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GLOBAL IDEAS

31 January 2013

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Unilever — Cleaning up

Background
Unilever PLC is an Anglo-Dutch consumer goods company which manufactures branded and packaged consumer goods, including food, detergents, fragrances, home and personal care products. The company's portfolio of 400 brands, ranges from nutritionally balanced foods to ice creams, soaps and shampoos as well as everyday household care products. Some of the world-leading brands Unilever produces include Lipton, Knorr, Dove, Axe, Hellmann's and Omo. Unilever is the world's third-largest consumer goods company by revenue (after Nestle and Procter & Gamble) and currently 2bn consumers worldwide use a Unilever product on any given day.

The company was established 83 years ago out of the merger of Sunlight Soap and foods maker, Lever Brothers and Dutch group Margarine Unie. Its products are currently sold in 190 countries. Unilever is a dual-listed company consisting of Unilever N.V., based in Rotterdam (Netherlands), and Unilever PLC, its primary listing which is based in London (UK). Both Unilever PLC and Unilever N.V. have secondary listings on the New York Stock Exchange (NYSE). Currently its business segments are Personal Care, Food, Refreshment and Home Care. Unilever is trading at a 12M fwd P/E of 17.5x and a 12M fwd DY of 3.5%.

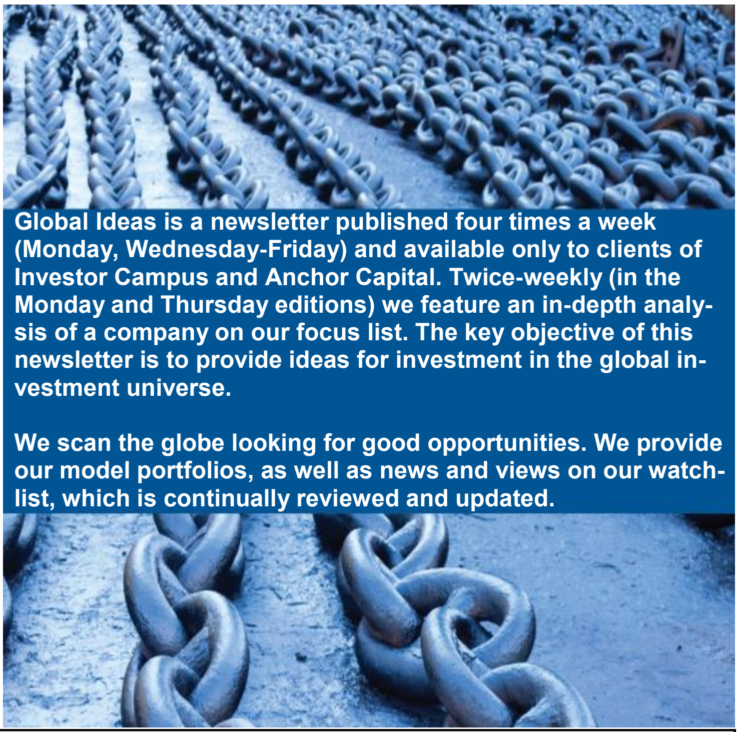
Unilever's metrics are as follows:

Spot (GBp)	2 566.00
Mkt Cap GBPmn	76 804
12M trailing P/E	18.88
12M fwd P/E	17.50
10-year average P/E	18.40
10-year average DY	3.70
FYE	31-Dec
P/Book Ratio	5.59
12M trailing DY	3.35
12M fwd DY	3.50

Source: Bloomberg, Anchor Capital

On 1 January 2009, Paul Polman succeeded Patrick Cescau as Chief Executive Officer of Unilever, joining the company from Nestlé. Since Polman took over at the beginning of 2009 the share price has increased by more than 58%. In 2010 Unilever unveiled its Sustainable Living Plan, which aims, over ten years, to double sales while at the same time reducing the environmental impact of its products and to give farmers and distributors in emerging markets (EMs) access to its supply chain.

Thus far the company has a consistent track record in terms of growth with a 9% CAGR over the past 20 years. Unilever has a 12M fwd DY of 3.5%, slightly above Procter & Gamble (PG) and Kimberly Clark's (KMB) 3.2% and 3.4%, respectively, but significantly above Colgate Palmolive's (CL) 2.5%. Compared with its peers, Unilever's share price (+9.4%) in 2012 outperformed Procter & Gamble (PG; +1.8%), but share price growth lagged Colgate Palmolive (CL; +13.2%) and Kimberly Clark (KMB; +14.8%). Unilever trades at a reasonable 12M fwd P/E of around 17.5x, compared with PG and CL's fwd P/Es of 17.6x and 21.7x, respectively. KMB's fwd P/E is the lowest at 15.0x.



