BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

10th June 2016

Food & Beverages

Unilever

Well priced Quality

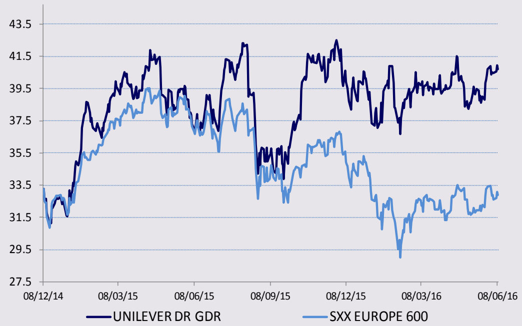
Fair Value EUR43 (price EUR40.95)
Fair Value 3350p (cours 3220p)

NEUTRAL

Bloomberg	UNA NA
Reuters	UNc.AS
12-month High / Low (EUR)	42.5 / 33.9
Market capitalisation (EURm)	116,495
Enterprise Value (BG estimates EURm)	126,497
Avg. 6m daily volume ('000 shares)	4,500
Free Float	100%
3y EPS CAGR	6.5%
Gearing (12/15)	NM
Dividend yields (12/16e)	3.19%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	53,272	52,966	55,431	58,309
EBIT(EURm)	7,865	8,056	8,668	9,355
Basic EPS (EUR)	1.83	1.88	2.04	2.21
Diluted EPS (EUR)	1.82	1.87	2.03	2.20
EV/Sales	2.40x	2.39x	2.26x	2.13x
EV/EBITDA	13.9x	13.4x	12.3x	11.3x
EV/EBIT	16.3x	15.7x	14.5x	13.3x
P/E	22.4x	21.9x	20.2x	18.6x
ROCE	18.9	19.0	20.7	22.3

Price and data as at close of 7th June



While Unilever's organic sales growth remains modest, there is substantial room for margin improvement and its very healthy financial position enables the group to undertake acquisitions. However, we derive a Fair Value of EUR43, implying a limited upside of 5%. We are initiating coverage with a Neutral recommendation.

- **Organic sales growth of 4% in 2016. The group's organic sales growth should remain modest this year.** Like its peers, it is impacted by the weak pricing environment**,** resulting from low commodity prices and deflationary pressures in Europe. **The economic slowdown and geopolitical problems in the emerging countries** are also holding back sales. We expect organic sales to grow 4% this year, i.e. a performance identical to last year and in the middle of the company's guidance (3%-5%).

- **Unilever, a margin story. The potential room for margin improvement is substantial,** coming from a combination of several factors. The group is working on **improving the mix** of its Home Care and Refreshment divisions. It also has two programmes, the New Functional Models and Zero Based Budgeting, which should enable the achievement of **EUR1bn of cost savings by 2018**. Our estimate is for **the operating margin to increase by 40bps in 2016 and in 2017, beating last year's performance and in the high end of the group's model (+30/40bps).**

- **An impending change in profile. Its very healthy financial position should enable the group to undertake acquisitions** and, in 2020, achieve its informal target of 70% of sales in HPC. **The group's growth potential thus looks set to progress.** Between 2010 and 2015, the growth in Personal Care and Home Care products was more than twice that of Foods/Refreshments.

- **NEUTRAL. Fair Value of EUR43.** Unilever is trading at a 2016e P/E of 21.9x vs 21.1x for Danone and 21.2x for Nestlé. **We have chosen to value the company using the DCF (50%) and sum of the parts (50%) methods, from which we derive a Fair Value of EUR43 per share (3,350p for PLC),** implying a limited upside of 5%.

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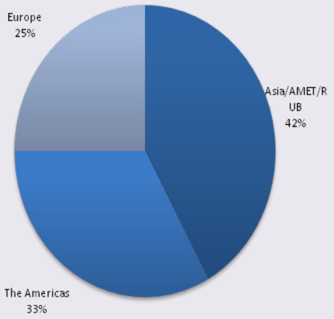
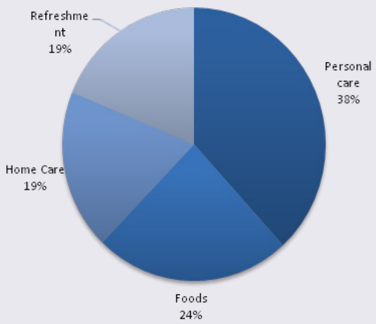
Sales breakdown by geography, 2016e



Sales breakdown by category, 2016e



Company description

Unilever is an Anglo-Dutch company which is present in four product categories (Foods, Refreshments, Personal Care and Home Care) and is divided into three regions (Asia/AMET/RUB, Americas, Europe).

Simplified Profit & Loss Account (EURm)	**2013**	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Revenues	49,797	48,436	53,272	52,966	55,431	58,309
Reported change (%)	*-3.0%*	*-2.7%*	*10.0%*	*-0.6%*	*4.7%*	*5.2%*
Organic change (%)	*4.3%*	*2.9%*	*4.1%*	*4.0%*	*4.7%*	*5.2%*
Adjusted EBITDA	8,167	8,147	9,235	9,433	10,165	10,988
EBIT	7,016	7,020	7,865	8,056	8,668	9,355
Change (%)	*-0.5%*	*0.1%*	*12.0%*	*2.4%*	*7.6%*	*7.9%*
Financial results	(530)	(477)	(493)	(463)	(419)	(380)
Profits from associates	127	143	198	110	115	118
Pre-Tax profits	7,114	7,646	7,220	7,703	8,364	9,093
Tax	(1,851)	(2,131)	(1,961)	(2,003)	(2,175)	(2,364)
Minority interests	421	344	350	370	400	440
Net profit _ group share	4,842	5,171	4,909	5,330	5,790	6,289
Restated net profit	4,607	4,634	5,210	5,330	5,790	6,289
Change (%)	*3.4%*	*0.6%*	*12.4%*	*2.3%*	*8.6%*	*8.6%*
Cash Flow Statement (EURm)						
Operating cash flows	8,099	7,854	9,351	9,062	9,603	10,038
Change in working capital	200	8.0	720	(26.7)	(262)	(569)
Capex, net	(2,027)	(2,045)	(2,074)	(2,013)	(2,106)	(2,216)
Financial investments, net	(411)	(398)	(460)	(460)	(400)	(400)
Dividends	(2,993)	(3,189)	(3,331)	(3,449)	(3,725)	(4,023)
Other	(1,101)	(1,444)	(1,605)	0.0	0.0	0.0
Net debt	8,456	9,900	11,505	10,002	8,805	7,770
Free Cash flow	3,856	3,100	4,796	4,587	4,922	5,058
Balance Sheet (EURm)						
Tangible fixed assets	9,344	10,472	11,058	10,101	8,988	7,670
Intangibles assets	20,904	22,174	25,059	25,560	26,327	27,117
Cash & equivalents	2,285	2,151	2,302	1,516	1,551	2,179
current assets	9,837	10,196	10,384	11,356	12,961	14,897
Other assets	3,143	3,034	3,495	3,625	3,761	3,901
Total assets	45,513	48,027	52,298	52,159	53,588	55,764
L & ST Debt	11,501	12,722	14,643	12,553	11,408	11,018
Others liabilities	19,197	21,042	21,573	21,643	22,153	22,453
Shareholders' funds	14,344	13,651	15,439	17,320	19,384	21,650
Total Liabilities	30,698	33,764	36,216	34,197	33,561	33,472
Capital employed	27,281	29,237	31,468	31,039	30,955	30,996
Ratios						
Operating margin	14.09	14.49	14.76	15.21	15.64	16.04
Tax rate	(26.44)	(28.23)	(27.57)	(26.38)	(26.36)	(26.34)
Net margin (restated)	9.25	9.57	9.78	10.06	10.44	10.79
ROIC	NM	18.36	18.87	19.02	20.69	22.35
Net debt/EBITDA (x)	1.04	1.22	1.25	1.05	0.86	0.70
Pay out ratio	66.64	69.67	66.21	69.89	69.49	69.09
Number of shares, diluted	2,924	2,883	2,855	2,855	2,855	2,855
Data per Share (EUR)						
Restated basic EPS	1.62	1.63	1.83	1.88	2.04	2.21
Restated diluted EPS	1.58	1.61	1.82	1.87	2.03	2.20
% change	*3.1%*	*2.0%*	*13.5%*	*2.3%*	*8.6%*	*8.6%*
BVPS	4.91	4.74	5.41	6.07	6.79	7.58
Operating cash flows	2.77	2.72	3.27	3.17	3.36	3.52
FCF	1.32	1.08	1.68	1.61	1.72	1.77
Net dividend	1.05	1.12	1.21	1.30	1.41	1.52

Source: Company Data; Bryan, Garnier & Co ests.

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1. Investment Case

Why the interest now?

The reason for writing now

While Unilever's organic sales growth remains modest, there is substantial room for margin improvement and its very healthy financial position enables the group to undertake acquisitions. However, we derive a Fair Value of EUR43, implying a limited upside of 5%. We are initiating coverage with a Neutral recommendation.

Cheap or Expensive?

Valuation

Unilever's 2016e P/E stands at 21.9x vs 21.1x for Danone and 21.2x for Nestlé. We have chosen to value the company using the DCF (50%) and sum of the parts (50%) methods, from which we derive a Fair Value of EUR43 per share for NV and 3,350p for PLC.

When will I start making money?

Catalysts

Unilever will publish its first half results on 21 July 2016. We forecast organic sales growth of 4.6% in H1, a performance similar to that of the Q1, the comparison base effectively continuing to be favourable. The operating margin should increase by 40bps to 14.9% in the first half, mainly due to an improvement in the mix.

What's the value added?

Difference from consensus

Our sales and EBIT forecasts are broadly in line with the consensus over the next two years.

Could I lose money?

Risks to our investment case

Unilever is more exposed to emerging markets than its peers. They account for 58% of the group's sales. Any deterioration in these markets could have a significant impact on our forecasts.

2. Unilever in brief

Fig. 1: History of the company

1872	In the Netherlands, Jurgens and Van den Bergh open their first factories to produce margarine
1884	In the UK, Lever & Co starts producing Sunlight soap
1927	Jurgens and Van den Bergh join forces to create Margarine Unie
1930	Margarine Unie teams up with Lever Brothers to create Unilever
1971	Lipton International is acquired
2000	Acquisition of Bestfoods
2002	Sale of 87 businesses without acceptable growth or margin potential, generating EUR6.3bn of sale proceeds
2005	Mr Patrick Cescau is named CEO
2009	Mr Paul Polman succeeds Mr Patrick Cescau
2016	Dr. Marijn Dekkers succeeds Mr Michael Treschow as Chairman

Source: Unilever

Fig. 2: Thirteen of the group's brands exceed one billion in sales

Source: Unilever

Unilever is divided into three regions: Asia/AMET/RUB (Asia, Australasia, Middle-East/Africa, Turkey, Russia, Ukraine, Belarus), the Americas and Europe.

Fig. 3: Breakdown of sales by category, 2016e

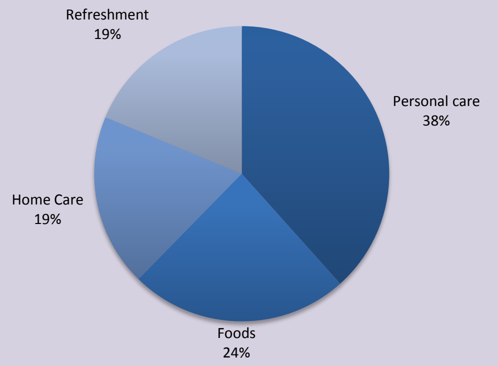
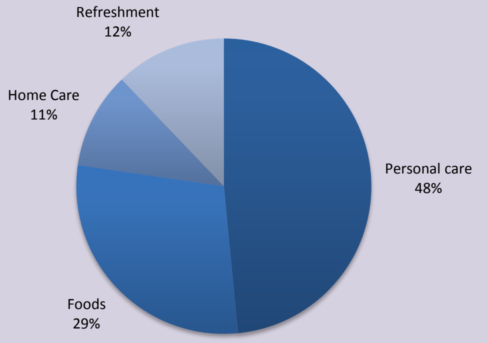


Fig. 4: Breakdown of operating profit by category, 2016e



Source: Unilever, Bryan, Garnier & Co

Unilever is present in four product categories: Personal Care, Foods, Home Care and Refreshment (ice-creams and teas).

Fig. 5: Breakdown of sales by region, 2016e

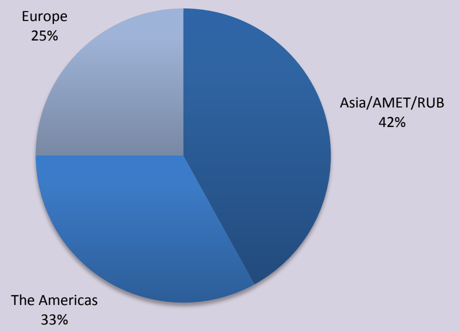
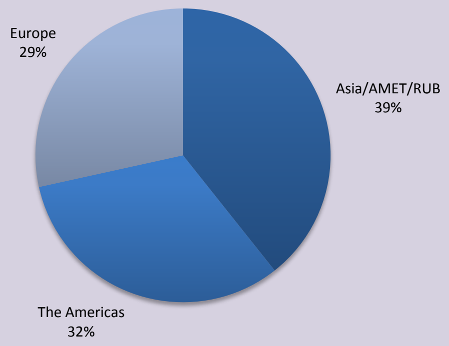


Fig. 6: Breakdown of operating profit by region, 2016e



Source: Unilever, Bryan, Garnier & Co

Emerging markets represent 58% of the group's sales. Its three main markets are North America (16% of the group's sales), India (8%) and Brazil (6%).

