Overview

- UL has over 400 well known brands including Cif, Knorr, Hellmann's, Lifebuoy, AXE, and Dove to name a few
- Over 13 of their brands generate over 1B euros
- The company has three segments
- Beauty & Personal care, Food & Refreshment, and Home Care
- Unilever's portfolio spans from multiple household and personal product categories as well as good and to a lesser extent, beverages, a

Financials

- Revenues have been flat
- Earnings and free cash flow have had some growth given margin improvements
- Strong gross profit margin
- Below our threshold of 20% operating margin
- Net margin and FCF margin are above our threshold
- The company passes our ROE only because of the significant amount of treasury stock
- The company has been issuing debt
- Per share numbers are growing faster than real numbers due to buybacks

Management

- The company cannot be run by a fool
- Management has been moving their assets and brands around. Management has been focused on having faster growing and more profitable segments reducing their exposure in frozen foods and increasing exposure in health and beauty products
- This is good but it requires lots of capital allocation
- Management has made some questionable moves like Dollar Shave club, and Johnson
- The 2017 approach from Kraft Heinz that sparked management into life indicates that Unilever was operating with inefficiencies in its cost base for too long, and that management had not been sufficiently focused on the financial performance of the business
- Dividends have been the main principle of returning capital to shareholders, and Unilever has delivered slightly above industry average
- Share repurchases have contributed to per share growth and capital return to shareholders
- However, mergers and acquisitions is the company's higher priority, particularly in beauty and personal care categories
- Although Unilever has been highly acquisitive in recent years, it has financed a substantial portion of its purchases through asset sales
- The firm's spending on acquisitions and net of disposals has been under 4B EUR since 2010, less than 7% of free cash flow over the same period
- Unilever has made some questionable acquisitions like the $3.7B Alberto Culver deal, which was executed at a fairly high multiple of 15 times EBITDA. The $1B acquisition of Dollar Shave Club, which was not profitable as a stand-alone entity, was also a rich multiple.
- And the pharmaceutical deal

Cons

- Not growing much
- Expect to grow with GDP
- Stable business

- Heavily impacted by inflation
- Asset heavy
- The law of large numbers is unfavorable for the large consumer companies, moving the needle on Unilever's $50B top line in a low-growth environment is challenging, especially as growth is largely being driven by niche, local, and artisanal brands
- Unilever has struggled to adapt its business mode, with management recently admitting that in its strategy to give more product development autonomy to regional management, the company had lost focus on scalable innovation

Pros

- Strategies to streamline the cost structure include 5S, which is focused on supply chain and gross margin efficiencies; zero-based budgeting, which has replaced budgets and spending targets with operational KPIs and focuses on marketing spending and overheads
- Delivered 15% reduction in middle and senior management
- 2B EUR in annual cost savings, half will be reinvested into the business in 2021 and 2022 and ROIC in the mid to high teens, higher than recent history

Moat

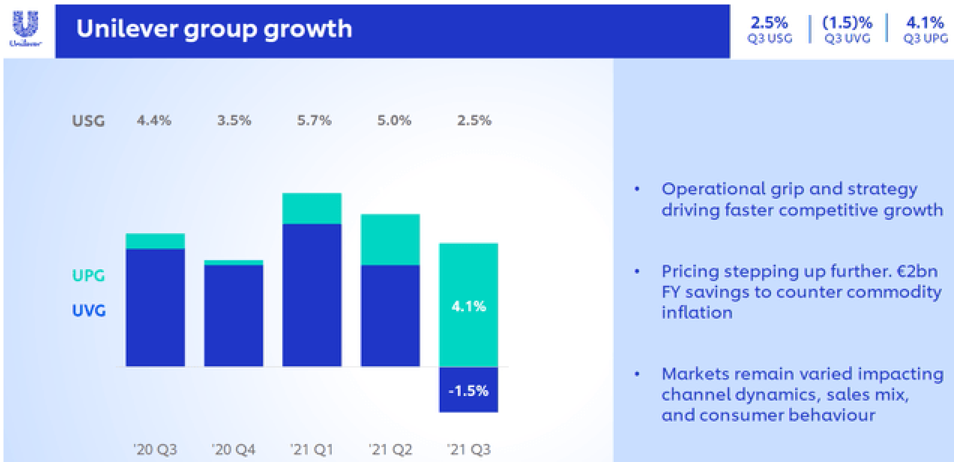
- Wide economic moat from two sources
- Entrenchment in the supply chain of retailers an intangible asset and a cost advantage

