Unilever NV UN (NYSE) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods

Unilever Gains More Exposure to Premium HPC Price Points With Seventh Generation Acquisition

See Page 2 for the full Analyst Note from 20 Sep 2016

Philip Gorham, CFA, FRM
Sector Strategist
philip.gorham@morningstar.com
+31 (0) 20 560 2962

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The primary analyst covering this company does not own its stock.

Research as of 20 Sep 2016
Estimates as of 12 Sep 2016
Pricing data through 20 Sep 2016
Rating updated as of 20 Sep 2016

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

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Investment Thesis 22 Jul 2016

Unilever's scale and scope give it competitive advantages, and with 58% of sales generated in emerging markets, the firm offers substantial exposure to growth markets. However, although we view the shift in emphasis to personal care from packaged food as a net positive, we expect Unilever to have limited success in expanding its volume and margins simultaneously, given the highly competitive nature of its categories.

Management's stated objective is to achieve organic sales growth, driven by volume, at an above-market rate; we view this as an appropriate strategy that is likely to consolidate the firm's moat over time. As retail is a low-margin, volume-driven business, this should help cement Unilever's place as a primary vendor that is entrenched in its customers' supply chains globally. The company should benefit from tailwinds from the structural shift to faster-growing personal care from food, the potential disposal of the developed-markets spreads business, geographic white space opportunities and premiumisation in laundry and beauty care; these tailwinds should help Unilever achieve volume-driven organic growth. However, a more-focused Procter & Gamble is also pursuing volume growth, as are others, and competition in Unilever's core markets is likely to continue to be intense.

It is this intense competition that makes us somewhat sceptical on Unilever's margin opportunity. After several years of optimising the cost structure and achieving mid-single-digit emerging-markets volume growth, Unilever's midcycle EBIT margin has barely improved, rising around 100 basis points to 15%. This is at the low end in the HPC group and well below firms in other staples categories. It is indicative of the categories' competitiveness that cost savings rarely flow through to the bottom line, with neither Unilever nor P&G consistently achieving their volume targets. For the past two years, Unilever has spent 17% of its revenue on marketing and research and development costs; we suspect this expenditure will act as a cap to margin expansion, since over time, the highly competitive operating environment and commodification of brands may drive these expenditures higher still.

Vital Statistics

Market Cap (USD Mil)	136,876
52-Week High (USD)	48.00
52-Week Low (USD)	37.92
52-Week Total Return %	16.3
YTD Total Return %	6.9
Last Fiscal Year End	31 Dec 2015
5-Yr Forward Revenue CAGR %	3.5
5-Yr Forward EPS CAGR %	6.6
Price/Fair Value	1.03

Valuation Summary and Forecasts

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Price/Earnings	19.0	23.0	*22.9*	*21.0*
EV/EBITDA	9.8	13.0	*12.9*	*12.1*
EV/EBIT	11.1	15.4	*15.0*	*13.9*
Free Cash Flow Yield %	3.8	4.6	*3.1*	*4.7*
Dividend Yield %	3.3	2.8	*2.8*	*2.9*

Financial Summary and Forecasts (EUR Mil)

Fiscal Year:	2014	2015	*2016(E)*	*2017(E)*
Revenue	48,436	53,272	*52,858*	*55,181*
Revenue YoY %	-2.7	10.0	*-0.8*	*4.4*
EBIT	8,383	7,622	*7,914*	*8,510*
EBIT YoY %	9.9	-9.1	*3.8*	*7.5*
Net Income, Adjusted	5,391	4,909	*5,119*	*5,556*
Net Income YoY %	11.3	-8.9	*4.3*	*8.6*
Diluted EPS	2.06	1.88	*1.98*	*2.15*
Diluted EPS YoY %	12.9	-8.9	*5.6*	*8.6*
Free Cash Flow	5,288	3,673	*5,069*	*4,973*
Free Cash Flow YoY %	1.0	-30.5	*38.0*	*-1.9*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Netherlands-based Unilever NV and U.K.-based Unilever PLC operate Unilever Group, a diversified household and personal product (57% of total sales) and packaged food (43%) company. The firm's brands include Knorr soups and sauces, Hellmann's mayonnaise, Lipton teas, Axe and Dove skin products and the TRESemme hair-care brand. The firm recently acquired the mail order men's grooming business Dollar Shave Club.