Global Ideas is a newsletter published four times a week (Monday, Wednesday-Friday) and available only to clients of Investor Campus and Anchor Capital. Twice-weekly (in the Monday and Thursday editions) we feature an in-depth analysis of a company on our focus list. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watchlist, which is continually reviewed and updated.

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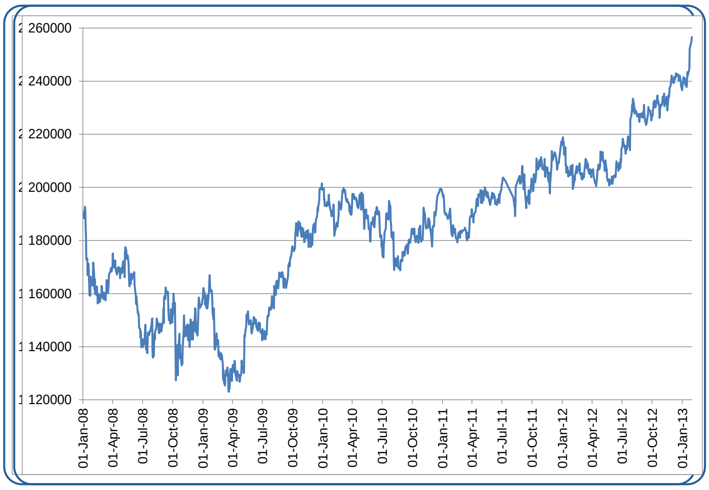
Unilever vs peers P/E and DY comparatives

Name	Price	12M fwd P/E	12M fwd DY	Mkt cap (mn)
Procter & Gamble	$75.08	17.6	3.2	$205092
Kimberly-Clark	$88.14	15.0	3.4	$34320
Unilever	**GBp2566**	**17.5**	**3.5**	**GBP76818**
Colgate Palmolive	$110.85	21.7	2.5	$52370

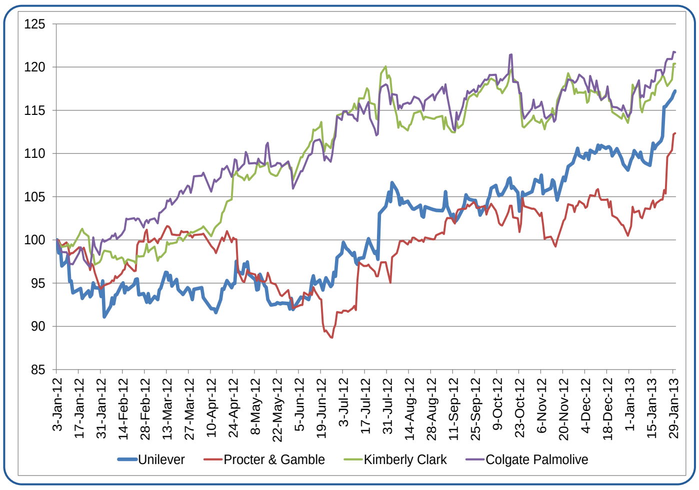
Source: *Bloomberg, Yahoo Finance, Anchor Capital*

Unilever share price performance (January 2008 to date, GBp)



Source: *TimBukOne, Anchor Capital*

Unilever vs peers share price performance (rebased to 100 at January 2012)



Source: *TimBukOne, Anchor Capital*

4Q12 results:

Unilever announced 4Q12 results in late January with the company posting solid top-line growth of 7.8% during the last quarter, driven in large degree by a strong 4.8% jump in sales volume. FY12 revenue increased 10.5% YoY to EUR51.3bn ($68bn) and net profit jumped 5.4% to EUR4.5bn. 4Q12 sales rose 8.6% to EUR12.6bn, ahead of market expectations. In terms of geography, EMs drove most of Unilever's 2012 growth and the final quarter was no exception as EMs clocked-up net growth in sales of 10.8%. Unilever's consistent performance in developing markets was also reflected in the overall 12-month sales from EMs, which was up 11.4% YoY. Developed markets (DMs) registered a net sales increase of 4% during 4Q12 compared with only 1.6% during the 12-month period – a key sign of a resurgence in demand for consumer products in countries such as the US. The results pushed Unilever's sales to over the EUR50bn mark, meaning it has gotten a quarter of the way toward the goal its Chief Executive Paul Polman set three years ago to double the company's sales to EUR80bn. Polman hasn't set a deadline for Unilever to hit the EUR80bn mark, but he said sales would need to increase 7% p.a. to double over roughly a decade. He believes 90% of the growth can be achieved without acquisitions. The GBp20.39/share quarterly dividend will be paid on 13 March, up from GBp18.79/share in 4Q11.