Earnings

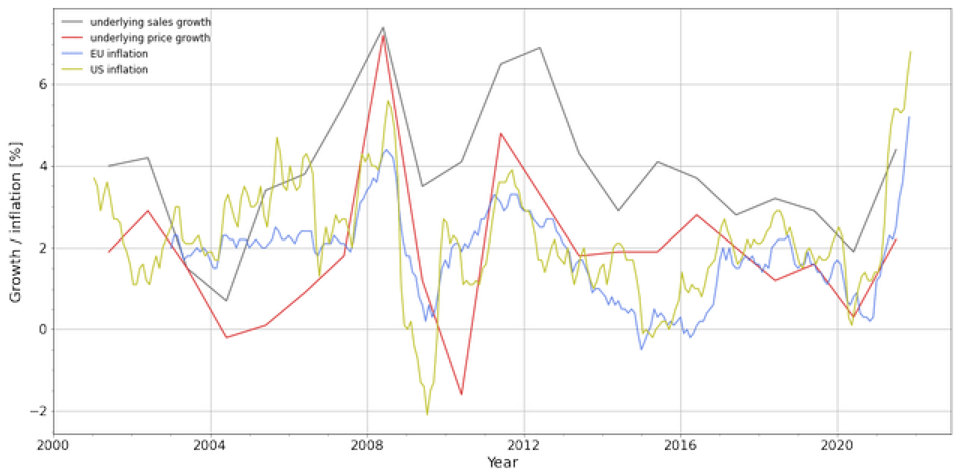
- Q4
- Began raising prices to offset inflation
- Management has warned that further cost pressures to come
- Expecting lower margins for 2022
- Morningstar stated that the guidance that cost pressures will not ease until 2024, which has increased the risk to their valuation
- To recover inflation must abate, however, price increase in commodities may be somewhat sticky
- In Q4 sales grew by 4.9% YOY and full-year by 4.5% fastest growth in almost a decade, but the 3.2% underlying sales growth on a two-year average basis is more reflective
- Morningstar continues to estimate a consistent 3.4% sales growth

Inflation Hedge - https://seekingalpha.com/article/4479632-unilever-caution-reflected-in-lagging-returns

- To combat inflationary pressures UL raised prices in Q3 by 4.1% to maintain underlying sales growth

- 

- The question is if UL can further raise prices?
- As we can see prices rose by 4.1% while volumes declined by -1.5%



- The graph shows Unilever has historically showered strong underlying pricing growth in times of elevated inflation. For example, in 2008 when inflation exceeded 4% in both the US and EU, underlying sales growth was fully driven by pricing growth
- In 2011, when inflation reached 3%-4% again pricing drive sales growth
- The other way around, the company lowered prices in 2010 to boost sales growth by expanding volumes
- Although UL has shown to have pricing power, what stops customers from choosing another brand? Nothing really. So if UL decides to raise prices to much there are substitutes. As we have seen recently UL raised prices by 4.1% and volumes dropped by 1.5%. Inflation is around 7%, so in reality they are still down.

The company did very little buybacks during 2021 although the stock is being undervalued. Instead of trying to acquire businesses the company should have repurchased back its stock.

Risk Factors
Private label
20%-25% of Unilver's cost of goods sold is linked to energy prices, and this could rise if economic growth re-accelerates.

ESG risks, consumer pushback against unrecyclable packaging and natural resources such as palm oil are some of the biggest risk. Have stats of how many tons of virgin plastic UL uses.