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Morningstar Analysis

Unilever Gains More Exposure to Premium HPC Price Points With Seventh Generation Acquisition 20 Sep 2016
Unilever is to acquire Seventh Generation, a North American household and personal care product manufacturer, for an undisclosed amount. With the target's sales likely to be around $250 million this year, we believe Unilever could have paid close to $1 billion. For Unilever, we reiterate our wide moat and stable trend ratings, our EUR 40 and $44 fair value estimates for the Amsterdam-listed ordinary shares and ADRs, respectively, and our GBX 3,250 and $44 fair value estimates for the London-traded ADRs.

The acquisition makes strategic sense for Unilever. Seventh Generation's household and personal care products contain fewer chemicals and use recycled packaging, which appeals to the environmentally conscious consumer. Although it is still a fairly niche category (at around 5% of the household detergent category), natural cleaning products are growing at a low-double-digit rate and offer one of the few premiumisation opportunities in a category that we believe will be susceptible to trading down in the long term. Store brand competition tends to be higher and pricing power weaker for products that are perceived to offer little consumption utility and are not consumed in social settings. Natural cleaning products, therefore, may add significant value to the environmentally conscious consumer.

This is evident in the sometimes hefty price premium achieved by natural household products at retail. We estimate that across the portfolio, Seventh Generation can sell at a premium of around 20% to competitive brands and a 60% premium to private label. U.S. sales of the brand are roughly equal to those of close competitors Mrs. Meyer's and Method in aggregate. While we do not believe this acquisition alone moves the needle on Unilever's valuation, we think the additional exposure to premium price points should drive a greater contribution from price/mix in the company's household and personal care portfolio (57% of 2015 sales).

Valuation, Growth and Profitability 22 Jul 2016
Following second-quarter results that were broadly in line with our forecasts, we are maintaining our $44 fair value estimate for Unilever NV's ADRs. Our valuation implies 2017 forward multiples of 22 times and 13.4 times price/earnings and EV/EBITDA, respectively, a free cash flow yield of 4.4%, and a dividend yield of 2.9%.

We estimate Unilever's medium-term revenue growth rate to be just short of 5%, driven in roughly equal measure by price/mix and volume. We expect it to take another two years before Unilever can achieve this level of growth, however, as slower growth in emerging markets and deflation in Europe are likely to constrain volume growth and price/mix, respectively.

Although we model some margin expansion over Unilever's 2015 EBIT margin of 14.3%, we are sceptical Unilever can achieve sustainable margin expansion beyond its historical midcycle margin of around 15%. We see opportunity to improve profitability in home care, but we suspect most cost savings will be reinvested in marketing rather than flowing through to the bottom line. Unilever operates in some highly competitive categories, and its brands are not a source of its competitive advantages. Therefore, we regard the 17% EBIT margin generated in 2014 as being the peak of the cycle, and we think close to 16% is a more realistic normalised EBIT margin. In the near term, spending on marketing may offset lower commodity costs, and we forecast a 15% EBIT margin for the next two years.

Although Unilever's presence in emerging markets (57% of sales in 2015) is causing some short-term volatility, we believe it will also be a driver of long-term growth. We assume a 5% stage 2 EBI growth rate, very slightly above its competitors.

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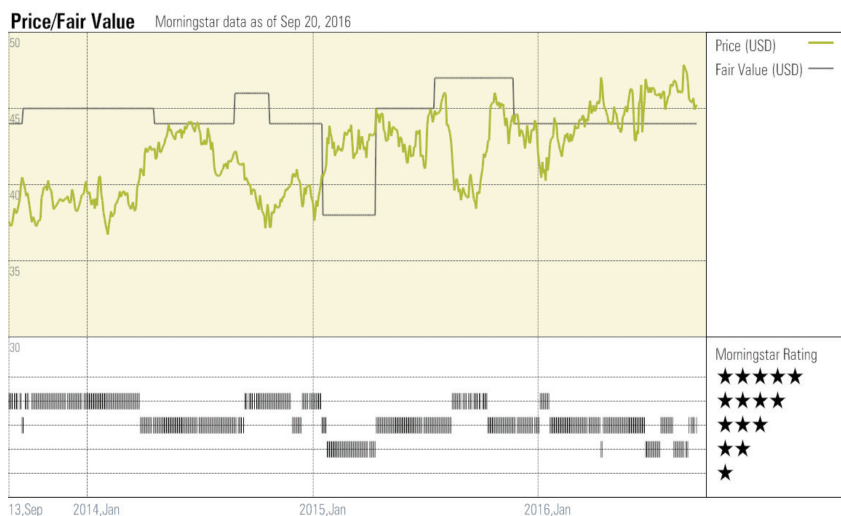

Our fair value estimate is derived only from our discounted cash flow model, but it is supported by our sum-of-the-parts analysis, which yields a $44 valuation. Our dividend growth models imply a 6.7% dividend growth rate at our fair value estimate.