Following the release of its results Unilever share price gained 3% to close at GBp2,527.00, a record-high at that stage for the company. Since then the share price has reached new highs on a daily basis, closing at GBp2,566.00 on 30 January.

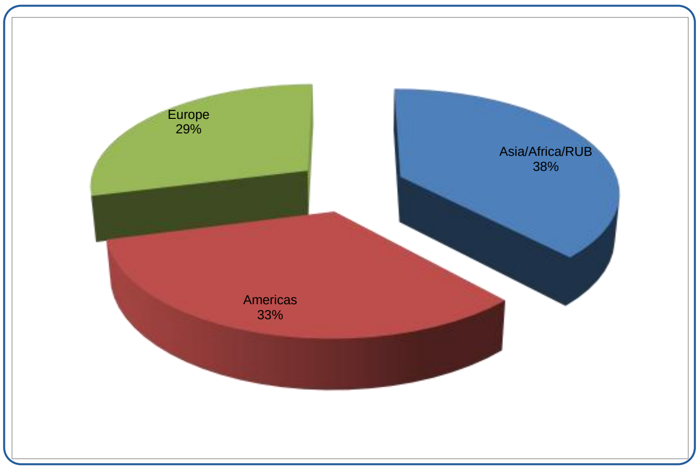
On a growth path…

The company's growth has been driven by innovation, white space expansion and most importantly its presence in EM economies. In terms of geography, EMs drove most of Unilever's growth in 2012 with both volumes and prices contributing equally and underlying the company's continued dominance in regions such as South Asia and South-East Asia. Due to the Unilever's long history of operating in EMs (such as India and Indonesia), the company has a large footprint in EMs, which now account for 55% of the group's total revenue, helping to offset the slowdowns in Europe and North America.

An example of the potential in EMs, according to market research firm *Euromonitor International,* the percentage of homes with washing machines in China is expected to increase from 73% in 2010 to 80% by 2015. This means the country will have an additional 41mn homes with washing machines, highlighting the sheer size of the opportunity in the Chinese market for a company like Unilever which produces washing detergents.

Overall the DMs in which Unilever trades were subdued, although the company's performance in the last quarter was much better than it was in previous quarters, Unilever's aggressive pricing and packaging strategy to displace more expensive competitors such as Procter & Gamble seemed to be picking up pace in North America and Western Europe considering the general economic weakness in these regions.

Unilever sales by region



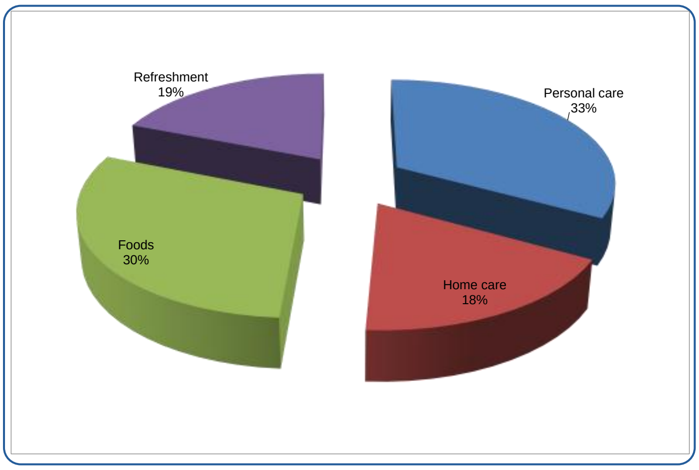
Source: *Company reports, Anchor Capital*

Divisions

Unilever has four divisions, Personal Care, Foods, Refreshment and Home Care. A significant difference in the performance of Unilever's two key divisions -- Personal Care and Foods is the result of demand in EMs pushing Personal Care products further, while flagging demand in DMs is bringing down net sales from the company's Foods division.

In terms of sales, Personal Care is the company's largest segment, generating a major portion of its revenue from EMs with strong growth in demand for products like shampoos and soaps. This helped this division register robust underlying sales growth of 11.8% in 4Q12, while for the 12 months sales growth also finished in the double-digits (10%), mostly driven by an increase in volume rather than price. This underlines the company's best-in-class sales and distribution channels even in remote EMs. However, the company's Foods division painted a less rosy picture, with an underlying decline in sales of 0.1% over the last quarter, primarily due to a major bulk of sales in this division coming from DMs where general economic malaise has led to slowing demand for these products.