Fig. 7: Emerging markets as a % of the group's 2016e sales

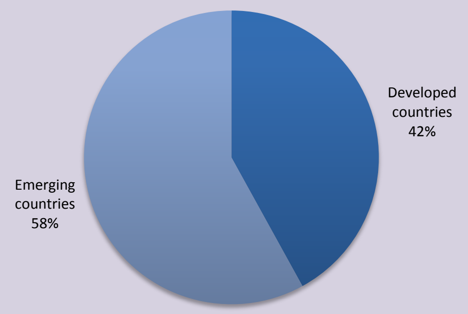
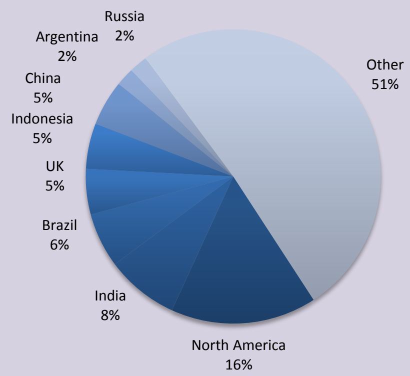


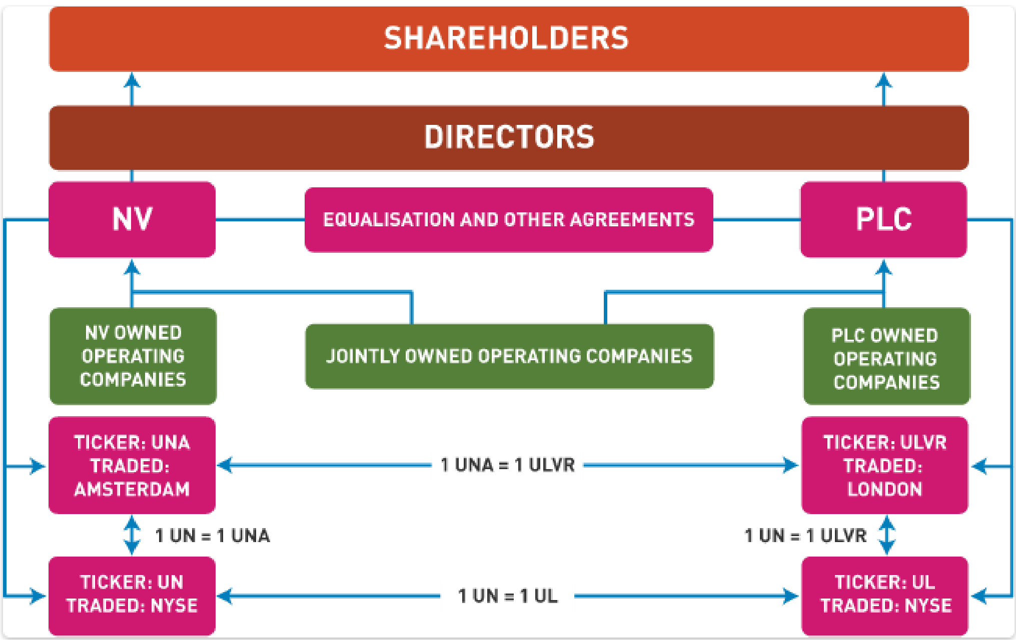
Fig. 8: Main countries for the group (% of sales), 2016e



Source: Unilever, Bryan, Garnier & Co

Unilever functions as a single entity, with NV and PLC the two parent companies for the group. Their legal entities are separate but they have the same directors and are linked by agreements to ensure the unity of governance and management. Their shares are listed for trading separately (one for one equivalence).

Fig. 9: Unilever's legal structure



Source: Unilever

3. Organic sales growth of 4% in 2016

We expect Unilever to post organic sales growth of 4% in 2016 in view of the weak pricing environment (3.1) and the tough political and macro-economic background in emerging countries (3.2).

3.1. A weak pricing environment

The pricing growth should be subdued in 2016 given commodity price weakness at a global level and deflationary pressures in Europe.

3.1.1. Commodity price weakness

The FAO Food Price Index recorded a 19% fall in 2015

In May 2016, the FAO Food Price Index stood at 156 points, up 2.1% vs April but down 7% vs May 2015. In 2015, this index declined by 19%. The only agricultural commodities to have seen a price increase in the past year are sugar and chocolate, impacted by unfavourable weather conditions in Africa and South East Asia.

Fig. 10: Trend in the FAO Food Price Index

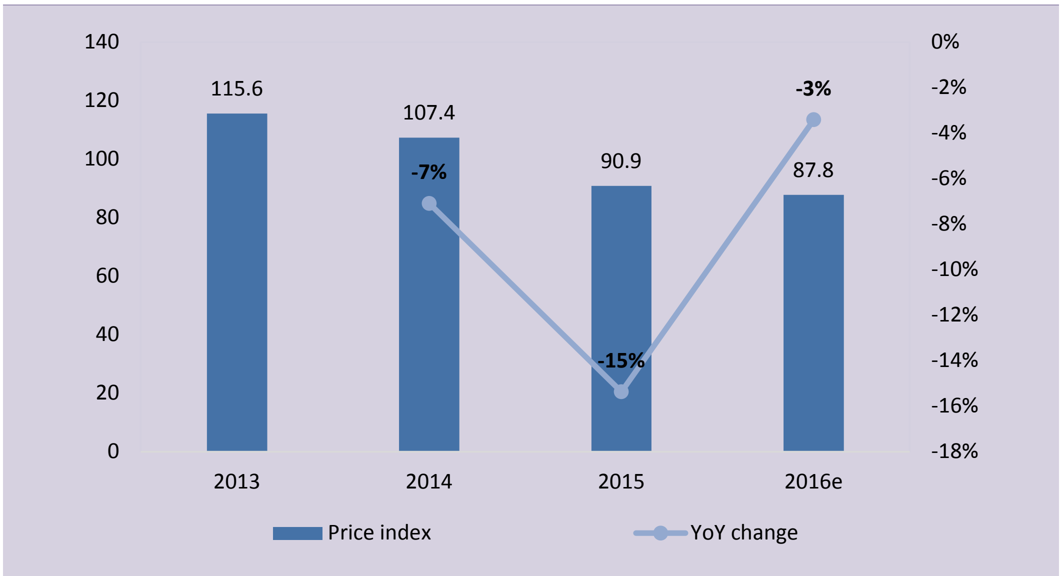
Source: FAO

A capacity surplus explained by a slowdown in the emerging countries and the decline in energy costs

Excess capacity is behind the fall in agricultural commodity prices. In the 2000s, the explosion in demand from emerging countries led to a reallocation of resources towards agricultural production. For the past four years, **there has been a slowdown in these markets (particularly China)** which has put downwards pressure on prices. **The reduction in energy costs** has also encouraged production. The oil price collapsed by 47% in 2015, reaching its lowest level since 2014 and this decline is expected to continue in 2016, the World Bank forecasting a fall of 21% for the year. This is linked to both supply and demand: on the supply side, a more-rapid-than-expected resumption in Iranian oil exports, higher US production thanks to cost savings and efficiency gains and an OPEC strategy prioritising market share preservation and, on the demand side, a particularly mild winter in the Northern hemisphere and low growth projections in the major emerging economies. It is worthwhile noting that, **contrary to expectations, the El Nino meteorological phenomenon did not drive an increase in agricultural commodity prices last year.**

Agricultural commodity prices are expected to fall further in 2016, although the beginning of a cyclical upturn should take place over the course of the year.

Fig. 11: Food commodity price index



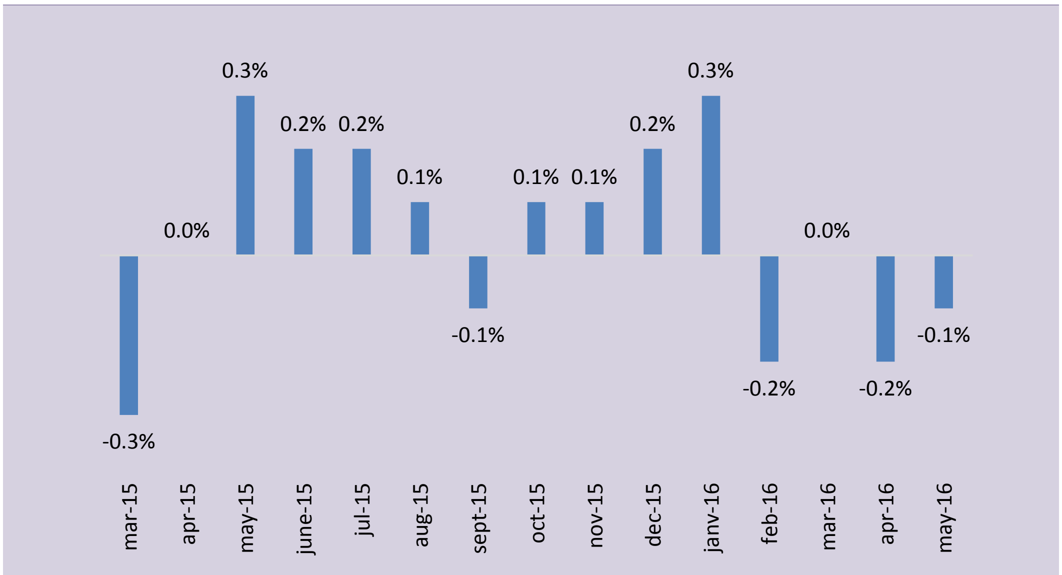
Source: World Bank

3.1.2. Deflationary pressures in Europe

Defined as a general and enduring reduction in the level of prices, deflation is not far off in the euro zone. In May, prices fell by 0.1% after -0.2% in April.

Fig. 12: Annual price variations in the euro zone

The euro zone is close to deflation

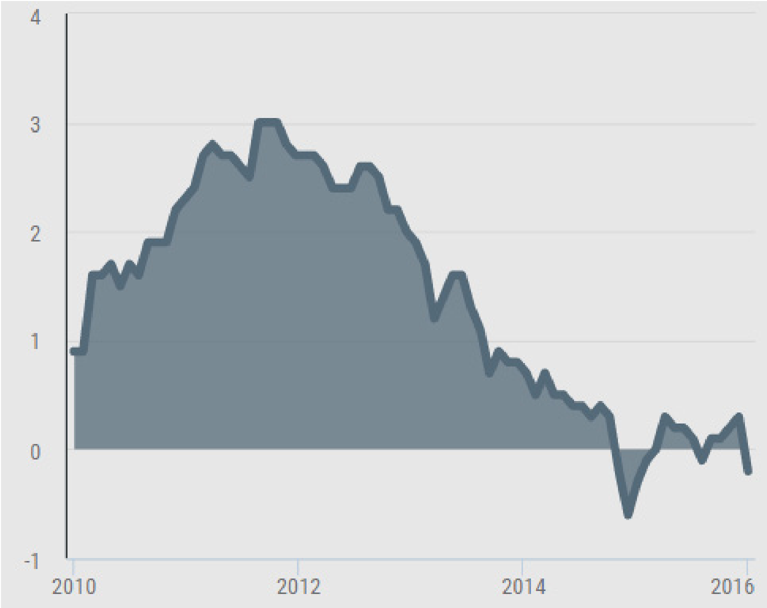


Source: Eurostat

Since March 2014, inflation has never exceeded 0.5% on an annualised basis

Whereas the European Central Bank considers that inflation needs to be around 2%, this figure has never exceeded 0.5% on an annualised basis since March 2014.

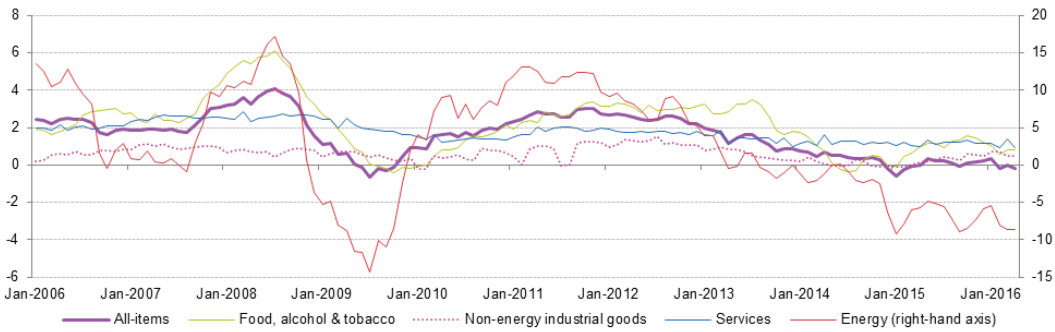
Fig. 13: Annual inflation rates in the euro zone (%)



Source: Eurostat, Alternatives Economiques

The price falls do not only concern energy but also services, industry and food/alcohol/tobacco.

Fig. 14: Price changes in the euro zone by category, 2006-2016

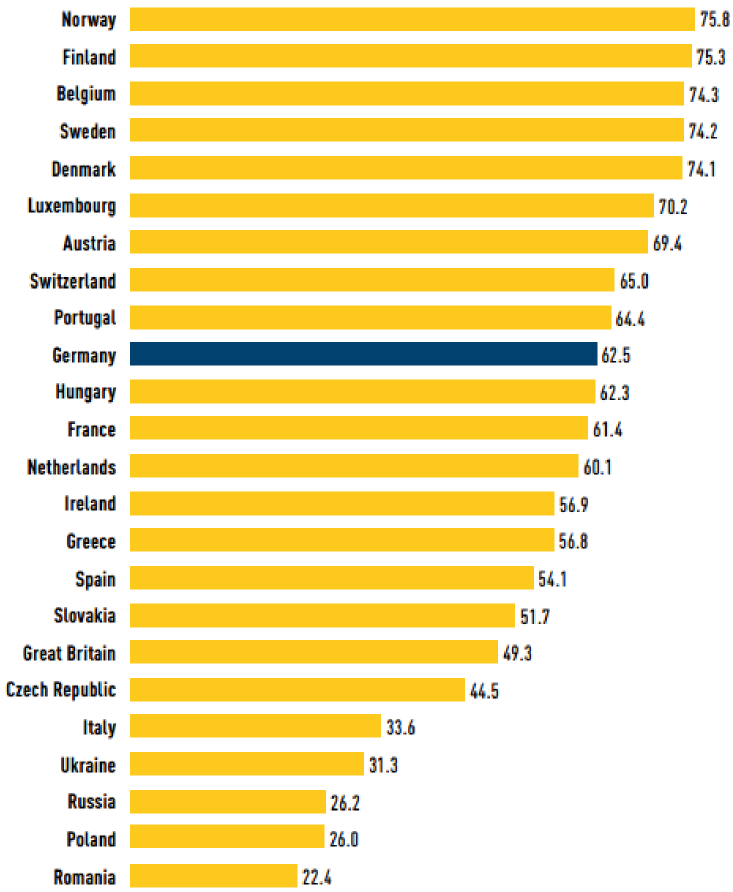


Source: Eurostat

This fall in the general level of prices is taking place despite the accommodative monetary policy of the European Central Bank which should have stoked inflation. **The strengthening of the euro and the commodity price weakness are behind this.** The downwards pressure on food prices is also partially explained by **the power gained by large retailers.**

The concentration of the banners has continued in practically all European Union countries as a result of the increased penetration of modern retail concepts (supermarkets, hypermarkets and discount stores). The market shares of the five largest retailers are approaching 74% in Belgium, 62% in Germany and 61% in France…In June 2015, Ahold and Delhaize announced their merger.