Scenario Analysis

Our assumptions of Unilever's medium- to long-term growth rate (of which volume, price and mix are the drivers) and profitability are the key variables in our scenario analysis. Given Unilever's consistent results in recent years, the potential valuation outcomes are quite narrow, and we assign the firm a low uncertainty rating. This is in line with P&G and Nestle, other large-cap and fairly diversified names in the consumer packaged goods space.

Our bull case assumes faster sales growth and that margins expand as a result of cost savings flowing through to earnings and greater fixed-cost leverage. We assume that revenue grows at 6% in the final two years of our forecast period. This is above Unilever's mid-single-digit organic growth rate of recent years, and we would expect upside to our base-case revenue forecast to come primarily from volume and mix. Primarily as a result of cost savings, we assume a bull-case midcycle operating margin of 17.5%, 170 basis points above our base-case assumption. Around 50 basis points of this comes from fixed-cost leverage, particularly on marketing expenses, which we assume to be in line with our base case, despite the higher volume growth. Under these conditions, our valuation of Unilever would be $53.

We think downside to our fair value estimate could come from structurally lower volume growth and increased margin pressure from higher marketing and research and development spending. In our bear case, we assume a 3% medium-term revenue growth rate. This is more akin to a developed-market consumer business than one with more than half of its revenue from emerging markets, but it could happen if consumer spending suffers a structural impairment in developing markets. We assume a medium-term operating margin of 13.3%, fairly close to the trough margin of 12.9% generated in 2009. Some of the 220-basis-point margin erosion from our base case occurs as a result of operating deleverage, but around 70 basis points occurs due to higher marketing spending. Our fair value estimate under these conditions would be $34.

Economic Moat

We think Unilever has a wide economic moat derived from two sources: its entrenchment in the supply chain of retailers (an intangible asset) and a cost advantage. The firm’s broad portfolio of products across multiple categories and supermarket aisles creates a virtuous cycle of competitive advantages, comprising intangible assets, switching costs and cost advantages, that new entrants simply could not replicate. Unilever’s portfolio spans multiple household and personal product categories as well as food and, to a lesser extent, beverages, and the firm generates nearly EUR 50 billion in revenue. This makes Unilever one of the most important suppliers to retailers globally and differentiates it from narrow-moat competitors

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with smaller product portfolios.

In our opinion, one of the biggest challenges facing consumer product manufacturers, and the primary reason for the intense competition among the leading players, is the finite nature of shelf space and distribution capacity. Retailers, whose business model is dependent on volume, are unwilling to take risks with untested stock-keeping units and suppliers unless they receive slotting fees large enough to transfer the risk of consumer adoption to the manufacturer, and they give priority shelf space to high-velocity products in order to maximise fixed-cost leverage. For manufacturers, breadth of portfolio offers the best chance of owning at least a few of the category-growing brands at any point in time and on a consistent basis; this makes them an important partner to retailers and distributors. In turn, this puts them in a strong position to negotiate for limited physical shelf space.

Another key industry challenge is the high cost of customer acquisition (primarily marketing expenses and research and development costs). Unilever's scale and scope help the firm achieve levels of cash flow generation that allow it to invest behind its brands and to finance the slotting fees necessary when introducing new products, an intangible asset that cannot be replicated by new entrants. In 2015, Unilever spent 15% of its revenue on advertising and promotion, or A&P, expenses, the most in the household and personal-care space aside from the prestige beauty manufacturers. This spending has steadily ticked higher from 13% of sales in 2011, and it excludes costs directly related to shelf space, which are deducted from gross revenue. The firm spent a further 2% of its sales on research and development, around average for the group. This level of spending creates a virtuous cycle for the larger players because higher spending on marketing and line extensions can drive volume and category growth, assuming execution is effective. This makes the products more appealing to distributors and retailers and in turn is likely to win shelf space.