Unilever sales by division



Source: Company reports, Anchor Capital

The performances of its other two divisions - Refreshment (iced teas and ice-creams) and Home Care (detergents and surface cleaners) - were also relatively robust, as underlying sales growth increased by 6.7% and 7.0%, respectively. This was due to the increased demand from EMs fulfilled through its deep sales channels and improved product portfolio.

The following are the reasons we like the share

- Despite Unilever's focus on beating its competitors on price in DMs and increasing the uptake of its products in the more price-sensitive EMs, the company's margins were steady over 2012 as its overall core operating margin increased 30 bpts. The company has noted that this shows its volume growth can be sustained despite pricing pressure.

- The fact that its presence in EMs can result in a volatile performance does not impact Unilever since the company is not reliant on a single EM for its growth. Unilever doesn't generate more than 6% of sales from any individual EM country. However, in total, EMs account for 55% of its sales.

- The company has paid dividends since 1937 and has raised them for 12 consecutive years.

- Fourteen of Unilever's brands (Magnum, Omo, Sunsilk, Floro, Knorr, Dove, Ola, Rama, Surf, Lux, Axe, Lipton, Hellmann's and Rexona) generate sales in excess of EUR1bn p.a. and account for over 50% of its growth.

- The company's ongoing programme of product launches, where it primarily takes existing Unilever goods and rolls these goods out into new markets has served it well. An example of this is Unilever's roll-out of its Tresemme shampoo brand in Brazil and India last year and the launch of its Magnum ice cream bars in the US (the world's biggest ice-cream market) in 2011 and in the Philippines in 2012.

- The company has a track record of successful product innovations for example its Knorr jelly bullion pot, which is manufactured specifically for making borsch soup in Russia, and its Dove shampoos and conditioners for damaged hair have attracted consumers.

- The streamlining of its huge corporate structure which began in 2005 under a programme called 'One Unilever' was completed in 2009 and resulted in a single company, board and head office for each country and EUR1bn of costs being driven out of the business. The company also moved to a single SAP system, transformed human resources, established a single supply-chain organisation and outsourced its transactional finance to IBM in North American and Europe and to Capgemini in South America, Asia and Africa. Although this programme was set in motion by his predecessor, Polman has been pushing this during his tenure and helping Unilever pare operating costs.

- Unilever has been faster at so-called 'reverse engineering' of its products (i.e. making products affordable to poorer customers by starting with the price the customer can pay and then calculating how to deliver such a product profitably), which has paid dividends for the company.

- Digital spend – The company boosted its digital advertising expenditure by c. 40% in 2012 (by EUR470mn to EUR6.5bn), reflecting the company's growing emphasis on using online touchpoints to reach consumers.

- Despite sluggishness in Unilever's food business and its European region, the company's overall performance remains impressive.

We see the following as possible challenges for the company:

- Unilever's spreads business (including the Flora margarine brand and others), is more exposed to the sluggish DMs and is also the biggest drag on the group's growth, with the foods business growing by a comparatively weak 1.8% in 2012. The company has also indicated it believes in 2013 those markets in which it operates will continue to be difficult and competition will remain intense with consumers still impacted by the effects of austerity measures.

- High commodity cost inflation (Brent crude chart – past year);

- On the back of the eurozone crisis and austerity measures, DMs were more subdued in 2012 and it looks likely this situation will continue. Unilever's full-year sales grew only 0.8% in Europe and the company's operating margin was down 90 bpts (it should be noted though that this was against a strong prior year).

Conclusion:

Unilever is beating rivals as well as a lacklustre economic backdrop by focusing on the personal and home care segments, which are aligned more to the high-growth regions (Latin America and Asia) and which grew c. 10% in 2012. Overall the company's exposure to high-growth EMs has also served it well. Despite its relatively high valuation, we think Unilever's investment potential is in early days yet, looking at the company's EMs exposure and sustained margin expansion. EMs, which make up c. 55% of the company's turnover, grew 11.4%. Unilever's rivals have been slower to move into these fast-growth regions and because of this Unilever's performance has been in distinct contrast to the lacklustre performance of its main rival, Procter & Gamble (currently in the middle of a $10bn restructuring exercise) which has also lost market share to Unilever.

Although Unilever did not give a specific outlook at its results for 2013, it repeated its mantra of focusing on growing ahead of its markets, on the back of steady core operating margin improvement and strong cash flow.

Marco de Matos

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