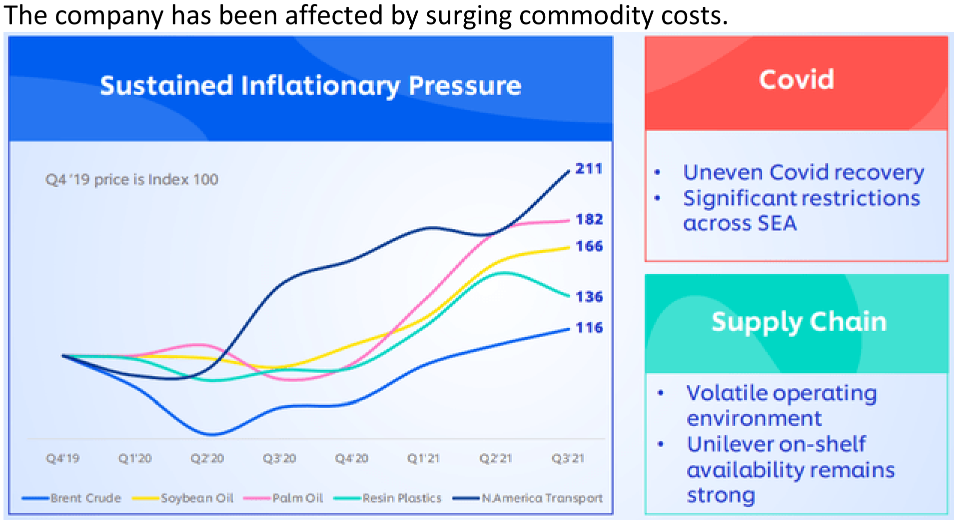
Mergers and acquisitions will be a key strategic pillar for UL. There is a risk that UL can overpay for acquisitions. UL has historically sold and purchased many brands. They try to take advantage of changing consumer tastes and their scale. However, a fool cannot run this company.

The company is in a highly competitive industry. There are no switching when it comes to purchasing a consumer staple product. Where UL has an edge is the retailer relationships, scale, and consistency of product. Consistency of product is not a competitive advantage in the US since most products we buy from Walmart, HEB... are high quality, but when you go to other countries like Mexico you will probably want to buy trusted products like UL.

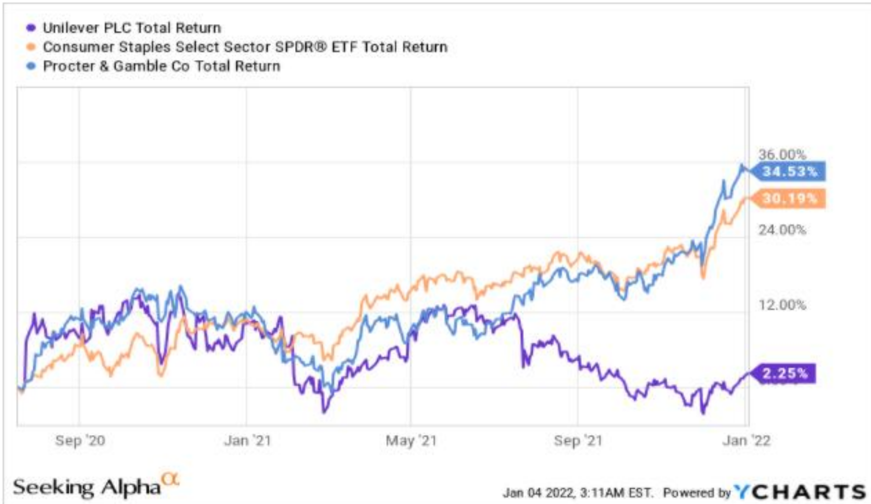
UL competes on prices, quality, the company must find ways to differentiate. Their food segment has become commoditized that is why we have seen the company shift towards faster growing segments that have more pricing power. But what stops competitors from replicating this?