Fig. 15: Market share of the five largest retail chains



Source: Metro Compendium 2015/16

The four largest French purchasing groups concentrate 92% of the sales of mass market and fresh self-service products

This trend towards retail sector concentration is not only apparent at the level of the banners but also at the level of purchasing groups, whose function is to pool a retailer's orders and then divide them between the stores. In France, several retailers merged their purchasing groups in 2014: Système U and Auchan in September, Intermarché and Casino in October, and Carrefour and Cora/Match in December. According to Kantar Worldpanel, the four largest French purchasing groups concentrate 92% of the sales of mass market and fresh self-service products.

The choices of the French groups have acted as a catalyst for mergers seen on a much wider scale. In November 2014, Auchan entered into a partnership with the German company Metro, only a few weeks after its agreement with Système U (centrale Eurauchan). Colruyt, Conad and Coop joined Alidis (Eroski, Edeka, Intermarché) in August 2015 while REWE joined Coopernic (Leclerc, Coop Italia and Delhaize) in early 2016.

Fig. 16: The Alidis international alliance, the leading European purchasing group

Source: Les Mousquetaires

Retailers have many ways to pressure suppliers: delisting threats, longer payment periods, increased shelf costs, etc.

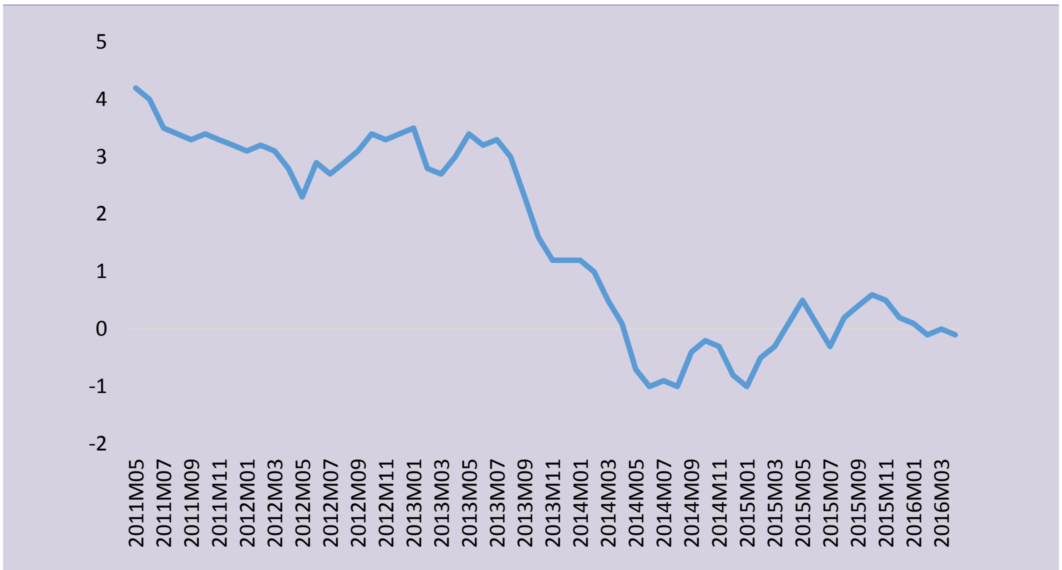
Given this concentration, the negotiating conditions with retailers have become tougher. They have several ways of putting pressure on suppliers to obtain price decreases or guaranteed margins: **threats of delisting, longer payment periods, increased shelf costs (linked to the positioning of products on the shelves), increase in advertising expenses, etc. For retailers, commodity price weakness is another argument to justify their demands.** Of course, must-have brands and products which attract footfall benefit from greater negotiating power.

There is thus downwards pressure on retail prices in Europe. In France, of the €103bn of consumer goods sold last year, product promotions accounted for €3bn. The price differential between private labels and national brands is closing in the country. National brands are often the subject of promotional activity as they attract consumers.

3.1.3. A pricing growth of 1.9% in 2016

The decline in global commodity prices and the deflationary pressures in Europe (which are partly due to the power gained by large retailers) are causing weak food retail prices. **In the European Union, the inflation of these food retail prices lost 300bps since May 2011.**

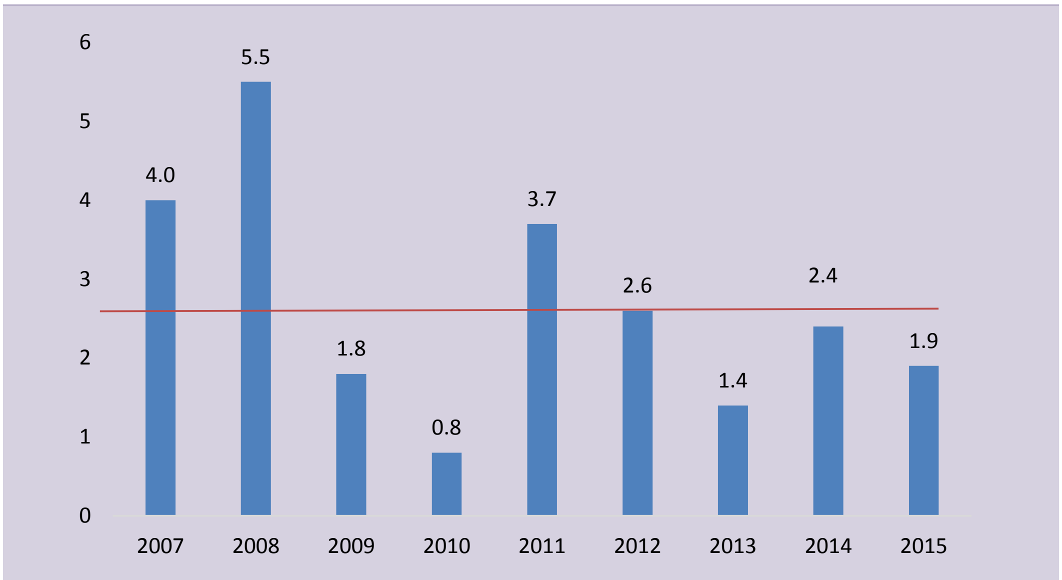
Fig. 17: Annual rate of change of food retail prices in the European Union



Source: Eurostat

The increase in food retail prices also decelerated in the United States. They were only up 1.9% in 2015 versus 2.4% in 2014 and an average of 2.6% over the last twenty years.

Fig. 18: Trend in food product prices (%) in the United States



Source: USDA

25% of Unilever's raw material costs are linked to oil

Unilever is mainly exposed to oil (derivatives), which represents 25% of its raw material costs. In 2015, the 47% fall in the price of oil was passed on in the retail prices of personal care and home care products (particularly in China and India), their packaging being produced from oil derivatives. **The company is also dependent on palm oil,** whose price is expected to decline by 1% next year. In total and excluding currency effects, the price of the group's raw materials should remain stable this year.

Fig. 19: Trend in the price of crude oil ($)

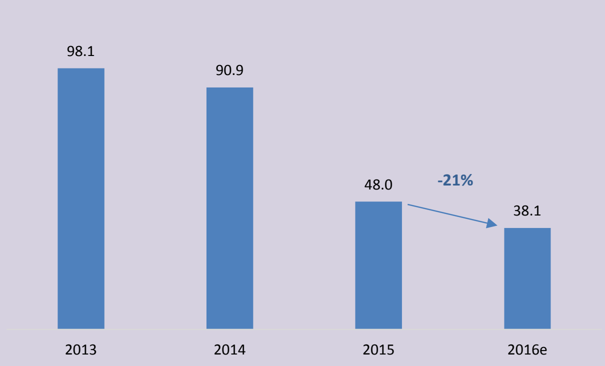
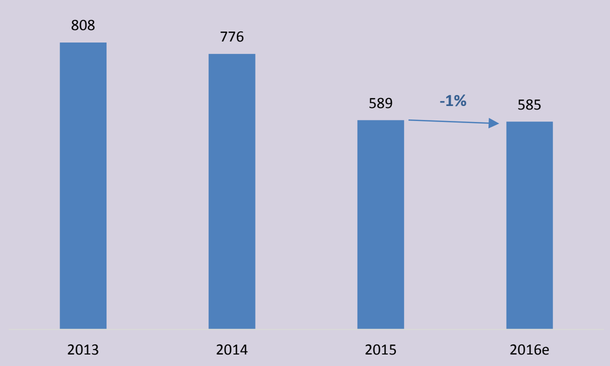


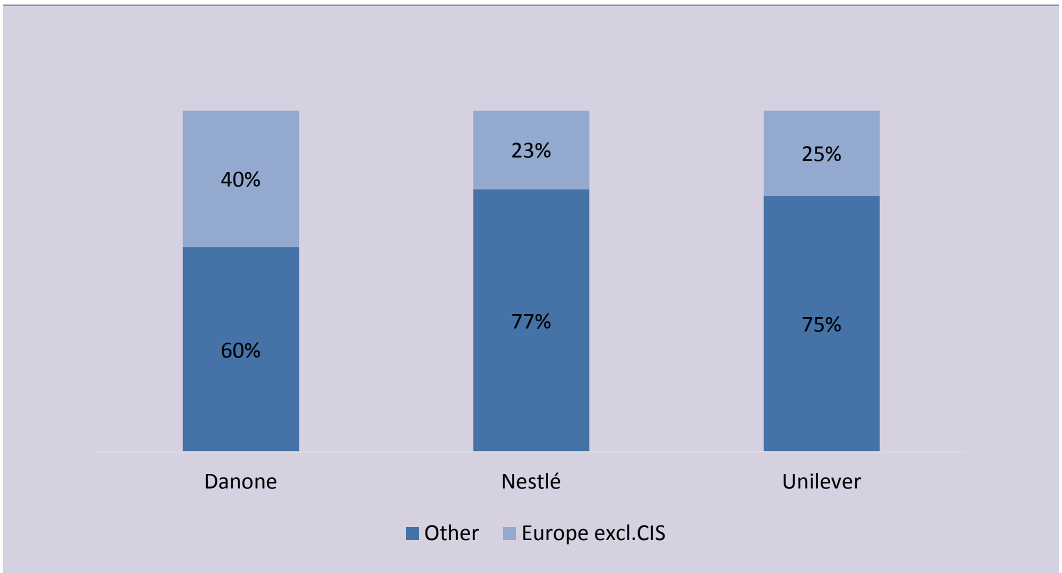
Fig. 20: Trend in the price of palm oil ($/mt)



Source: World Bank

The euro zone which is suffering from deflationary pressures represents 25% of the group's sales (Nestlé: 23% and Danone: 40%).

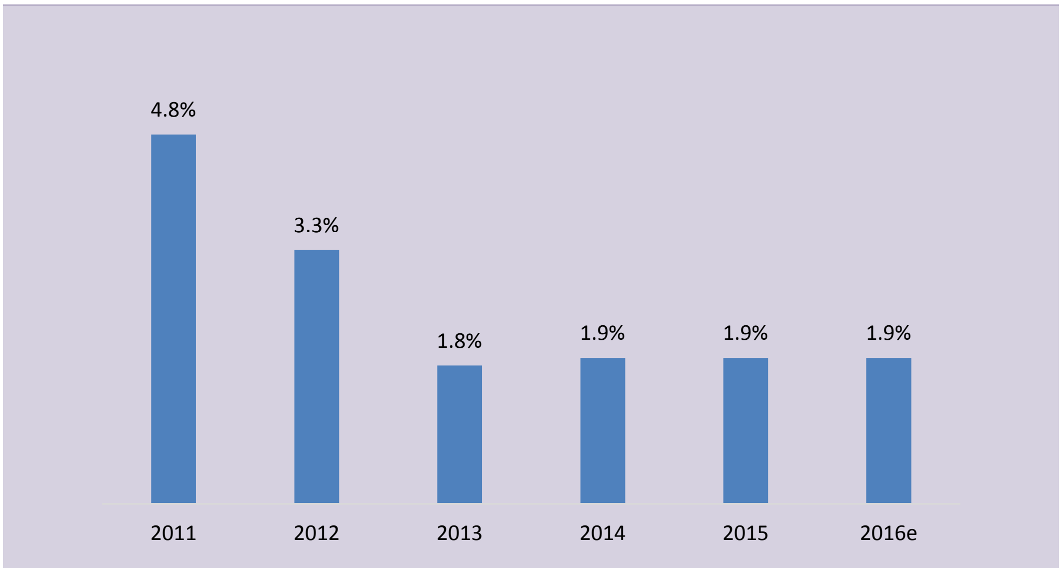
Fig. 21: Europe as a percentage of sales



Source: Companies, Bryan, Garnier & Co

We expect 1.9% pricing growth in 2016, in line with last year's performance and the indications given by Unilever. This is the result of deflation in Europe, price stability in North America and inflation short of historical levels in Asia/AMET/RUB. Prices in Latin America should continue to increase double digit.

Fig. 22: Pricing growth



Source: Unilever, Bryan, Garnier & Co

3.2. Pressure on volumes in the emerging countries

The economic slowdown and geopolitical problems in the emerging countries are negatively impacting the performance of food companies.

