Hindustan Unilever Limited

IND AS SESSION

Hindustan Unilever Limited

7th December, 2015

Present:
Mr. Sanjiv Mehta, CEO and Managing Director
Mr. P.B. Balaji, CFO and Executive Director, Finance and IT
Mr. Dinesh Thapar, General Manager, Head of Treasury, Investor Relations and M&A

PB Balaji:

Thanks for your patient listening and firstly let me recognize Akeel as the professor in the room. And thanks Akeel, this was absolutely a wonderful and a passionate delivery of what IFRS is all about. And you are going to be pretty popular on this. And of course Aasif joins us as a controller. This is his second month in the job, didn't look like that at all. And ably supported by the team that's working with Aasif. So thanks for taking us through the implications in HUL. Sanjiv is just back from Dhaka, and to be here. I am sure we can stop the questions on IFRS and its implications on HUL. Let's get on to other questions that you may want. Over to you.

Question:

One question on your pricing strategy. It's something which last conference call we talked a lot about. So given that the commodity costs still remain very benign, we have recently seen some price hikes in detergents. What's the thought process on inflation and your ability to take up prices if input costs remain very benign as it is. So just on how you're thinking about it and how does one think about the recent price hikes in detergents that happened.

Sanjiv Mehta:

Okay. You know if you look at our portfolio this year, half the portfolio we had price rise, and in half the portfolio we had taken a price down, and that kind of netted it off, also taking into account the impact of tax holidays getting over. So you virtually saw that more or less it was at a same level as our underlying volume growth, broadly speaking. Now what's the story coming out of here? First is our price value equation. You don't price in isolation. You look at it from a context of commodity prices, and you look at it from a context of your competitive pricing. And that's when you decide what kind of pricing you need to have. Taking price down doesn't mean that we don't have the pricing power. Pricing power is based on relative pricing. And that's where our brands remain very strong, and that's where our pricing remains. But like I said last time when we met or when we there on the conference call, we have learnt from 2009. We don't want to lose consumer franchise. We want them to be with our brands. So this year, we did the right thing in correcting the price value equation, and ensuring that people remain with our brands. So what is going to be the pricing in the future, would depend of course on commodity process, the first thing. One is of course, once the anniversary happens the entire volume growth will get reflected in the top line. But there would still be categories where we hope where the sensitivity to pricing would be less, and there are opportunities – because many times lot of pricing is led by innovations. When you come with offerings which give better benefits to consumers, there are opportunities to take the price up. We would be looking at it and I don't want to take a guess, at the end of the day whether the oil prices are going to remain $45 or will they go down to $35 or will they go up to $60 is as much as your guess as mine. No one can predict that. But we will play the game dynamically. We don't play the game for a quarter, we don't play the game for a year. We want the consumers to remain with our brands and that's how we will play.

Question:

A follow up on that. So if I look at the recent price hikes in detergents, so of course input costs remain benign. Is there something in the competitor environment which is giving you confidence to again take prices up a little bit?

Sanjiv Mehta:

Specific things on detergents if you notice, we are trying to play WIMI in a much more precise manner. And that's how we see benign commodity environment. We will definitely look at opportunities on both sides. If you look at detergents you would have seen both things happening simultaneously. There are markets where you have taken down prices. There are markets where you have taken up prices simultaneously, depending on what is the brand position there, what are the kinds of strengths we see, what are the needs in that particular market, and how have we deployed money back in that market again. It will also need to be looked at what's the A&P deployment of that model etc. So we believe that we are now starting to play WIMI far more suavely because the organization is in place, the first round of interventions are there. This is what you should start seeing going forward. Classically for a business like ours, some level of inflation is very healthy. And if you have your volumes going strong, your brand equities are strong and you get some inflation, so much the better. But if it doesn't happen, doesn't matter. We will ensure that we play the game in the right way for the long term health of the business.

Question:

One question on competitive intensity. Now we've seen commodity process down for almost 12 months. And in price competitive segments like soaps and detergents, we've seen increased competitive activity both from the organized players as well as mushrooming of small regional brands as was expected. So just wanted to understand has the competitive intensity now stabilized, having seen almost a year of sort of down side on input cost in the last 3 or 4 months? Have you seen any more mushrooming of regional players? Any more aggression from the regional players? Or now in the last 3 or 4 months or maybe more than that have you seen a stable environment? Or would you not yet call that out?

