIVE FORECAST

THE company's Q1 volume growth was 4%, up from 2% in the previous three quarters

THE gross margin expanded by 155bps year-on-year as total raw material costs declined in Q1

Going ahead, HUL's management expects pricing growth to be in low single-digit in the second half of FY25 (H2FY25). A favourable base should also help the company's revenue growth in the second half of the year. "With a further improvement in volume growth and return of pricing contribution, we expect HUL's revenue growth to largely converge with that of peers in H2FY25," said a report by BNP Paribas.

Based on *Bloomberg*'s consensus estimates, the HUL stock currently trades at almost 52 times estimated earnings for FY26. Sure, valuations aren't exactly appealing but investors could argue many consumer stocks are pricey currently. Even so, the recent appreciation in the share price may keep further large upsides at bay in the near-term. A good monsoon season should bring comfort, and so should a continuous improvement in rural demand. On the other hand, a slower-than-expected pick-up in volume growth remains a key risk ahead.