3.2.1. Emerging countries are facing numerous difficulties

The World Bank has revised down its growth forecast for the emerging countries in 2016

The macroeconomic environment remained gloomy in 2015, the deceleration in the emerging countries having more than offset a modest recovery in the developed countries. Global economic growth stood at 2.4% for the year, after +2.6% in 2014. **The emerging countries posted growth of 4.3% in 2015, i.e. the lowest level since 2010. For half of them, annual growth fell short of expectations,** the biggest disappointments coming from energy exporting countries (Angola, Nigeria, Colombia, Russia, Venezuela, etc.), and those in the grip of conflicts (Ukraine) or undergoing a tightening in monetary policy (Brazil). A low point does, however, appear to have been reached in 2015 in that the World Bank expects emerging country economic growth to accelerate to 4.8% in 2016. Even so, this is **60bps below its previous forecast.**

Fig. 23: Real economic growth rates and their revisions

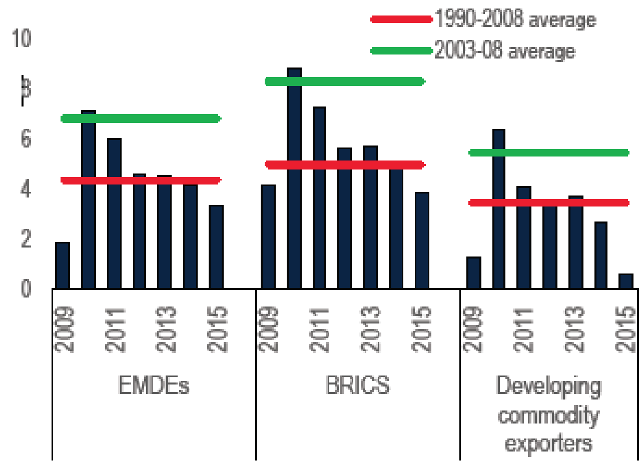
	2013	2014	2015e	2016f	2017f	2018f	(Percentage point difference from June 2015 projections) 2015e	2016f	2017f
World	**2.4**	**2.6**	**2.4**	**2.9**	**3.1**	**3.1**	**-0.4**	**-0.4**	**-0.1**
High income[2]	**1.2**	**1.7**	**1.6**	**2.1**	**2.1**	**2.1**	**-0.3**	**-0.2**	**-0.1**
United States	1.5	2.4	2.5	2.7	2.4	2.2	-0.2	-0.1	0.0
Euro Area	-0.2	0.9	1.5	1.7	1.7	1.6	0.0	-0.1	0.1
Japan	1.6	-0.1	0.8	1.3	0.9	1.3	-0.3	-0.4	-0.3
United Kingdom	2.2	2.9	2.4	2.4	2.2	2.1	-0.2	-0.2	0.0
Russia	1.3	0.6	-3.8	-0.7	1.3	1.5	-1.1	-1.4	-1.2
Developing countries[2]	**5.3**	**4.9**	**4.3**	**4.8**	**5.3**	**5.3**	**-0.4**	**-0.6**	**-0.2**
East Asia and Pacific	7.1	6.8	6.4	6.3	6.2	6.2	-0.3	-0.4	-0.4
China	7.7	7.3	6.9	6.7	6.5	6.5	-0.2	-0.3	-0.4
Indonesia	5.6	5.0	4.7	5.3	5.5	5.5	0.0	-0.2	0.0
Thailand	2.8	0.9	2.5	2.0	2.4	2.7	-1.0	-2.0	-1.6
Europe and Central Asia[2]	3.9	2.3	2.1	3.0	3.5	3.5	0.3	-0.4	-0.2
Kazakhstan	6.0	4.4	0.9	1.1	3.3	3.4	-0.8	-1.8	-0.8
Turkey	4.2	2.9	4.2	3.5	3.5	3.4	1.2	-0.4	-0.2
Romania	3.5	2.8	3.6	3.9	4.1	4.0	0.6	0.7	0.6
Latin America and the Caribbean[2]	3.0	1.5	-0.7	0.1	2.3	2.5	-1.5	-2.3	-0.6
Brazil	3.0	0.1	-3.7	-2.5	1.4	1.5	-2.4	-3.6	-0.6
Mexico	1.4	2.3	2.5	2.8	3.0	3.2	-0.1	-0.4	-0.5
Colombia	4.9	4.6	3.1	3.0	3.3	3.5	-0.4	-0.9	-0.9
Middle East and North Africa	0.6	2.5	2.5	5.1	5.8	5.1	0.1	1.4	2.0
Egypt, Arab Rep.[3]	2.1	2.2	4.2	3.8	4.4	4.8	0.0	-0.7	-0.4
Iran, Islamic Rep.	-1.9	4.3	1.9	5.8	6.7	6.0	0.9	3.8	4.7
Algeria	2.8	3.8	2.8	3.9	4.0	3.8	0.2	0.0	0.0
South Asia	6.2	6.8	7.0	7.3	7.5	7.5	-0.1	0.0	0.0
India[3]	6.9	7.3	7.3	7.8	7.9	7.9	-0.2	-0.1	-0.1
Pakistan[3,4]	4.4	4.7	5.5	5.5	5.4	5.4	-0.5	1.8	0.9
Bangladesh[3]	6.1	6.5	6.5	6.7	6.8	6.8	0.2	0.0	0.1
Sub-Saharan Africa[2]	4.9	4.6	3.4	4.2	4.7	4.7	-0.8	-0.3	-0.3
South Africa	2.2	1.5	1.3	1.4	1.6	1.6	-0.7	-0.7	-0.8
Nigeria	5.4	6.3	3.3	4.6	5.3	5.3	-1.2	-0.4	-0.2
Angola	6.8	3.9	3.0	3.3	3.8	3.8	-1.5	-0.6	-1.3

Source: World Bank

The factors responsible for the emerging slowdown remain intact

This performance nonetheless remains very markedly below historic levels in that the factors responsible for the slowdown in recent years continue to prevail: low commodity prices, weak global trade, low productivity growth and currency volatility…The high level of liabilities denominated in dollars also presents a risk to these economies as any further increases in US interest rates could have devastating consequences.

Fig. 24: Economic growth for the emerging countries below its historic levels



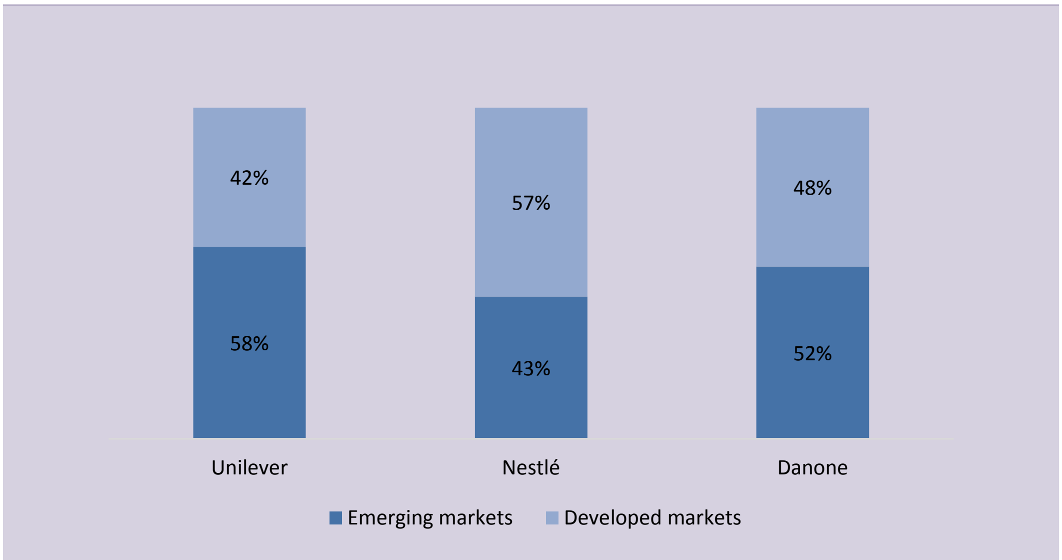
Source: World Bank

3.2.2. Volumes up 2.1% in 2016

The emerging markets represent 58% of Unilever's sales, a higher proportion than for Nestlé (43%) and Danone (52%).

Unilever has the highest exposure, generating 58% of its sales in emerging markets

Fig. 25: Weight of emerging markets (as % of group's sales)



Source: Companies, Bryan, Garnier & Co

However, only 22% of Unilever's emerging country sales are generated in risky markets, namely Brazil, China and Russia (Nestlé: 30%; Danone: 35%).

Fig. 26: Exposure to Brazil/China/Russia (% of group's sales)

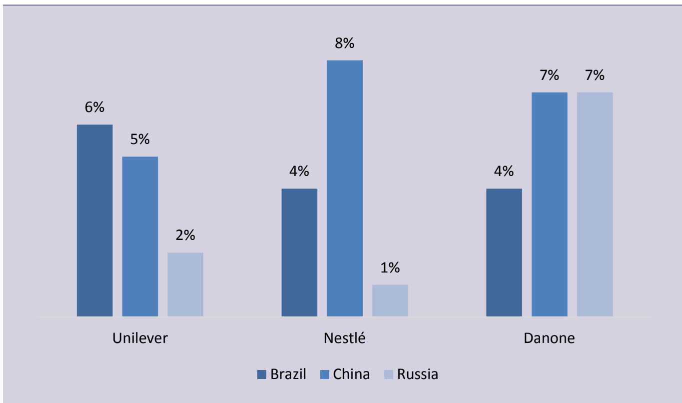
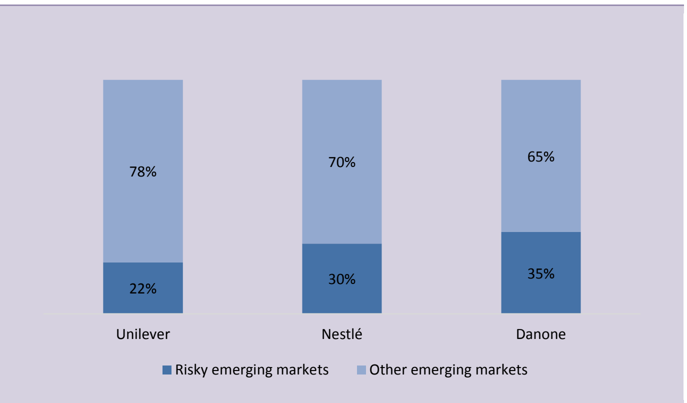


Fig. 27: Exposure to risky emerging markets (% of group's sales in emerging countries)

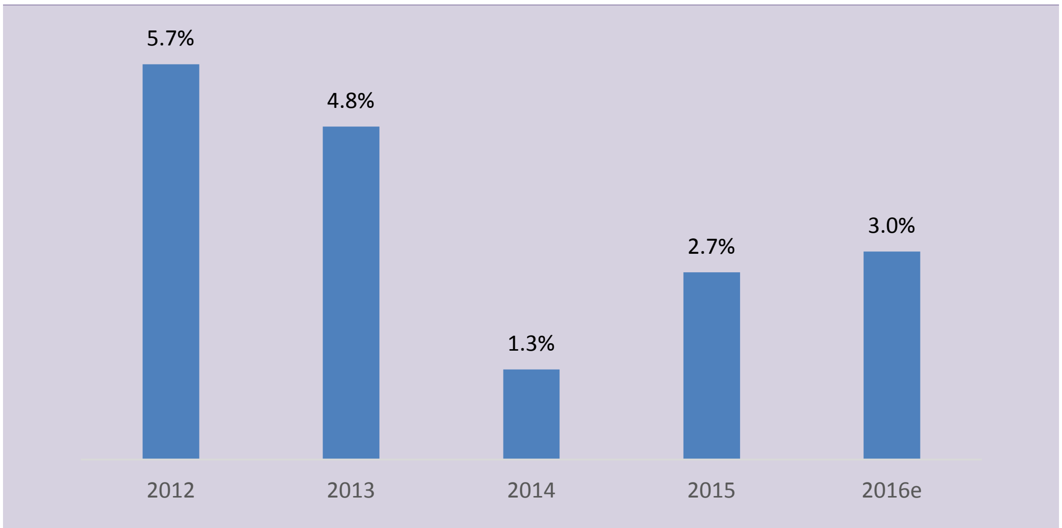


Source: Companies, Bryan, Garnier & Co

While the group's performance in emerging markets remains below historic levels, it compares favourably with that of its peers

Unilever's volumes in the emerging markets rose by 2.7% in 2015, i.e. an improvement relative to 2014 which had been impacted by destocking in China (volumes up by just 1.3%). This performance remains well below historic levels but compares favourably with those of its peers (P&G, Colgate, Mondelez, etc.). The group's market shares are proving very resilient. Its US competitors are having to contend with ever-more unfavourable currency effects and, as a result, are increasing their prices even more significantly. **Unilever's volumes in the emerging countries should slightly improve to +3% in 2016.**

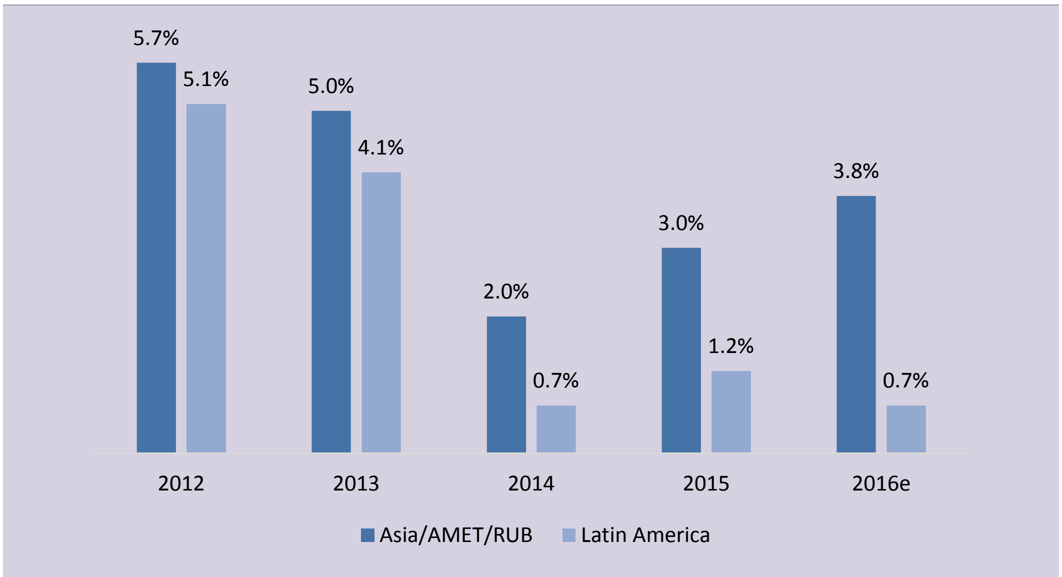
Fig. 28: Change in the group's volumes in the emerging countries



Source: Unilever, Bryan, Garnier & Co

Latin America and Asia/AMET/RUB should post respective volume growth of 0.7% and 3.8% over the year.