Sanjiv Mehta:

See when the commodity prices are benign, lot of players come in and they don't immediately come in at the first moment. You know you keep seeing them mushrooming. And if you go to the heartland of India, you will be amazed with the number of brands operating over there. Now there are many brands which would come and go. Some are able to sustain for a much longer time. Now that's an opportunity which they see, and we are not surprised. So they will remain there as long as commodity prices remain where they are able to make money. From perspective of how we spend the money which is very critical, first is innovations. A lot of money gets spent based on how the innovation cycle comes in, when we renovate a brand, when we innovate a brand. The second is competitiveness. We want to ensure that the number of eyeballs we get are not less than the market share we possess. And third of course is a lot of money we place under market development. Now, market development is a choice. Many companies might not do it and they will let it flow into the bottom line. Now we are the market leaders. We believe that we have to not only protect today, we have to be future ready. So we do invest significant amount of money in market development. And this today it allows us to do that.

Question:

Just a follow up on that point you made that when the prices of input costs fall, the players don't necessarily come in immediately. It takes some time to come in. So do you think that process is now over that whoever had to come in has come in or do you think there are still as we speak more players coming in.

Sanjiv Mehta:

You know the mushroom players, they keep going and they keep coming. So I wouldn't believe that it has reached a stage where you can sit back and say, now I can put my feet up on the table. I don't think so.

Question:

Just a follow up on Arnab's question, I think he referred to the commodities linked pricing, I mean for let's say soaps and detergents and probably tea. But what about the other part of your portfolio, the personal care part of it mostly. How do you look at pricing in that part of the portfolio in a generally weak consumer inflationary environment? What's been the learnings and anything to understand?

Sanjiv Mehta:

It has to be led by innovations. That's the key thing. The consumer has to perceive that you're giving him more benefits. Because a consumer never looks at pricing in isolation. He looks at what price what value I get. So we always look at price value. But I would believe there are some categories which are less involved, which are more price sensitive. The other categories which are more involved which are less price sensitive, there with good innovations you would still have opportunity to take pricing.

Question:

To make a statement or a hypothesis that in a generally low consumer inflationary environment, innovation is the single largest driver for pricing and not a plain vanilla price increase of let's say Fair and Lovely which is going to be difficult to implement without any material impact on volumes. Is that a fair hypothesis?

Sanjiv Mehta:

That's right. Whenever we do innovation, our objective is it should be margin accretive as far as possible and that's what we aim for. Invariably we also look at that we give better benefits, more benefits and can we price it higher.

Question:

I have a question on the WIMI initiative that you spoke about a last few quarters ago where the central was clearly a great opportunity for you to increase per capita spends. We know that the rural environment has not been very encouraging. But given your experience of observing that initiative and some impetus there, have you noticed some excitement anecdotal trends that sort of excites you?

Sanjiv Mehta:

See the way we are looking at it is Central India for us is growing at a much faster rate than the rest of India. And that's bang on strategy. What are we doing in Central India? One is we have a heightened focus. We have a full team now based out of Lucknow. And the whole job is to look at the opportunity in Central India. Second is again like I was telling, market development we are focusing huge amount in Central India.

Question:

Wanted to get your thoughts on not only as HUL, but as FMCG industry on Patanjali. Because 6 months back it was something which was rising. Now it seems to be – I mean do you actually think it is a serious risk right now to large players? And does it look like anything which is disruptive? How do you look at this phenomena? Because consumer brands normally take decades to build. And the kind of turnovers that have been talked about is what has been built over decades by other companies.

Sanjiv Mehta:

You know first is the game has just started guys. So don't come to a conclusion at this stage. And don't prepare obituaries of anyone. This is a long game and it will be played out. What happens is when you launch several categories, of course you immediately get a big bump. But then you have to look at the health of the brand, you have to look at the consumer off take, you have to look at the penetration levels. But obviously with the kind of quick gains they have got, they have done some good job. No question about that. And like I tell every time, we respect our competitors, be it multinationals, be it local, be it regional. We have high respect and we look at learning from each one of them, what are the things we can imbibe from them. But our obsession is with consumers, not with competitors. I'll just tell you, 50 years back the largest consumer good company in India was HUL, 2015 largest FMCG company is HUL, 2065 what's the place – but I know which one it will be.