It is, of course, possible for new entrants to penetrate the market, and startups can give a retailer price leverage over the large manufacturers. Burt's Bees, when it entered the market in the 1980s and 1990s, is an example of a niche brand taking shelf space in the HPC category. However, there are significant risks to supply-chain disruption with the smaller players, which is a risk to the retailer that can be mitigated by allocating shelf space on a localised, trial basis. This gives large players such as Unilever time to adjust to the entrance of a new brand, and through cost advantages generated from economies of scale, incumbents are well positioned to replicate the competitive product and offer it to retailers at a lower cost. This limits the shelf space awarded to the new entrant and prevents it from achieving the scale necessary to invest behind its emerging brand. This self-reinforcing combination of moat sources creates high barriers to entry that protect the vendors most entrenched in the retailers' supply chains.

Unilever has one of the strongest cost advantages within the diversified HPC space, according to our framework. It is a fairly efficient manufacturer, with one of the lowest costs per employee, behind only prestige beauty-care names Estee Lauder and L'Oreal. Within the mass beauty segment, only Beiersdorf operates on a lower cost structure, as measured by our framework, which excludes discretionary expenses such as advertising. Beiersdorf's narrow product portfolio and more-focused production process makes it a slightly more efficient operator than Unilever.

Notably, brands are not a particularly strong competitive advantage for Unilever in aggregate, and the firm generates average scores across all metrics in our brand strength framework. The firm has achieved pricing in line with, but not in excess of, inflation during the past three years.

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Morningstar Analysis

Our wide moat rating is supported by Unilever's ability to sustain excess returns on invested capital. Even when goodwill is included, ROIC has averaged 19% during the past five years and 20% during the past nine. We expect that figure to remain around 20% during the next five years.

Moat Trend

The two threats that we believe could destabilise economic moats in the consumer staples industry are channel shifts and the risk of changing levels of customer acquisition costs. In both cases, however, we believe Unilever's defences are robust, and we assign the firm a stable moat rating. We see emerging risks to the competitive positioning of branded consumer products firms from the growth of both discounters and the online channel, but developments to date suggest that manufacturers' competitive advantages could transfer to the new channels. In addition, we see little evidence that the cost of acquiring customers is changing, meaning that Unilever's wide moat is steady.

Unilever's entrenchment in retailers' supply chain could be at risk if alternative channels such as hard discounters and online retailing continue to take significant share. The e-commerce channel may solve the challenge of finite shelf space, as storage capacity in a distribution center is much greater than that of a store, and paying for primary shelf space is not required. In turn, this may lower barriers to entry and open the door to new competition for branded products. In the U.S. bath and shower category, to which Unilever is exposed through brands such as Axe and Dove, Internet retailing has almost tripled its share of industry value in the past decade and represented 6.5% of all sales last year. In the United Kingdom, the online channel tripled to almost 10%. Much of this channel shift has occurred at the expense of store-based retailers, whose share fell 160 basis points to 88% in the United States and 380 basis points to 87% in the U.K. The trend is less pronounced in emerging markets, where Internet penetration is lower and Unilever has a strong presence, although e-commerce now represents more than 12% of the bath and shower category in China. There are significant hurdles to the growth of the e-commerce channel in consumer staples, however, including the sometimes prohibitive cost of distribution in a temperature-controlled environment, and low distribution density that makes the distribution economics unattractive at this stage in the industry maturity cycle. In addition, we believe that the relationship between manufacturers and online retailers could develop in much the same way as the conventional channel, with superior positioning on websites eventually commanding a premium, analogous to today's slotting fees. The evidence so far suggests that the e-commerce business model is far from achieving a profitable critical mass, and that even if it continues to grow, barriers to new vendors' entry may remain fairly high.

In developed markets, online entrants such as the Dollar Shave Club, which we estimate has 5% volume share and 1% value share of the U.S. razor market, and was recently acquired by Unilever, have been able to grow because they circumvent the primary barrier to entry that we have identified: the dominance of shelf space by large manufacturers. The online-only business model allows manufacturers to distribute via third-party freight companies, rather than wholesale distributors, and it requires no shelf space. The viability of the online model is dependent, however, on its ability to meet customer acquisition costs, which are prohibitively high for the vast majority of startups. Some new entrants have gained traction through low-cost Internet videos, but as the touchpoints of such marketing are limited, we believe current online players must utilize costlier mass media marketing channels. Doing so would require heavy investment in marketing, an area in which the upstarts cannot compete with the large diversified consumer product manufacturers. Unilever spent EUR 6 billion on A&P expenses in 2015, and Procter & Gamble spent EUR 8.3

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Morningstar Analysis

billion. There is little evidence to suggest that the advent of digital and social media marketing, which now represents 20% of Unilever's advertising expenses, is lowering those customer acquisition costs. This is helping, for the time being, to keep Unilever's wide economic moat stable.