Fig. 29: Change in group's volumes in Latin America and Asia/AMET/RUB



Source: Unilever, Bryan, Garnier & Co

At the level of the group, we expect volumes to increase by 2.1% in 2016, i.e. a similar performance to last year.

Fig. 30: Change in volumes at the group level

Source: Unilever, Bryan, Garnier & Co

3.3. 23% of Unilever sales are exposed

Our last sector note aimed to estimate the risky percentage of Danone and Nestlé sales in the light of recent food industry trends. We have analysed the Unilever portfolio in the same manner.

The food industry is the focus of much attention, first and foremost from politicians who are prioritising the fight against obesity and speaking out against food insecurity in the face of multiple sanitary scandals. **Regulations are proliferating:** taxes on calorific products, stricter standards on product labeling, advertising, etc. **Put simply, the environment is less favourable for big companies. In parallel, some sociological developments are putting them under pressure:** the growth in e-commerce and e-advertising, increased consumption outside the home and, especially, the emergence of the Milennial generation. **At the opposite, newly-created brands are proving very dynamic.** They have been able to take advantage of new technologies to become known and benefit from lower distribution costs. Their smaller size enables them to adapt more easily to the new regulations. More importantly, they offer products which respond to consumer desires that big companies have not been able to satisfy.

Big companies are reformulating their products: reduction in portion sizes, decrease in salt, sugar and saturated fatty acids and, inversely, addition of healthy ingredients (vitamins, minerals, etc.). This approach has its disadvantages: additional costs, technical obstacles and, especially, possible rejection by consumers disappointed with the taste or concerned about the ingredients used as substitutes. **An alternative solution for big groups is to acquire a small brand (e.g. purchase of Annie's by General Mills in September 2014)**, thereby reinforcing their innovation capability and efficiency, enhancing their reputation, etc. This strategy is, however, not without risk: loss of customer confidence, retaliatory measures on the part of large retailers, etc. Furthermore, these acquisitions are too small to make a difference.

Danone generates only 16% of sales in risky categories, which is to say negatively impacted by the food industry trends as outlined above. This concerns yoghurts sold in Europe (excluding CIS countries). **Nestlé has higher exposure. We estimate that 25% of its portfolio is at risk,** corresponding to the sales in developed countries of frozen and chilled products, cooking aids, liquid and powdered beverages, confectionary and ice-cream.

Fig. 31: 16% of the Danone portfolio is at risk

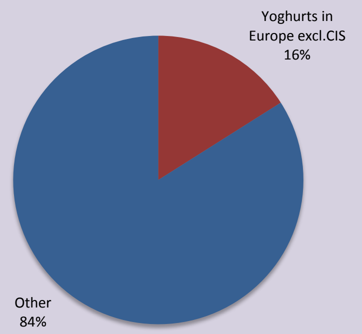
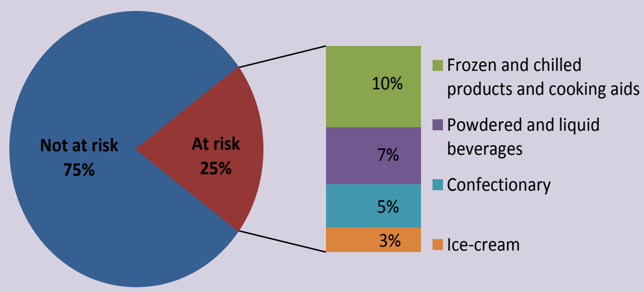


Fig. 32: This percentage stands at 25% for Nestlé



Source: Companies, Bryan, Garnier & Co

We estimate that 23% of Unilever's sales (the totality in the developed countries) is at risk given the recent food industry trends. This breaks down as follows:

- **Ice-creams: 8%**

Ice-cream manufacturers are experiencing a structural decline in volumes in the developed countries. This is the result of changes in consumer tastes, the latter prioritising small formats and healthier alternatives like frozen yoghurts and artisanal ice-creams. The competition has thus considerably increased, particularly from small brands. Nevertheless, Unilever is proving resilient, particularly in Western Europe where the group is successful in the premium segment with Magnum, Carte D'Or and Ben & Jerry's.

- **Tea: 2%**

The category is a good fit with the latest consumer trends (healthy, packed with antioxidants). But Unilever suffers from overexposure to the mainstream black tea segment, which represents 80% of its tea sales. Growth of the category is driven by premium green and fruit teas.

- **Savoury: 6%**

The first group's brand is Knorr which is sold worldwide. This category is experiencing a shift in consumer taste towards healthier food.

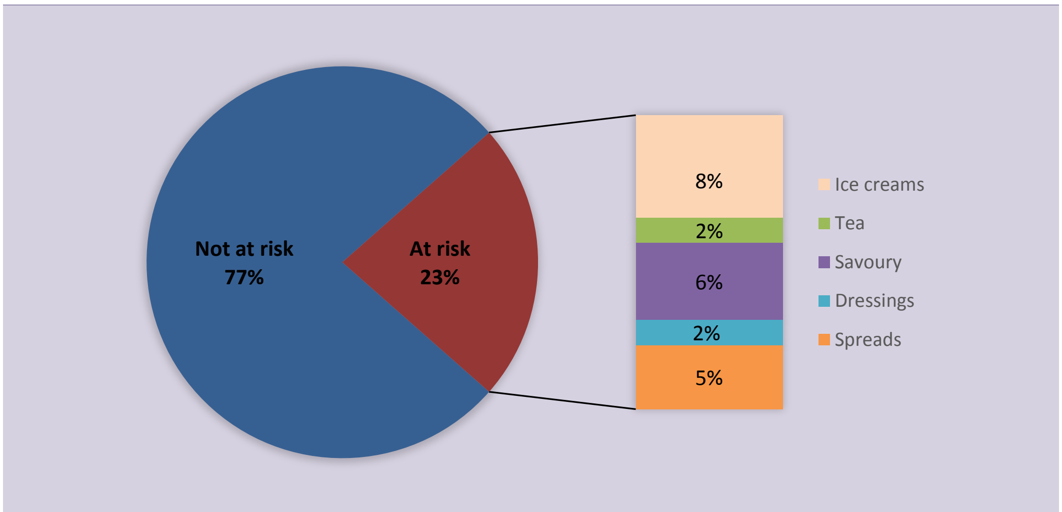
- **Dressings: 2%**

The Unilever portfolio principally comprises mayonnaise and mustard, two difficult categories given the recent consumer trends.

- **Spreads: 5%**

We will develop further the difficulties this category is experiencing in the developed countries.

Fig. 33: 23% of the Unilever portfolio is at risk



Source: Unilever, Bryan, Garnier & Co

3.4. Organic sales growth to be modest in 2016

We expect organic sales growth of 4% for Unilever in 2016. This is the result of the pressures on volumes in the emerging markets and the weak pricing environment (low commodity prices and deflation in Europe). The first half should benefit from a favourable comparison base. **This performance over the year is expected to be broadly similar to those of its peers (Danone: +4% and Nestlé +4.7%) and within the guidance range provided by the company (3%-5%).** The group reported an underlying growth of 4%, implying an outperformance vs a market up 2.5%. Maintaining this outperformance is one of Unilever's objectives for 2016.

In 2015, the group posted organic sales growth of 4.1%, very slightly above its annual guidance (2%/4%). The trend improved in the second half thanks to the basis of comparison (destocking in China in H2 2014), particularly favourable summer conditions and an inflation acceleration in Latin America.

The current underlying growth is +4%

Fig. 34: Group's organic sales growth

Source: Unilever, Bryan, Garnier & Co

The lack of acceleration in organic sales growth in 2016 goes with FX headwinds. We forecast a negative impact of 5% over the year, in line with the group's guidance (-5%/6%). The details by category and region are presented below:

Fig. 35: Sales by category

EURm	2015	2016e	2017e	2018e
GROUP				
Sales	**53 272**	**52 966**	**55 431**	**58 309**
% reported	10.0%	-0.6%	4.7%	5.2%
% FX	5.9%	-5.0%	0.0%	0.0%
% acquisitions/disposals	-0.1%	0.6%	0.0%	0.0%
% organic	**4.1%**	**4.0%**	**4.7%**	**5.2%**
Underlying volume/mix growth	*2.1%*	*2.1%*	*2.6%*	*2.8%*
Underlying pricing growth	*1.9%*	*1.9%*	*2.1%*	*2.4%*
PERSONAL CARE				
Sales	**20 074**	**20 262**	**21 425**	**22 754**
% reported	13.2%	0.9%	5.7%	6.2%
% organic	**4.1%**	**5.2%**	**5.7%**	**6.2%**
Underlying volume/mix growth	*2.3%*	*2.9%*	*3.2%*	*3.5%*
Underlying pricing growth	*1.8%*	*2.3%*	*2.5%*	*2.7%*
FOODS				
Sales	**12 919**	**12 704**	**12 894**	**13 087**
% reported	4.5%	-1.7%	1.5%	1.5%
% organic	**1.5%**	**1.5%**	**1.5%**	**1.5%**
Underlying volume/mix growth	*0.8%*	*0.8%*	*1.0%*	*1.0%*
Underlying pricing growth	*0.8%*	*0.8%*	*0.5%*	*0.5%*
HOME CARE				
Sales	**10 159**	**10 054**	**10 747**	**11 564**
% reported	10.9%	-1.0%	6.9%	7.6%
% organic	**5.9%**	**5.5%**	**6.9%**	**7.6%**
Underlying volume/mix growth	*4.0%*	*3.2%*	*4.1%*	*4.3%*
Underlying pricing growth	*1.9%*	*2.3%*	*2.8%*	*3.3%*
REFRESHMENT				
Sales	**10 120**	**9 947**	**10 365**	**10 904**
% reported	10.3%	-1.7%	4.2%	5.2%
% organic	**5.4%**	**3.2%**	**4.2%**	**5.2%**
Underlying volume/mix growth	*1.5%*	*1.2%*	*1.8%*	*2.2%*
Underlying pricing growth	*3.9%*	*2.0%*	*2.4%*	*3.0%*

Source: Unilever, Bryan, Garnier & Co

Fig. 36:

Fig. 37: Organic sales growth by region

	2015	2016e	2017e	2018e
ASIA/AMET/RUB				
% organic	**4.5%**	**4.4%**	**5.2%**	**5.7%**
Underlying volume/mix growth	3.0%	3.8%	3.6%	3.4%
Underlying pricing growth	1.5%	0.7%	1.6%	2.3%
THE AMERICAS				
% organic	**6.6%**	**6.4%**	**7.2%**	**7.7%**
Underlying volume/mix growth	0.4%	0.8%	2.2%	3.2%
Underlying pricing growth	6.1%	5.6%	5.0%	4.5%
EUROPE				
% organic	**0.4%**	**0.4%**	**0.6%**	**0.8%**
Underlying volume/mix growth	2.6%	1.2%	1.3%	1.4%
Underlying pricing growth	-2.2%	-0.8%	-0.7%	-0.6%

Source: Unilever, Bryan, Garnier & Co

4. Unilever, a margin story

Although Unilever's organic sales growth remains modest, there is substantial room for margin improvement. The group is working on **improving the mix** of its Home Care and Refreshment divisions (4.1). It also has a number of programmes in place which should enable it to achieve **cost savings (4.2).**

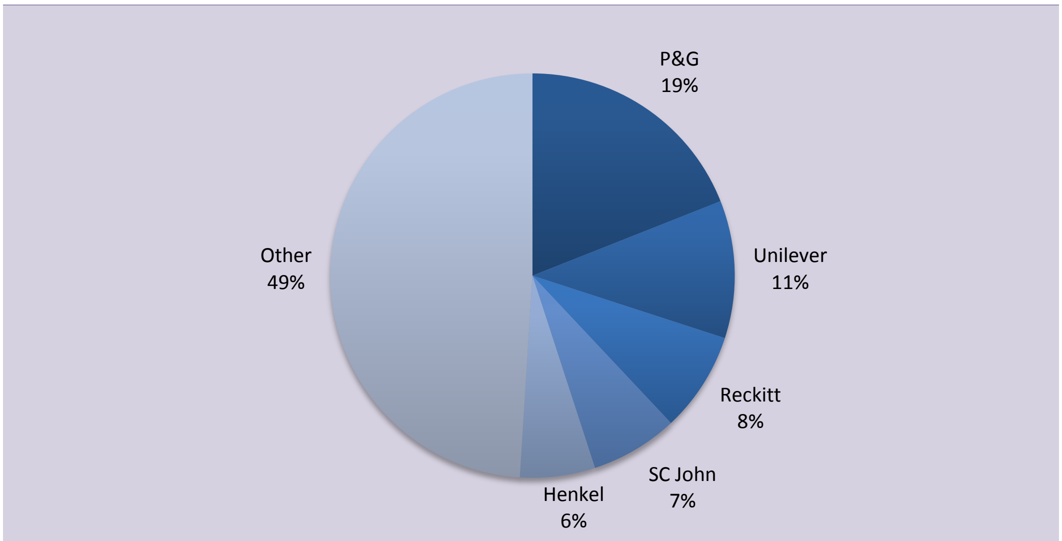
4.1. An improvement in the mix

Unilever's efforts directed at improving the mix primarily involve the Home Care and Refreshment divisions, each accounting for 19% of the group's sales.

The Home Care operating margin stood at 7.6% in 2015, a level well below that of its peers, with Henkel at 17% and P&G at 18%. Although some of this underperformance is explained by Unilever's over-exposure to *mainstream* products in the emerging markets (these countries representing 80% of the division's sales), this remains suprising given the Unilever market share in these segments, reaching 11% at global level (Laundry Care: 16%, Dishwashing products: 10%).