Question:

Sorry for the short term question, but this year season has not been very favorable for HUL in industry. So first we had somewhat poor monsoons and now the winter news is not very good. What do you think about that issue right now, is are you seeing – I mean obviously you can't talk much from a number perspective but is that also exerting pressure incrementally since you ended the previous quarter and whatever we discussed at the end of the quarter?

Sanjiv Mehta:

You know there are two things which are right now staring at us. One is Tamil Nadu. Tamil Nadu of course there has been a big disruption, all of us know. And we have a big market in Tamil Nadu. But right now our focus is not on sales but how can as a corporation we can do our bit to alleviate the suffering of people in Tamil Nadu. So just to give you, our bread factory we have been doing our best to make it run to capacity so that we can feed the hungry people over there. That is it. As far as the winters are concerned, you know we believe that winter should be coming in. I was in Dhaka today morning and I felt a bit colder than what it was a day before when I landed. Now that's the Eastern part. But I am sure it should come in. But yes when the winter comes in, it's very logical that the sale of winter products move up. But I keep saying we don't run the business for a quarter. So let's not worry about it. We are completely ready. As the wind blows, as the chill temperature goes down, as there is more whiff of cold air, our brands will be there on the shelf to meet the needs of consumers.

Question:

Sure. And from a national perspective with government talking about GST and too early as we were talking with Balaji to think about the impact. But are we getting more confident about the 7^{th} Pay Commission then followed by GST? As a leader are you seeing things getting better over the next 12 months?

Sanjiv Mehta:

Too early at this stage. But we would like GST to be implemented. We are very keen that it comes in as soon as possible. The impact of course as Balaji would have given to you depends on what the final rates are. But what are the things, why GST? One is people who today don't pay tax or evade tax, they will come on the tax net. So it becomes a much more level playing field. And for an organization like us it definitely helps. And second is it will allow us to bring in efficiencies which hitherto we have not been able to do. From an industry perspective I think it would be fabulous. From the country perspective it would be fabulous. Notwithstanding the hiccups of implementation. Because there would be an initial period where it will be very turbulent when it comes to implementation.

Question:

Sure. I think we have discussed this question again as a point in the past. But if you can give your views on urban versus rural, on the urban side inflation has gone down which means in general real incomes have gone up. Beyond that what are the – if at all any green shoots are there, on the rural side I think there is a theory that perhaps under the earlier government's regime there has been an advanced demand for a lot of these products. Now unless the economic activity picks up – and this government doesn't look like it will roll out freebies. So what will drive the growth in both these markets in your view from a medium term perspective? And what are the key milestones that you are looking for in both the markets, urban as well as rural?

Sanjiv Mehta:

Sure. You know my growth drivers, first is of course I have to protect the core. That's very critical for me. The second is premiumisation. And the third are the nascent segments or the market development. And what one thing that certainly happens, that when the prices go down it facilitates premiumisation. Because people hitherto who found a certain brand aspirational, but a bit unaffordable, when the total prices go down, they go for it. and that is also one of the reasons why is our biggest laundry brand now is Surf Excel and not Wheel. It's been doing so well. And that thrust will continue. The other of course is premiumisation which comes in very clearly with innovations. A classic example is Tressemme. Tressemme came at a higher price but our guys did a fabulous job of marketing. I am sure many of you must have tried Tressemme. You get a wonderful salon kind of hair at home. So that's doing wonderfully well. Same goes with Magnum. So that really helps you raise the entire price realization per ml or per whatever be the denominator of unit, to take your pricing up. Now talking about urban and rural, like I always say India is not a homogeneous country. If you look at the top 8000 or 10,000 villages today, the attitude, the aspiration, the ambition of the consumers is very similar to the tier 3 cities. So our thrust in those markets are how do we increase the assortment in those places? So that people who aspire and who want to spend money can do that. So that will again, though it is rural in a classical sense, but they are aspiring for bigger things. But if you were to step back and look at it from a macro perspective, you know many months, many quarters back I had told you that rural growth is coming down and now it is more or less – all of you guys would be agreeing with it that it has come down more or less to the same level as urban. Having said that, it is still growing. It is not that it has stopped growing. 5-6% underlying volume growth there will be countries who would give their left hand to get that kind of growth. And that is still happening in urban as well as in rural. But the mix is different. The other thing like I said, when times are tough, you could well say that let me stop my investment in market development. But I would put it the other way around. You need to keep continuing your thrust on market development because once the market picks up, it will certainly help your cost tremendously. Now what is going to help rural? The wage inflation is much lower than what it was say in the previous 3-4 years. That's a fact. The minimum support price increase is much lower. But what is going to fuel of course is once the infrastructure starts kicking in a big way, there is very clear evidence when infrastructure goes to rural areas, the GDP starts galloping. And that is certainly going to help the cause. And of course when more money is given to consumers in urban areas, I am absolutely certain it will help the cause of consumption. It will help the cause. But if you were to ask me are we seeing it right now, I would say it's too early yet. So I am very optimistic of the scenario in India and I think we are absolutely greatly placed. No longer is BRIC a great story. But India still remains.