Volume for most branded consumer product firms is much lower at discounters, where the majority of the roughly 6,000 SKUs are private label, relative to traditional big-box retailers, which have SKU counts above 40,000. The growth of the discounters, therefore, is also a risk to manufacturers' economic moats, particularly in the U.S. where discounters are underpenetrated relative to their position in Europe. However, one of the drivers of growth in Europe since the economic recovery began has been a move towards the middle market, with higher-end offerings that include a larger range of branded products. This, in turn, is opening the door to the discounter channel for the consumer product manufacturers and could limit the damage to branded vendors' volume, even as the discounter channel grows.

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Bulls Say/Bears Say

Bulls Say

- With a 15% midcycle operating margin outside of restructuring items, Unilever has more flexibility than some of its competitors to cut costs and invest behind its brands.
- Unilever is among the strongest emerging-market plays in consumer staples, with 58% of 2015 sales generated in such markets. Despite the recent slowdown, we believe this exposure offers the potential for above-industry long-term volume growth.
- We applaud Unilever's recent repositioning towards household and personal care, as we believe the narrower focus can aid better brand management.

Bears Say

- Although Unilever's emerging-markets exposure should be a long-term volume driver, it may pose some near-term volatility.
- Unilever operates in some highly competitive categories, in which brands are becoming commodized, and in which manufacturers must invest heavily to generate a continuous pipeline of innovation or face heavier competition on price.
- The middle-market grocery channel is losing share to hard discounters and high-end retailers such as Whole Foods. These retailers stock fewer branded consumer products than traditional supermarkets.

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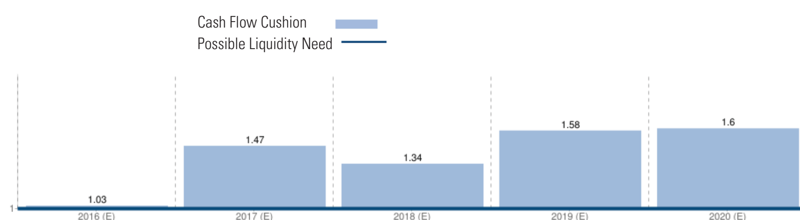
Five Year Adjusted Cash Flow Forecast (EUR Mil)

	2016(E)	2017(E)	2018(E)	2019(E)	2020(E)
Cash and Equivalents (beginning of period)	2,302	671	1,094	241	219
Adjusted Available Cash Flow	2,416	2,435	1,496	3,278	3,279
Total Cash Available before Debt Service	4,718	3,106	2,590	3,519	3,498
Principal Payments	-3,583	-1,222	-1,088	-1,367	-1,346
Interest Payments	-608	-577	-536	-541	-528
Other Cash Obligations and Commitments	-410	-313	-313	-313	-312
Total Cash Obligations and Commitments	-4,601	-2,112	-1,937	-2,221	-2,186

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	EUR Millions	% of Commitments
Beginning Cash Balance	2,302	17.6
Sum of 5-Year Adjusted Free Cash Flow	12,904	98.8
Sum of Cash and 5-Year Cash Generation	15,206	116.5
Revolver Availability	6,550	50.2
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	21,756	166.6
Sum of 5-Year Cash Commitments	-13,055	—

Financial Health

We give Unilever an issuer credit rating of A+, implying low default risk. Debt/capital and debt/adjusted EBITDA amounted to 0.5 and 1.3, respectively, in fiscal 2014, below average in the mature consumer staples industry. In the absence of acquisitions, it is possible that Unilever could lower these ratios to 0.25x and 0.75x by the end of 2019. Debt maturities are fairly well laddered, and we do not anticipate any solvency problems in the medium term, particularly as Unilever held over EUR 3.5 billion in cash and financial assets (EUR 671 million of which was long-term) on the balance sheet at the end of 2014.

However, management has stated that it will not sit on a cash pile, and we think the most likely use of its capital is acquisitions. Merger activity is commonplace in the HPC space, and we think Unilever has opportunities for bolt-on acquisitions in the EUR 1 billion to EUR 3 billion valuation range, but also has the potential for a transformative deal if necessary. With debt/EBITDA running at 1.3x at the end of 2014, Unilever is less leveraged than most of its HPC peers. Debt/EBITDA of 2.0x is not uncommon in consumer staples (close competitors Clorox and Kimberly-Clark are levered to this degree, as was Procter & Gamble before selling its beauty assets) and gearing at this level could unlock a further EUR 10 billion in cash. In addition, at 12x 2015 EBITDA, we estimate a sale of the North American and European spreads business could yield a further EUR 7.5 billion. We expect Unilever to be particularly active in the prestige beauty segment, where the firm is currently underpenetrated with around EUR 400 million in annual sales, and emerging markets will continue to be a focus.