The group is aiming to double the margin on Home Care products

Fig. 38: Global market shares in Home Care products



Source: Euromonitor

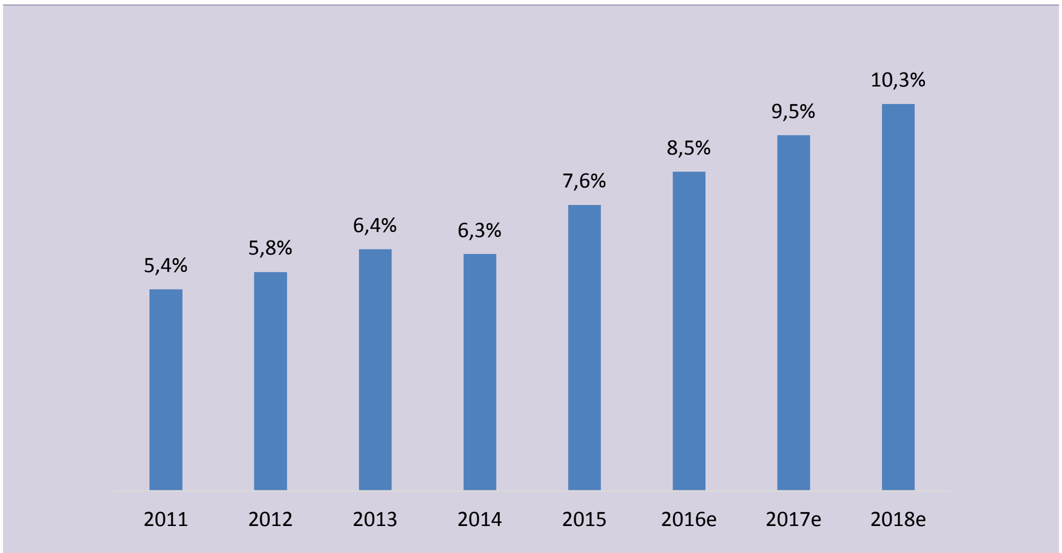
Unilever has said that it is aiming to double the operating margin of Home Care. For a number of years, the successes recorded by the group have been few but 2015 marked something of a turning point with a 130bp increase in margin thanks to the reduction in the number of references and an improving mix. **This improvement in mix should enable a further increase in profitability over the next three years (in 2016e, +90bps to 8.5%):**

Surf Sensations

Source: Unilever

- The company has multipled innovations like super-concentrated formulas and doses of detergent giving an enhanced feeling of freshness, enabling **margin accretion**.
- It has embarked on a **move up-market on some of the existing brands** like the Comfort Intense fabric conditioners or Surf detergent (Surf Sensations).
- Lastly, it is looking to **increase the proportion of higher-margin products like fabric conditioners and liquid detergents** in its portfolio

Fig. 39: Home Care product margins



Source: Unilever, Bryan, Garnier & Co

Ben&Jerry's Cookie Dough 'Wich

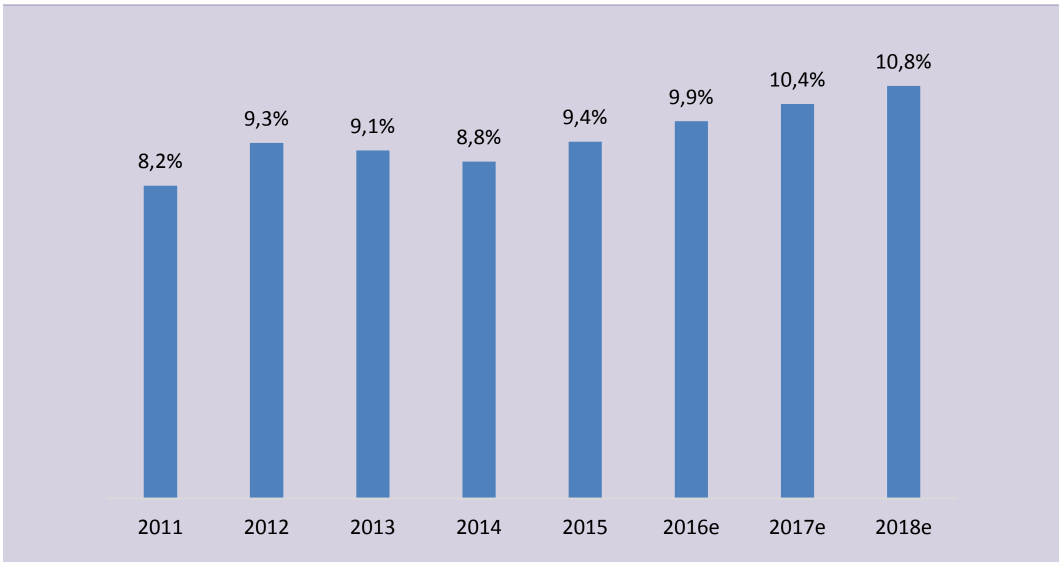
Source: Unilever

Unilever is also looking to increase the operating margin of the Refreshment division, two-thirds of whose sales are ice-creams and one third tea. The company is the leader in the two categories. In total, its world-wide market share in ice-creams is 23% versus 11% for the number two Nestlé. In tea, its worldwide market share is 12% whereas Tata, the number two, has only 3%. In 2015, Refreshments posted an operating margin of 9.4% and thus continued to be dilutive for the group. We estimate the margin of Ice Cream was below 10% while the margin of tea was slightly higher. To remedy this situation, Unilever **has launched a move up-market.**

- **Ice-creams**. The company has reinforced its already-strong portfolio of premium brands (Ben & Jerry's, Magnum and Carte d'Or) with the acquisitions of Talenti (2014) and Grom (2015). There have also been numerous innovations like, for example, the Pink & Black Magnums (new flavours) and Ben & Jerry's Cookie Dough 'Wich (ice-cream sandwiches).
- **Tea**. Unilever wants to correct its overexposure to *mainstream* black tea (80% of sales). To this end, it has extended the Lipton range to green and black speciality teas which are more premium and has developed ready-to-drink teas (Pure Leaf brand). It has also launched capsules with the Lipton TO machine (40 cents a capsule) and invested in new distribution networks with the acquisition of Australian tea retailer T2 (75 stores currently) in 2013.

The company should intensify its upgrading efforts over the next three years. We thus forecast a 50bp progression in the Refreshment operating margin to 9.9% in 2016.

Fig. 40: Refreshment margin



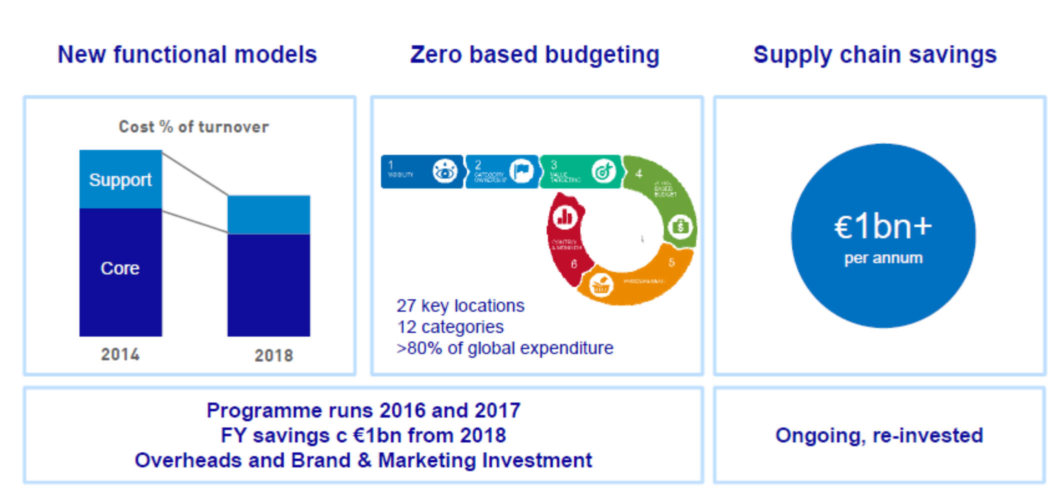
Source: Unilever, Bryan, Garnier & Co

4.2. Substantial cost savings

Two new programmes in 2016:
- New Functional Models
- Zero Based Budgeting

Every year, Unilever realises EUR1bn of supply chain savings, enabling it to offset the rise in raw material prices. In 2016, two new cost-saving programmes will be rolled out: the New Functional Models and Zero Based Budgeting.

Fig. 41: The group's different programmes



Source: Unilever

4.2.1. New Functional Models

The group's overall organisation remains unchanged with four categories and eight clusters. The programme has several objectives:

- Faster roll-out of the marketing programmes and new technologies at global level
- More attuned to local consumer needs
- A simpler, more agile structure: fewer layers, clearer accountabilities, accelerated decision-making process, etc.

The New Functional Models programme implies a reduction in staff costs

Fig. 42: Aims of the New Functional Models

Source: Unilever

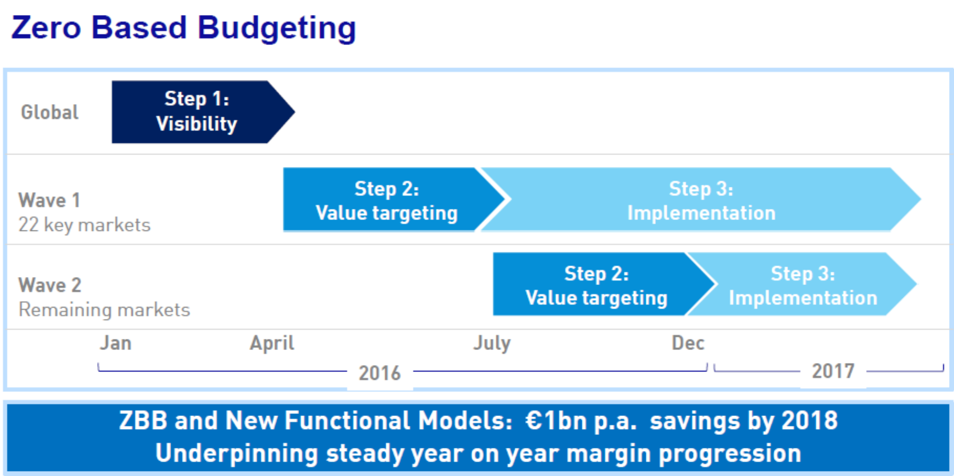
Concretely, this should enable a **reduction in costs, and particularly staff costs**. Peter Van Kulve, who previously headed up South East Asia, is responsible for this programme which **should be rolled out as of H2 2016.**

4.2.2. Zero Based Budgeting

During its Investor Seminar in December 2015, Unilever announced that it would be implementing a Zero Based Budgeting programme from 2016. The principle is different from that of other cost-savings programmes in that it is looking to reduce overheads in absolute terms without benchmarking the competition and other industry norms. **Each department begins the year with a zero budget and must justify every item of expenditure by the expected return.** The programme should be rolled out in several steps:

- The first was completed at the end of April. It consisted of obtaining better visibility on what had been spent and by whom, and appointing managers for each of the 18 pre-defined cost segments.
- An amount of savings was set with each of the 18 managers during the second step which is being rolled out between May and July.
- During the third step, there will be regular reporting to ensure the savings are achieved.

Fig. 43: The steps of Zero Based Budgeting



Source: Unilever

In total, the two programmes should generate EUR1bn of savings by 2018

In our view, Unilever satisfies the conditions required for the success of a ZBB programme:

- A flexible corporate culture (several cost-saving programmes have already been realised)
- Belonging to a mature industry whose growth does not require substantial investment
- The existence of barriers to entry. Unilever has an extensive distribution network, particularly in emerging markets like Indonesia, India and Brazil.

Unilever has indicated that the **New Functional Models and ZBB programmes will deliver at least EUR1bn of savings by 2018.** We expect half these savings to come from the New Functional Models and the other half from ZBB. Whereas the first programme primarily concerns staff costs, the second is more focused on overheads and marketing expenses. These savings, which will be partially reinvested, should have a positive impact on the operating margin as of H2 2016.

4.3. A 40bp increase in operating margin in 2016

The improvement in mix and cost-saving programmes should enable an increase in operating margin of 40bps in 2016 and 2017

Our forecasts show a strong progression in the gross margin over the next two years (+80bps in 2016 and +70bps in 2017) given the improvement in the Home Care and Refreshment divisions' mix but also weak raw material prices. In 2016, the latter are expected to be stable in dollars but increase by 3% to 5% in local currencies in view of the currency devaluations in Russia, Brazil, South Africa and Indonesia. In particular, Unilever is benefiting from the lower oil price which reduces its Home Care and Personal Care divisions' input costs.

This increase in gross margin coupled with the reduction in overheads coming from the New Functional Models and Zero Based Budgeting programmes should enable a 40bp increase in the operating margin in 2016 and 2017, above last year's performance and in the high end of the company's model (+30/40bps). On publication of its Q1 sales, the management said that the difference between the first and second halves is unlikely to be significant.