Question:

I have a question with regards to the medium term story and premiumisation etc. If I were to just take a simple example of shampoo let's say, we started with the sachets many, many years back, and today that same sachet is available at Rs.3. Your brands have gone on to become more premium, Dove and then Tressemme. But then Tressemme is available in the same Rs. 3 sachet. I am not sure if over a period of this time, the volume of sachets as a percentage of the total shampoo volumes of the country have actually come down or gone up. But in this case of course several years have passed. The price points remain the same. So where is the premiumisation and what is the tipping point?

Sanjiv Mehta:

Today a lot many people buy our premium sachets as opposed to mass sachets. So even within sachets, there are different price points. At Re.1 you have Clinic Plus and then you have more expensive sachets with Dove and Tressemme. Now clearly there has been an upgrading when it comes to people buying more of the premium brands. So the premium we see in bottles, the upgrading, they have also seen that happening in sachets. But still sachets remain a big part of the market. There is no question about that. But the shampoo story, you need to look at it from a context that how the penetration levels have gone up. The penetration level say 15 years back or 10 years back was significantly less than the 80% penetration levels we see today. And that's how the markets have grown.

Question:

And what do you see the tipping point for you to really premiumise your own price point? For example if you look at it today, maybe Tressemme is the same as Head & Shoulders and the same as Dove, and all of them are available at Rs. 3 sachets.

Sanjiv Mehta:

That is where the strength of the brand comes in my friend. But are you asking me a question whether how will consumers move from sachets to bottles? That would be to a large extent dependent on the economic conditions in the country. When you have more money in the hands of consumers, what we have seen, the consumers who go for bottles are very different from consumers who go for sachets. There are two different sets of consumers. And only when they have more money in their hands, do they migrate to the bottles.

Question:

But I think, if I just take the current situation -- of course one can blame it again on the economies that the economy is not good and therefore there have been price cuts – so the scenario is that people are still using sachets. But at the same time your competitors as well as yourself has gone ahead and cut prices on bottles.

Sanjiv Mehta:

You know the pricing of shampoos we didn’t start it. We responded to it. We can hypothesize what must have been the rationale behind our friends reducing the price. It could be various reasons. One possible reason is that they might feel it might give a fillip to bottles. But still the price points of sachets and bottles are so huge, it is not going to result in a large scale immediate migration to bottles. But we were very clear. We might be having 50% of the market, but we will do our unblinking defense when it comes to our category position. That important bit that we have not stopped doing is focusing on developing the conditioner market. Conditioners are what shampoos were 25 years back. Our huge investments are going into developing the conditioners. Just like we made people switch from washing their hair from toilet soaps to shampoos. Now we are saying guys that’s half the job done. You really get great hair after you use conditioner after using shampoo.

Question:

One question for Balaji. While the premiumisation drive is very well understood, when I look at the last 1 year or the last 3 years, definitely premiumisation would have been a tail wind for your margins. But considering that there has been this commodity correction in the last 1 year, if you could just help us understand let’s say what component of your margin expansion is premiumisation. I am not looking for a number exactly. I am generally trying to understand that premiumisation is still the largest component. Or in the last 1 year it is largely the commodity. Again the reason is that recently Nestle called out the last 9 months’ performance, and quantified that 3/4th of the gross expansion in the last 9 months actually has been commodity. Earlier it has been largely price increases over cost. Just to put a broad number to it.