Dividends have historically been the most frequently utilised vehicle for returning capital to shareholders. However, in the absence of acquisitions, a low probability scenario in our opinion, we would not rule out a share repurchase program. Unilever's dividend payout ratio of 62% is slightly

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higher than its peer group at around 50%, but we believe the firm has ample flexibility to grow the dividend at a mid single digit rate in the medium term, even in the event of acquisitions.

Enterprise Risk

Even within the relatively defensive consumer staples space, Unilever has delivered some of the most consistent organic growth of its peer group in recent years. The firm's breadth of portfolio across geographies and product categories limits brand and execution risk, and we assign Unilever a low uncertainty rating. Nevertheless, management has few self-help levers to pull to stimulate top-line growth, so volume, price and mix, the three primary drivers of the business, are all somewhat sensitive to macroeconomic conditions. At the gross margin, too, the firm is exposed to the economic cycle. Around 20%-25% of Unilever's cost of goods sold is linked to energy prices, and this could rise if economic growth accelerates. Packaged goods manufacturers have taken advantage of the recently benign commodity cost environment to lower prices in some markets, a strategy designed to help mitigate the loss of middle-market retailers to both discounters and high-end stores. It is possible that when commodity costs rise, margins could be squeezed if the retail environment remains deflationary, although past cycles suggest that Unilever and its competitors should be able to pass through commodity cost inflation to consumers.The strategy of entering the prestige personal-care market through acquisitions, though appropriate, comes with some inherent risk. Synergies are limited, and it is far from certain that Unilever will be able to execute successfully in a competitive marketplace with a different route to market than its core business in mass beauty care. Having already acquired REN Skincare, Kate Somerville, Dermalogica and Murad, Unilever is close to achieving a critical mass of volume in the prestige beauty industry that should give it competitive advantages. It is likely, however, that the firm will be interested in further bolt-on acquisitions to bolster its scale. Such an acquisitive strategy comes with the risk that management could overpay for targets.

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Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods

Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
NA	NA	NA	NA	NA

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
VA CollegeAmerica Washington Mutual	0.18	0.32	-1,041	30 Jun 2016
BlackRock Equity Dividend Fund	0.11	0.71	-44	31 Jul 2016
Neuberger Berman Socially Rspns Fund	0.07	4.15	—	31 Jul 2016
AMG Yacktman Fund	0.06	0.98	—	30 Jun 2016
Invesco Comstock	0.05	0.65	118	30 Jun 2016
Concentrated Holders				
YCG Enhanced Fund	—	6.22	27	30 Jun 2016
Global Strategic Income Fund	—	5.33	-3	30 Jun 2016
ProFunds VP Europe 30	—	5.00	-3	30 Jun 2016
ProFunds Europe 30 Fund	—	4.56	11	30 Apr 2016
Neuberger Berman Socially Rspns Fund	0.07	4.15	—	31 Jul 2016

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
BlackRock Advisors LLC	0.13	0.18	2,577	30 Jun 2016
Wellington Management Company LLP	0.06	0.02	1,056	30 Jun 2016
Fidelity Management and Research Company	0.04	0.01	990	30 Jun 2016
Janney Montgomery Scott LLC	0.01	0.35	310	30 Jun 2016
Cooke & Bieler LP	0.05	1.58	307	30 Jun 2016
Top 5 Sellers				
WHV Investment, Inc	0.01	4.78	-1,914	31 Mar 2016
Arrowstreet Capital Limited Partnership	0.08	0.39	-1,785	30 Jun 2016
Capital Research & Mgmt Co - Division 3	0.18	0.37	-1,041	30 Jun 2016
Capital Research and Management Company	0.18	0.32	-1,041	30 Jun 2016
USAA Investment Management Company	0.02	0.08	-372	30 Jun 2016

Management 22 Jul 2016

We rate Unilever's stewardship as Standard. The firm has a complex ownership structure, with Amsterdam-listed Unilever NV and London-listed Unilever PLC owning a combination of separately owned and joint-owned operating companies.