Fig. 44: Operating margin by region

	2015	2016e	2017e	2018e
ASIA/AMET/RUB				
Margin	13.5%	13.9%	14.3%	14.8%
Variation in bps	30	40	40	40
THE AMERICAS				
Margin	14.6%	14.9%	15.2%	15.4%
Variation in bps	-10	30	30	30
EUROPE				
Margin	17.1%	17.5%	18.1%	18.5%
Variation in bps	90	50	50	50

Source: Unilever, Bryan. Garnier & Co

Fig. 45: Operating profit by category

EURm	2015	2016e	2017e	2018e
GROUP				
EBIT	**7 865**	**8 056**	**8 668**	**9 355**
% reported	12.0%	2.4%	7.6%	7.9%
Margin	**14.8%**	**15.2%**	**15.6%**	**16.0%**
Variation in bps	30	40	40	40
PERSONAL CARE				
EBIT	**3 788**	**3 881**	**4 172**	**4 506**
% reported	13.9%	2.5%	7.5%	8.0%
Margin	**18.9%**	**19.2%**	**19.5%**	**19.8%**
Variation in bps	10	28	32	33
FOODS				
EBIT	**2 354**	**2 332**	**2 401**	**2 474**
% reported	2.1%	-1.0%	3.0%	3.0%
Margin	**18.2%**	**18.4%**	**18.6%**	**18.9%**
Variation in bps	-40	13	27	28
HOME CARE				
EBIT	**775**	**857**	**1 019**	**1 193**
% reported	33.9%	10.5%	19.0%	17.0%
Margin	**7.6%**	**8.5%**	**9.5%**	**10.3%**
Variation in bps	130	89	96	83
REFRESHMENT				
EBIT	**948**	**987**	**1 075**	**1 183**
% reported	16.9%	4.1%	9.0%	10.0%
Margin	**9.4%**	**9.9%**	**10.4%**	**10.8%**
Variation in bps	50	55	46	47

Source: Unilever. Bryan. Garnier & Co

5. An impending change in profile

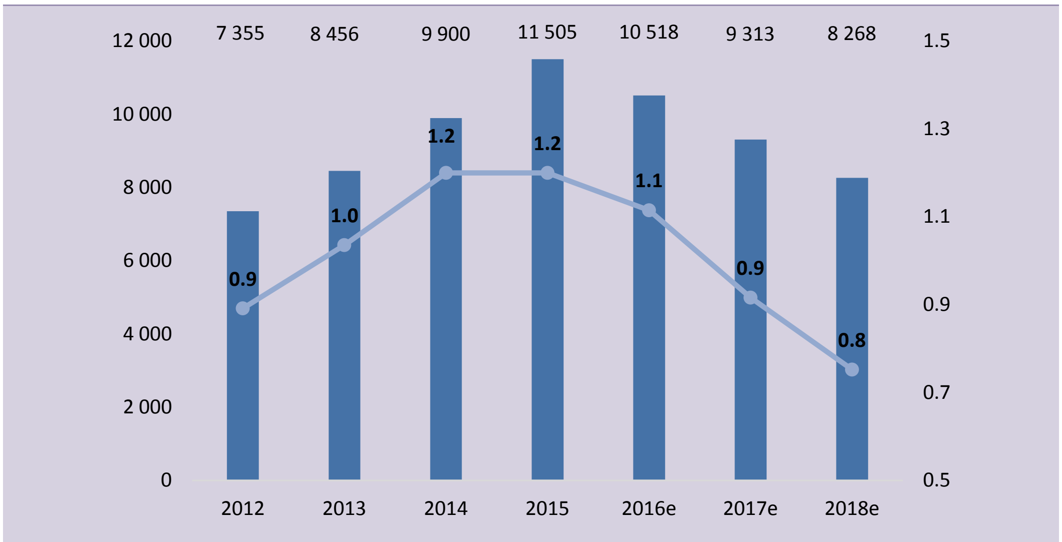
Its very healthy financial position should enable the group to undertake acquisitions and achieve its informal goal of generating 70% of sales in HPC in 2020. Were these acquisitions not to materialise then returns to shareholders are potentially on the cards. Furthermore, it is worthwhile noting that any sale of the spreads business would have only a limited impact on EPS but would be accretive to the group's organic sales growth.

5.1. A very healthy financial position

In 2016, Unilever's net debt should amount to EUR10.5bn, implying a net debt/EBITDA ratio of 1.1x (1.2x in 2015).

A net debt/EBITDA ratio of 1.1x in 2016e

Fig. 46: Net debt/EBITDA ratio



Source: Unilever, Bryan, Garnier & Co

Assuming that the group prefers not to exceed a net debt/EBITDA ratio of 2.5x (the level required to maintain its A+ credit rating), we calculate that it has a potential war chest of **EUR13.1bn in 2016e and EUR16.1bn in 2017e.** Were it to accept a net debt/EBITDA ratio of 3.0x (a level reached in 2001 following the acquisition of Bestfoods), EUR17.8bn would be available in 2016e and EUR21.2bn in 2017e.

EUR13.1bn is available in 2016 with a net debt/EBITDA ratio of <2.5x

Fig. 47: Debt capacity

	2016e	2017e	2018e
Net debt/EBITDA ratio	1.1x	0.9x	0.8x
		2.5x	
Debt capacity	**13,064**	**16,100**	**19,201**
Total net debt	23,582	25,413	27,469
		3.0x	
Debt capacity	17,781	21,182	24,695
Total net debt	28,299	30,495	32,963

Source: Unilever, Bryan, Garnier & Co

5.2. Acquisitions on the cards

Target for 2020: 70% of sales in HPC

Unilever has the resources to proceed with acquisitions. While no category can be ruled out, the company has shown a marked **preference for personal care products,** its (informal) objective being to reduce its exposure to foods and generate **70% of sales in Personal Care and Home Care products by 2020.** These categories currently contribute 57% of the group's sales against 49% in 2010. Unilever's growth potential is thus expected to increase. Between 2010 and 2015, the growth in Personal Care and Home Care products was more than twice that of Foods/Refreshments.

Fig. 48: Composition of the Unilever portfolio between Food and HPC

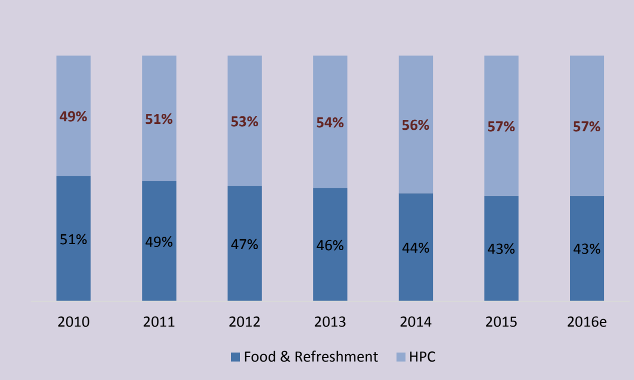
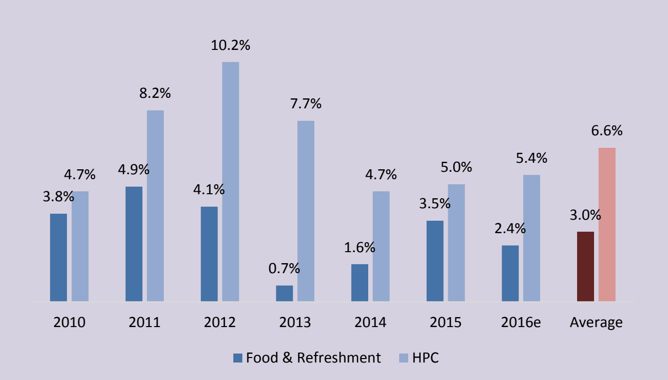


Fig. 49: Growth in the Food and HPC divisions



Source: Unilever, Bryan, Garnier & Co

Considering that Unilever has resources of EUR13,1bn in 2016 and EUR16,1bn in 2017 and assuming an acquisition valued at 15.5x EV/EBITDA, we calculate **EPS accretion of 3% in year one and 4% in year two.**

Fig. 50: EPS impact of an acquisition in 2016

EURm	Current		Pro forma
EBIT	8 056	817	8 873
Net interest	-463	-585	-1 048
Associates	110		110
Pre-tax	7 703	232	7 935
Taxation	-2 003	-61	-2 064
Minorities	-370		-370
Net income_group share	5 330		5 501
Number of shares	2 840		2 840
Basic EPS	**1.88**		**1.94**
Accretive impact			**3%**

Source: Unilever, Bryan, Garnier & Co

Fig. 51: EPS impact of an acquisition in 2017

EURm	Current		Pro forma
EBIT	8 056	1 012	9 068
Net interest	-463	-715	-1 178
Associates	110		110
Pre-tax	7 703	297	8 000
Taxation	-2 003	-78	-2 081
Minorities	-370		-370
Net income_group share	5 330		5 549
Number of shares	2 840		2 840
Basic EPS	**1.88**		**1.95**
Accretive impact			**4%**

Source: Unilever, Bryan, Garnier & Co

Colgate has been mooted as a target numerous times in recent years. The acquisition of the latter would help Unilever to achieve its goal of generating 70% of sales in personal care and home care products by 2020, thereby accelerating its transition from a food player to an HPC company. Its HPC sales would increase by 600bps to 63%.

Fig. 52: Composition of the Unilever portfolio, 2016e

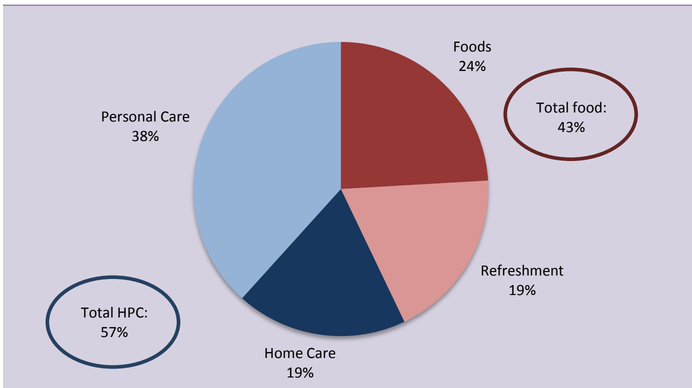
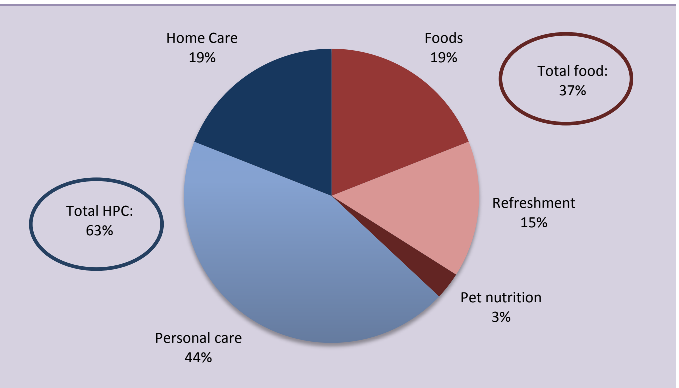


Fig. 53: Composition of the Unilever portfolio in the event of the acquisition of Colgate, 2016e



Source: Unilever, Colgate, Bryan, Garnier & Co

We don't believe in an acquisition of Colgate

We deem this acquisition to be extremely difficult to realise from a financial perspective. Assuming a 35% premium to current share price level, it would cost the company USD95 per share or USD85bn (EUR76bn). Net debt would thus reach a very high level of 6.5x, even taking into account synergies equivalent to 5% of sales. For the net debt/EBITDA ratio to fall to a more reasonable level of 3.2x, the group would have to issue shares on a one for two basis at a price of EUR32.7 (a 20% discount to current level).

This acquisition would also be highly complex. It would effectively require the disposal of a portion of the two companies for anti-trust reasons. We consider it very unlikely that Unilever will launch such a transaction while a number of efforts need to be made internally, particularly in terms of improving the performance of margarines or rolling-out the ZBB.

Fig. 54: Impact of the acquisition of Colgate on the net debt/EBITDA ratio, 2016e

EURm	**100% debt**	**1 for 2 rights issue**
Net debt _ Unilever	10,518	10,518
Net debt _ Colgate	5,023	5,023
Debt issued for Colgate	76,347	29,899
Total net debt	**91,888**	**45,440**
Equity issue		**46,448**
EBITDA_Unilever	9,433	9,433
EBITDA_Colgate	4,739	4,739
Total EBITDA	**14,171**	**14,171**
Net debt/EBITDA (x)	**6.5**	**3.2**

Source: Companies, Bryan, Garnier & Co

Acquisitions totaling EUR400m of sales over one year would add 45bps to the group's organic growth

In our view, tactical transactions are more likely. Within the personal care category, prestige brands remain Unilever's preferred target. The group is aiming to generate EUR1bn of sales in the segment by 2020 versus EUR400m (including Nexxus) currently. As a comparison, L'Oréal generates more than EUR4bn in prestige brands (in its Luxury and Active Cosmetics division). Unilever has already realised four acquisitions in the segment in 2015, namely Kate Somerville, Murad, Dermalogica and REN. **The aim is to gradually correct its overexposure to the mass market segment** whose growth rate is 3% versus 6% for prestige brands, and whose margins are inferior. **Tactical transactions would be enough to enhance the group's growth profile, were they to be frequent.** If they total EUR400m of sales over one year, they would add 45bps to the group's organic growth.

5.3. Return to shareholders

Were no acquisitions to materialise, numerous options might be envisaged such as share buybacks. Assuming a EUR16.1bn programme (i.e. maximum debt capacity in 2017e), half to be realised in 2016 and the other half in 2017, at an average share price of EUR40.9 (spot), **we calculate diluted EPS accretion of 3.6% in 2016 and 11.6% in 2017. In our view, Unilever should nonetheless priortise an increase in dividend, the yield already exceeding 3%.** We estimate an 8% increase over the next three years.

Fig. 55: Simulation of a share buyback programme in 2016-2017

	2016e	2017e	2016e	2017e	2016e	2017e
Amount (EURm)	10 000		16 100		20 000	
Number of repurchased shares (in millions)	245		394		489	
New diluted EPS	1.91	2.17	1.93	2.26	1.95	2.33
Accretive impact	**2.2%**	**6.9%**	**3.6%**	**11.6%**	**4.5%**	**14.8%**

Source: Unilever, Bryan, Garnier & Co

5.4. Limited impact from a disposal of spreads

The downturn in margarines reached 5% in 2015

The Foods division (24% of the group's sales and 29% of operating profit) mainly comprises savoury products (45% of divisional sales), **dressings** (18%) and **spreads** (30%). In 2015, savoury products (flagship brand: Knorr) saw organic growth of 5% thanks to emerging countries and a number of intelligent innovations focused on the naturalness of the products. The dressings performance was also satisfactory, the growth of the Hellman's brand having reached 7% over the year. However, **spread sales were again down (-5%), penalising the whole division,** the latter posting organic growth of just 1.5% in 2015, well below the level of the Group (+4.1%). Unilever nonetheless continues to gain market share in the spreads segment.

Fig. 56: Breakdown in Food sales in 2015

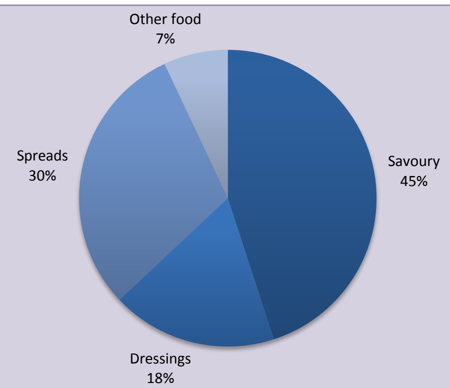
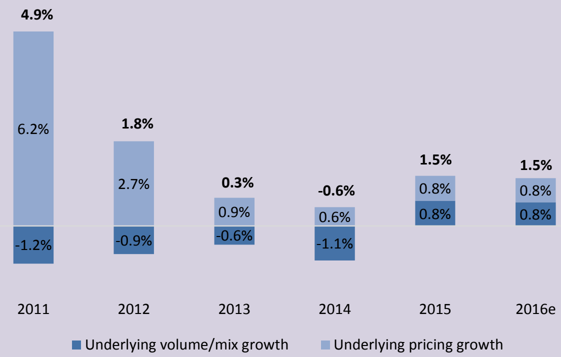


Fig. 57: Organic sales growth of Food



Source: Unilever, Bryan, Garnier & Co

Spread sales in the developed countries fell by 7% in 2015

Spreads in developed countries (5% of total sales) constitute the main problem, with organic sales down 7% last year. The group registered slight positive organic sales growth in emerging markets.