P.B Balaji:

Let me put it in a slightly different context. What are the drivers for margin improvement and what are the more sustainable drivers which you can bank on. That's where you are going with this question. Yes, commodities coming off as I always keep calling the source of funds, and how do you deploy the funds is something that we think through. There is a net benefit that is there which we called out as well saying that clearly cost of goods sold has come off substantially. That's the first element of the margin improvement. Second element of margin improvement will be mix which is what you call as premiumisation. But for me I decode that as mix, saying that better margin product – and those better margin products can come from very many directions. I could be selling a better category. I could get a category mix, I could get a brand mix, I could get a SKU mix, I could get a channel mix. All these then contribute to driving mix at an overall level. And typically when you look at improvements in this, I would expect to see at least about let's say 10-20 bps every year coming through as mix on a sustainable basis. This is what I call as long term how do you then plan this margin improvement out. Whether it is your core root of margin improvement. And third, I would look at operating leverage. And that if you look at our fundamental virtuous circle of growth that we call out, we want volume growth. Why are we paranoid about volume growth? Because volume growth, the sensible pricing which is linked to commodities and inflation, what brands can pull of gives you great turnover growth, that will automatically start giving you operating leverage. Kick in savings programs that we are very good at pulling out. You didn't have the kitty to actually invest back in you're A&P. Invest a portion of that in you're A&P then it starts driving you further volumes. So that's how the circle completes itself. And then you are able to knock off a portion of this into your kitty which we always call as modest improvements in operating margins which we are on to. But the key one is how much you invest back. Key one is how much can you get out of operating leverage. And this volume can you get a mix going. So you are actually looking for profit opportunities at each one of these. And this thing works together as one cohesion.

Question:

Just a question on GST. Don't want to sort of second guess what's the R&R going to be, on what base or what is your current tax etc. But assuming that many of the companies who are paying tax currently will get some amount of benefit. Again I don't want to speculate on what amount of benefit that is. My question is given the categories you are in, do you think that large part of this benefit will just get passed on to the consumer? Or do you think there are some categories in which you would actually see accretion on account of this?

P.B Balaji:

Okay, let me put it differently. First of all, let us figure out what the revenue neutral rate is. That will decide for me whether it is source of funds or use of funds. I don't know. Once the decision then gets taken, if it is indeed a source of funds, then we need to really think through how do you want to deploy it. And the first money, the port of call for the money is market development.

That's how my virtual circle of growth will kick in, because as much as we generate savings, I am very clear that the bottom line that we pass through should be modest improvements in operating margins. Because that is how you build businesses that last for a long, long period of time. So we are not in it for a short term. So for me, GST, I am approaching it in a very neutral manner. I am revenue neutral from that perspective. Let's see what the numbers play out. Then we decide how we dynamically use the funds or if there is no call for funds, there is no innovation plans, there is nothing that is out there, obviously we will go for the bottom line if it is a source of funds. But if for any reason let's assume it is a cost then again we will have to go back to the traditional other conversation we have okay commodities have gone up, cost has gone up, what do you want to deploy. We don't straightaway take a pricing. Then we start looking at how as a cost levers kick in. But one or two things as a philosophy the way we operate, think source of funds, use of funds. Source of funds can come from anywhere. Commodities, GST, efficiencies, leverage, mix, all these are source of funds. Use could go anywhere depending on where we believe is the right bang for the buck that we can get. Our going in position, use any funds you get out there after you protect your modest improvement operating margin you are committed to, to drive market development, drive brand salience, build capabilities. That's something that will be done relentlessly. That is how we look at it.

Question:

Actually the philosophy of modest improvement in operating margins has taken you to an all time high margin now. So why is this paranoia about modest improvement? I am saying why not no improvement? Why not take you to a level where you say I want to take my brand a fortress where other people will not find it profitable to enter. Where does this come from? I mean there are successful companies in the world which say you know I don't want to make more money than this.