Unilever has historically delivered strong shareholder returns, outstripping the returns of the AEX and FTSE over the past decade. Dividends have been the preferred vehicle for returning capital to shareholders, and Unilever has had an above-industry-average payout ratio of around 62% for the past three years. Share repurchases have contributed relatively little to shareholder returns, but when management has bought back shares, it has generally done so at a level that has created value for shareholders. We expect the firm to continue its high dividend payout and to be opportunistic when it comes to repurchasing shares, although mergers and acquisitions will probably remain a higher priority, particularly in prestige 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 (net of disposals) has been just EUR 371 million since 2010, less than 2% of the cumulative free cash flow to the firm over the same period. By and large, Unilever's activity in mergers and acquisitions has added value. The $3.7 billion Alberto Culver deal, for example, was executed at a fairly high 15 times EBITDA, but significant geographic whites pace for the brand allowed Unilever to roll it out in some large markets, including Brazil. The $1 billion acquisition of Dollar Shave Club, which we do not believe was profitable as a standalone entity, was also a rich multiple, but will give Unilever a strong presence in the the emerging business-to-consumer channel.

Although we recognize Unilever's fairly strong record of

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capital allocation, we are somewhat concerned about the recent spate of senior management departures. The most senior executive to go was CFO Jean-Marc Huet, who was replaced by Graeme Pitkethly in October 2015. Marc Mathieu, global senior vice president of marketing, and Michel Dallemagne, executive vice president of hair care, departed in May 2015. In June 2015, Antoine de Saint-Affrique, the head of foods, left to become CEO of Barry Callebaut. This all follows the loss of Dave Lewis, then-president of global personal care, to the top job at Tesco in July 2014. Although two of the departures are understandable, with Unilever executives taking CEO positions at two respected mid-cap consumer companies, the sheer volume of turnover surely leaves Unilever's managerial bench somewhat weakened. The executive churn may imply a lack of operational upside, either organic or transactional, or even dissension amongst senior leaders with regard to corporate strategy.

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Analyst Notes

Unilever's In-Line Q2 Highlights Value of Its Moat and Emerging-Markets Footprint 21 Jul 2016

Unilever's second-quarter organic sales growth of 4.7% was bang in line with our forecast and the first quarter, although we slightly underestimated the extent to which currency movements would drag down reported results. We are reiterating our EUR 40 and $44 respective fair value estimates for the Amsterdam-traded shares and their ADR counterparts, as well as our GBX 3,250 and $44 respective fair value estimates for the London-traded PLC shares and their ADR counterparts. Unilever's wide moat remains intact, and we believe its scale and financial flexibility provide it with defences against competitive threats.

Volume growth of 1.8% and price/mix of 2.8% represented a slightly heavier skew to price/mix in Unilever's second quarter, as a slight weakening of deflationary pressures in Europe and emerging-market price increases helped drive organic sales. Underlying sales growth in emerging markets of 7.7% underlined Unilever's status as one of the strongest emerging-market plays among large-cap consumer staples firms. Organic growth at or above 6% in the Asia and Americas segments is a primary reason for Unilever's outperformance of Nestle in recent quarters. We expect Nestle's growth to again undershoot that of Unilever by several basis points in the second quarter.

Another reason for Unilever's solid performance is execution. Its gross margin was 80 basis points higher year over year in the first half of the year, ahead of our estimate of 60 basis points. Despite higher SG&A spending, partially affected by currency movements, respectable execution at the gross margin assisted the 50-basis-point improvement in the first-half EBIT margin.

In the long term, Unilever's greatest challenge comes from the emergence of new entrants, both as a result of the migration to modern channels and in emerging markets. We think Unilever's economic moat, stemming from its scale and ability to invest to drive top-line growth, should allow it to generate long-term excess returns.

Unilever's Acquisition of Dollar Shave Club Highlights Risks to Moats in Consumer Staples 20 Jul 2016

Unilever is to acquire Dollar Shave Club, the online upstart in male grooming, for $1 billion, an acquisition that we think is more significant for its implications about the emerging threat from e-commerce in consumer staples than for its financial impact on Unilever. Nevertheless, we are reiterating our wide moat and stable trend ratings for Unilever, as we still believe that the competitive advantages of the large-cap consumer products manufacturers will help them defend their position against most online new entrants. We are also reiterating our EUR 40 and $44 fair value estimates for the Amsterdam-listed ordinary shares and ADRs, respectively. However, we are raising our fair value estimate for the London-traded ordinary shares to GBX 3,250 from GBX 3,100 to account for the recent depreciation in sterling against the euro. Our $44 fair value estimate for the London-traded ADRs remains unchanged.