Fig. 58: Breakdown of spread sales between developed and emerging countries, 2015

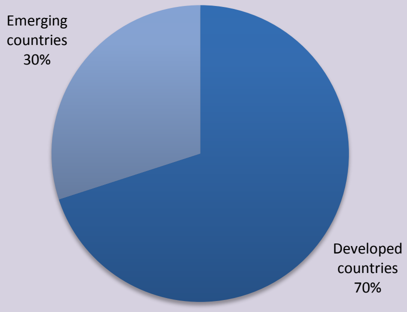
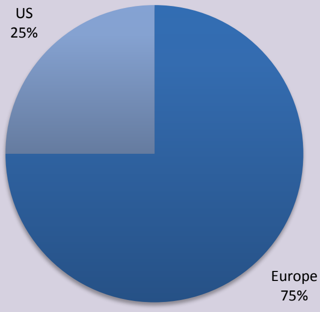


Fig. 59: Geographical breakdown of spread sales in developed countries, 2015



Source: Unilever, Bryan, Garnier & Co

The segment is suffering from a change in consumer tastes, the latter prioritising natural foods over those presented as healthy but industrial. Unlike butter, margarine comes from a factory. The **decline in bread consumption** has constituted an aggravating factor as has the **substantial reduction in the price of butter between 2014 and 2015** which led to a substitution effect.

The group is multiplying initiatives to halt the decline in volumes. It is innovating by creating melanges (butter and margarine) and products for use in cooking (a growing segment), or by changing the texture (liquid margarine). It is also trying to reactivate the pro-active brand (contributing to a reduction in cholesterol) which is currently in decline after several years of very strong growth. Lastly, it is changing the marketing content by emphasising the naturalness of its products.

2016 is key: were the decline in volumes to be similar to that of 2015, the group will consider other options such as a disposal. On 1 July 2015, Unilever set up a separate unit for the European and US activities (The Baking, Cooking & Spreads Unit), something that would facilitate this type of transaction. Unilever's efforts to improve the margarines performance could be helped by a rebound in the price of butter. We expect substitution to take place and margarine volumes to show signs of an improvement as of a 5% increase. The fact is that the Q1 2016 did not see a turning point, the group having reported a 5% fall in total spread sales (developed and emerging countries).

If the group were to use the disposal proceeds to buy back its shares, the EPS dilution would be only 2%

In our view, a disposal is likely. We do not put into question Unilever's efforts but given the market dynamics we are not all that confident of an improvement in spread volumes. In the event of a disposal, the group is likely to want to hold on to the margarine activities in emerging countries where the growth profile is better and which have not been included in the BCS unit. We expect margarine sales in developed countries to decline by 7% in 2016 to EUR2,477m and their EBIT margin to be 20% (above the divisional margin of 18%) and we apply a multiple of 9.8x (25% discount relative to the average multiples for Danone and Nestlé). **We thus derive an enterprise value of EUR4,975m.**

Organic sales growth would automatically increase by 35bps

The operating deleverage should be limited since the BCS unit has its own distribution network and central functions. We calculate a dilutive impact of 5% on EPS if the proceeds are used to pay back debt. **However, the group is likely to use the proceeds to buy back its shares and the dilution would then be 2%. The benefit would be a 35bp uplift in organic growth, together with a greater focus on the other divisions.**

For the sake of convenience, the group may prefer to establish a joint-venture and, in this case, it could sell 51% of the share capital to a third party, deconsolidate the business (thereby increasing organic growth by 35bps) but retain a portion of the cash flows.

6. Neutre, Fair Value: EUR43

Unilever's 2016e P/E is 21.9x for average EPS growth of 6.5% over the next three years. This does not compare favourably with its peers (6.1). Half of our Fair Value of EUR43 is based on a DCF and half on a sum of the parts, implying limited share price upside of 5% (6.2).

6.1. Stock market performance and multiples-based valuation

The shares overperformed the DJ Stoxx by 1.5% over the last three months and by 15% in 2015.

Fig. 60: Performance relative to the DJ Stoxx in 2015

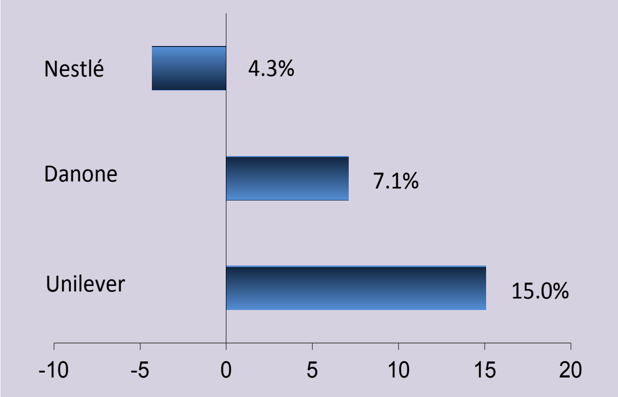
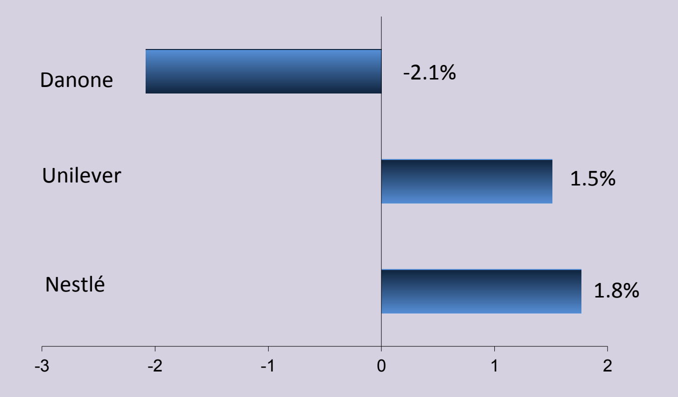


Fig. 61: Performance relative to the DJ Stoxx in the last three months



Source: Thomson Reuters

Unilever is trading at a significant premium relative to its historic average of the past ten years (21% in terms of EV/EBIT and 22% on P/E). Nestlé's premium is approaching 20% in terms of EV/EBIT and 18% on P/E. Danone is an exception (6% in terms of EV/EBIT and 10% on P/E).

Fig. 62: EV/EBIT over the last ten years

Unilever	Danone	Nestlé

Source: Thomson Reuters

Fig. 63: P/E over the last ten years

Unilever	Danone	Nestlé

Source: Thomson Reuters

Unilever's 2016e P/E stands at 21.9x vs 21.1x for Danone and 21.2x for Nestlé. Its EPS growth over the next three years reaches 6.5%, slightly below its peers (Danone: 7.1% and Nestlé: 7%).

Fig. 64: 2016e P/E

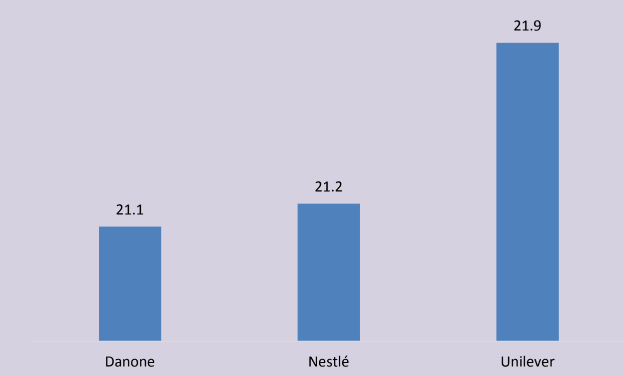
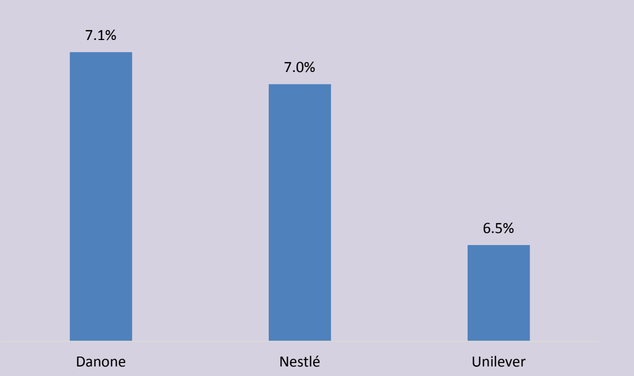


Fig. 65: Average EPS growth over the next three years



Source: Thomson Reuters

6.2. Valuation method

Half of our Fair Value of EUR43 is based on a DCF valuation and half on a sum of the parts, pointing to potential share price upside of 5%. The PLC Fair Value is 3,350p.

6.2.1. DCF: EUR43

Our DCF points to a Fair Value of EUR43 per share. In addition to our 2016-2018 estimates presented above, our assumptions are as follows:

- A WACC of 7.0% resulting from a 7.6% cost of equity with:
  - ✓ A risk-free rate of 1.6%
  - ✓ A market risk premium of 7%
  - ✓ A beta of 0.85
- A growth rate to perpetuity of 2% as of 2025
- An average recurring tax rate of 26%
- A growth rate of 5.6% in 2020 and a 10bp annual increase in the operating margin between 2020 and 2025.

Fig. 66: DCF (1/2)

EURm	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e
Sales	52,966	55,431	58 309	61,453	64,888	68,049	70,874	73,306	75,293	76,793
% change	-0.6%	4.7%	5.2%	5.4%	5.6%	4.9%	4.2%	3.4%	2.7%	2.0%
EBIT	8,056	8,668	9,355	9,921	10,540	11,122	11,654	12,128	12,532	12,858
EBIT margin	15.2%	15.6%	16.0%	16.1%	16.2%	16.3%	16.4%	16.5%	16.6%	16.7%
-Income taxes	-2,003	-2,175	-2,364	-2,496	-2,652	-2,798	-2,932	-3,051	-3,153	-3,235
+Depreciation	1,377	1,497	1,633	1,801	1,986	2,171	2,353	2,529	2,696	2,849
as % of sales	2.6%	2.7%	2.8%	2.9%	3.1%	3.2%	3.3%	3.5%	3.6%	3.7%
+Change in WC	-27	-262	-569	-615	-649	-680	-709	-733	-753	-768
as of sales	-0.1%	-0.5%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%	-1.0%
Operating cash flows	**7,403**	**7,728**	**8,054**	**8,611**	**9,225**	**9,814**	**10,366**	**10,872**	**11,321**	**11,704**
-Capex	-2,013	-2,106	-2,216	-2,323	-2,440	-2,545	-2,637	-2,712	-2,771	-2,811
as % of sales	-3.8%	-3.8%	-3.8%	-3.8%	-3.8%	-3.7%	-3.7%	-3.7%	-3.7%	-3.7%
Free cash flows	**5,391**	**5,622**	**5,838**	**6,288**	**6,785**	**7,269**	**7,730**	**8,160**	**8,550**	**8,893**
Discount coefficient	0.93	0.87	0.81	0.76	0.71	0.66	0.62	0.58	0.54	0.50
Discounted free cash flows	**5,031**	**4,897**	**4,747**	**4,771**	**4,805**	**4,805**	**4,769**	**4,698**	**4,595**	**4,461**

Source: Unilever, Bryan, Garnier & Co

Fig. 67: DCF (2/2)

Sum of discounted cash flows	47,580
+Terminal value	88,458
-Net debt	-11,505
-Pension	-1,569
-Minorities	-643
-Provisions	-1,140
+Financial assets	1,441
Equity value	**122,622**
Number of shares (m)	2,855
Fair Value (EUR)	**43**

Source: Unilever, Bryan, Garnier & Co

Fig. 68: Sensitivity analysis

		Growth rate				
		1.0%	1.5%	2.0%	2.5%	3.0%
	6.2%	46	50	54	60	68
	6.5%	43	46	50	55	61
	6.8%	40	43	46	51	56
WACC	7.1%	38	40	**43**	47	51
	7.4%	36	38	41	44	47
	7.7%	34	36	38	41	44
	8.0%	32	34	36	38	41

Source: Bryan, Garnier & Co

6.2.2. Sum of the parts: EUR44

We derive a Fair Value of EUR44 from our sum of the parts. The multiples for each of the group's divisions are calculated based on:

- Danone and Nestlé for Food and Refreshment
- Henkel, Reckitt and Procter & Gamble for Home Care
- L'Oréal and Beiersdorf for Personal Care

Fig. 69: Calculation of the multiples (x)

Food and refreshment	
Danone	12.0
Nestlé	13.4
Average	**13.0**
Home Care	
Henkel	12.0
Reckitt Benckiser	18.1
Procter & Gamble	14.3
Average	**14.8**
Personal Care	
L'Oréal	16.9
Beiersdorf	15.6
Average	**16.3**

Fig. 70: Sum of the parts valuation

EURm	Sales 2016e	EBIT 2016e	EBITDA 2016e	Multiple EV/EBITDA	EV
Personal Care	20,262	3,881	4,408	16.3	**71,849**
Home Care	10,054	857	1,118	14.8	**16,546**
Total Foods	22,650	3,318	3,907	13.0	**50,791**
Refreshment	*9,947*	*987*	*1,245*		
Foods	*12,704*	*2,332*	*2,662*		
TOTAL					**139,186**
Net debt					11,505
Funded schemes in deficit					1,569
Minorities					643
Provisions					1,140
Financial assets					1,441
Equity Value					**125,770**
Number of shares (m)					2,855
Fair Value					**44**

Source of all tables: Unilever, Bryan, Garnier & Co

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Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis. Momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

NEUTRAL Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

SELL Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56.2% NEUTRAL ratings 34% SELL ratings 9.7%

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