P.B Balaji:

For us the way we look at it is what are the strategies? Strategy is 4G growth. Consistent growth, competitive growth, profitable growth, responsible growth. What is the philosophy? How do we translate that into the P&L? I should give you volume growth, starting point, turnover growth should be ideally higher than volume growth, Ebidta growth should be slightly higher than turnover growth, and your cash growth needs to be higher than your Ebidta growth. If we can move this growing, that's a sustainable model. Question for me is just as much as you call it a sustainable business, there is a sustainable P&L. It needs to fire together. Otherwise we are investing in the short term or we are taking money in the short term or we are not being responsible with the P&L that has been given to us. our brands are strong, therefore we invest in it. That's how we look at it, I think it all goes to the philosophy with which you run the business rather than take short term views. If your view is next 60 years I should be there, then I should be looking at building capabilities, I should be looking at strengthening my brands, I should be looking at those brands looking profitable with every passing year. That is when they become sustainable. Brands need to stand on their own feet. I can't just say that I will draw a bottom line of profitability and say that's what it is. And after that everything else passes down to the shareholder or everything is invested back into the business. It doesn't work that way. It needs to be in balance between all the factors. You just can't swing one way or another way. Business is when in balance actually deliver quite well. That is how we would love the business to be. There needs to be a good hum of the business. But these flow goes together. Then it is value creating.

Question:

The question was around with the recent noise happening in the Ayurveda segment, is Levers also looking at – we know that you have a premium offering in the Ayurveda, but anything in the mass market? Is Levers consciously looking at this segment?

Sanjiv Mehta:

You know I will not just talk about Ayurveda, I will just talk about the broader natural segment. There is a very clear trend not just in India but also globally. People going towards natural. And we are very conscious about that. We need to strengthen our portfolio in the natural segment. And one of the first big steps we have taken is resurrecting Ayush. This is just a start. Just watch the space, there is more going to come on Ayush. Because we believe it's a fantastic brand, great properties. And perhaps it was launched maybe a decade earlier than what it ought to have been. But we clearly see the strength of the brand and what we need to do to make it much bigger brand.

Question:

And will Levers be open to any kinds of acquisitions to propel the growth in this segment?

Sanjiv Mehta:

See we are never allergic to acquisitions. But it has to make sense to us. We don't see many big candidates in the country. But we would certainly be exploring bolt on acquisitions. You have seen Unilever globally doing some fabulous acquisitions. Dermalogica, Ren, they are all at a premium end and many of them are more slanted towards the natural. So for us it is one is strengthening the brands that we have in our portfolio like Ayush, second is exploring the bolt on acquisitions, third is also looking at what opportune time we need to bring in India the acquisition which Unilever has done.

Question:

The last question was actually on the performance of Pepsodent. Can we have any update?

Sanjiv Mehta:

Pepsodent, we have not been entirely satisfied with performance as of date. Our marketing teams, our R&D teams have been very busy looking at how do we get the mix which will resonate well with the Indian consumers. So I would say give us a little bit more time and we would come back with a much stronger mix. I am very happy with the way Close Up has done.

Question:

How you spoke about business development, is there any particular category or segment that you are particularly excited about at this point of time and you are putting more weight behind that?

Sanjiv Mehta:

There are many. For instance if we look at our homecare, in homecare we have our liquids, we have matics, we have conditioners, fabric conditioners, then even the liquids, then dish wash. That’s a big area. When we look at personal care there is a plethora of area where we are focusing on. And when we look at market development, it is not just the nascent segments, we also pick up from a WIMI lens, there are many markets where relatively the penetration levels or consumption levels are low. So we even focus on how do we develop those markets and make them come up. Conditioner in hair that is very clearly a focus area for us. Higher order benefits in skincare, that’s a big area for us. Even if you look at hand and body, the penetration levels are very low. And even where the penetration levels are a bit decent, where the people use in terms of surface area is very small. So we have to convince the consumers that don’t look at using hand and body lotion only in the visible part. But also in the invisible part. Because that is how we will be able to grow the segment much bigger. For us, deos is clearly a market development and it will remain so for years to come. And same is with foods. Whether it is the premium end – you know if you look at the whole organized ice cream market, that in itself is very small. We are talking about US with 30 liters per capita. And here we are talking about not even a liter per capita. So we are talking about huge opportunities. And then you look at the packaged foods business. Soups, we are doing well. But still there are huge number of our countrymen who haven’t yet got the taste of soup. So we have to convert them into the habit of eating soups. The market development, and clearly if you were to ask me as a percentage of my business where we really focus a large part of it, it would be anywhere close to 20% where we put a huge amount of focus on market development.

Thank you so much. Always good to interact with you. Have a very pleasant evening.