Inflation risks
We emphasize that these inflationary pressures are very short-term in nature
Inflation is reaching a 40-year high at 7.5% annually. This is a critical short-term risk for UL. The company has increased prices to maintain the level of profitability. However, with the competition being harsh the company may have to absorb some of the price increased.

The company has been affected by surging commodity costs.



The management team seems to try to prove that it can achieve non-organic growth. The company almost executed an extremely risky acquisition for a very high valuation. It seems like the management is almost desperate to show significant growth using a giant acquisition. This is a risky move, much riskier than the execution of the company's long-term successful growth strategy of building its brands nd acquiring additional brands according to changes in consumer tastes.



Fundamentals
The company's sales have grown by 4.32% over the last 5-years. UL's sales in US dollars have grown at a slow rate of less than 1% annually. The company is focused more on earnings, and it buyers and sell brands to enhance profitability of its portfolio.

The company's earnings have been growing at a faster pace than the revenues. The company has improved its margins by using cost-cutting and constantly improving its portfolio to contain profitable brands. In addition, the company is buying back its own shares to improve EPS growth.

Management
The company attempted and failed to acquire the consumer healthcare business from the pharmaceutical company GSK.

UL made an offer to purchase GSK's consumer healthcare unit for $68B in cash, GSK rejected the offers and two other offers, saying that "they fundamentally undervalued the Consumer Healthcare business and its future prospects". Products included Advil painkillers, and Sensodyne toothpaste.

Unilever would have to take significant amount of debt, as the company only has $6B in cash assets. That would destroy shareholder value, lower ROIC, and put Unilever in a position that they may have only be able to reduce debt.

CEO Alan Jope has been under pressure because of the company's poor performance in recent times. Terry Smith of Fund Smith criticized the group in his annual letter to shareholders. He said the company has "lost the plot" with a focus on publicly displaying sustainability credentials at the expense of focusing on the business.

Under Alan Jope and previous CEO Paul Polman, Unilever has continued the sustainability drive spearheaded by Polman. Unilever has reshaped its portfolio by selling slower growing businesses such as its spreads unit and its tea business, while also acquiring GSK's consumer operation in India. In comparison to competitors, Unilever share have fallen 10% over the TTM, while Nestle shares have a 20% gain over the same timeframe, as the company has taken more aggressive steps to seek new growth and cull underperforming units. A little over a year ago, Unilever ditched their dual nationality (U.K. and Netherlands) and became solely a U.K. based entity, with one main reason being to ease prospects for mergers and acquisitions.

Nelson Peltz Hedge fund manager from Trian Fund Management. Previously served on P&G's board of directors from 2018-2021, strong-armed his way onto the board via a proxy vote that he demanded be recounted, ultimately being very costly for P&G. Peltz stepped down in August of 2021. Recently his hedge fund has began purchasing a significant amount of shares in Unilever. Aside from P&G and Unilever, he has made his presence felt with food, beverage, and snack company, Mondelez and General Electric.

Competitors
Estee Lauder, L'Oreal
Unilever has been focused on beauty and personal care products
It is one of the largest beauty stores

Brands are not a particularly strong competitive advantage for Unilever in aggregate, and according to Morningstar the company scores across metrics in their brand strength framework. The firm has achieved pricing in line with, but not excess of, inflation during the past three years.

Revenue by employees, net income by employees
Margins by competitors
Obligation ratio
ROCE, ROIC, ROE adjusted ROE

Valuation
Growth rate of 3.4%
FY2022 Guidance For 2022, management has acknowledged the task of managing inflationary pressure while investing for growth, and the rollout of their new operating model in Q3 of FY2022.

Conclusion
Unilever is a solid company. It is growing sales and EPS, even if the pace is not extremely impressive. The valuation is fair as the company is trading in line with its historical valuation. The risks are manageable as long as the management stays focused and careful, and there are enough growth opportunities worldwide for Unilever to leverage.

Not a top 10 idea