Dollar Shave Club was formed in 2012 as an online supplier of low-cost men's razors, and has since expanded into adjacent categories in men's grooming. Its annual sales growth rate of around 30% is reflected in the multiple of 5 times sales Unilever is paying for the business. Dollar Shave Club generated $152 million in turnover in 2015, which represents less than 1% of the men's razor market by value, according to Canadean, and although profitability was not disclosed, we believe it remains a low-margin business. This deal, therefore, barely moves the needle on Unilever's annual sales in excess of EUR 52 billion, and on our valuation. It does, however, signal that the mega-cap consumer staples manufacturers are taking seriously the risk of share loss from the shift to e-commerce. This

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Analyst Notes

acquisition gives Unilever a business-to-consumer platform, as well as management experienced in expanding a business in this channel.

Dollar Shave Club burst on the scene with an innovative social media commercial that went viral. To the extent that others could replicate its success, the rapid growth of the business highlights the emerging risk of new entrants to consumer products manufacturers, for so long the beneficiaries of high barriers to entry. Online distribution, whether direct to the consumer or through a third-party distribution centre, has the potential to circumvent manufacturers' battleground in the brick-and-mortar retail model: finite shelf space capacity and the high costs associated with attaining and retaining it. At a time when the strength of brands as a competitive advantage appears to be eroding (as demonstrated by the growth of the hard discounters and increasing price promotions in mainstream channels), the sector's historical barriers to entry could come under pressure over the next decade. We discuss this in depth in our October 2015 Observer, "Shopping for the CPG Brands Best Positioned for a New Era in Commerce."

We recommend that investors consider this risk carefully when owning companies most exposed to the threat of online entrants, particularly in certain personal-care categories, where low weight/value ratios may make distribution economically viable sooner rather than later. Industries less exposed to this threat may include alcoholic beverages and tobacco, where age restrictions and distribution controls may limit the growth of the online channel.

In a sense, however, Dollar Shave Club was lucky, and its success is the exception rather than the rule. We doubt that most online upstarts will be able to consistently reach the mass market so quickly because not all commercials are as successful and because they do not have the financial muscle to hire the leading marketing agencies. We have retained stable moat trend ratings on most of our global consumer staples coverage because we believe that the high level of spending on marketing (often at least 15% of sales) and research and development (usually around 2% of sales) by the large-cap firms, as well as the vast amounts of slotting fees paid to retailers, which vary greatly by category, will also prove to be a competitive advantage online. For example, in the business-to-consumer business model, the ability to reach consumers, either through traditional or digital marketing, will be critical, while in the third-party distribution model, the appearance at the top of a product search result is likely to be determined by fees or other financial incentives paid to the distributor. In short, we expect the large-cap names to continue to lead the industry if consumers migrate from the brick-and-mortar to the online channel, but the rise of Dollar Shave Club shows that evolution is bringing with it risks that investors must watch closely.

Unilever On Track in Q1; Outperforms Nestle, but Shares Fairly Valued 14 Apr 2016

Unilever's first-quarter reported sales decline of 2% on 4.7% organic growth was close to our forecast, and we reiterate our EUR 40 and $44 respective fair value estimates for the Amsterdam-traded shares and their ADR counterparts, as well as our GBX 3,100 and $44 respective fair value estimates for the London-traded shares and their ADR counterparts. Unilever's wide moat remains intact, and we believe its scale and financial flexibility provide it with defences against threats from e-commerce platforms, hard discounters, and shifting consumer preferences.

Unilever's 4.7% underlying growth was a modest slowdown from the 4.9% generated in fourth-quarter 2015 (and the 5.7% generated in the third quarter), but demonstrated that the company is outperforming Nestle, which reported first-quarter organic growth of 3.9%. The difference can largely be explained by Unilever's emerging-markets presence.

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Analyst Notes

Emerging markets represent almost 60% of Unilever's sales (45% of Nestle's) and delivered stronger volume growth and price/mix in the first quarter. Underlying growth in emerging markets was 8.3%, versus negative 0.3% in developed markets, with pricing up 4.4% (down 1.3% in developed markets). Given the deflationary environment in Europe, where fourth-quarter pricing deteriorated further to negative 2.4%, and the emerging-markets slowdown, this is a solid result for Unilever, which appears to be gaining share globally. We view this as evidence of its moat source: its ability to spend on reacquiring consumers and its strong relationships with retailers that allow it to increase its shelf space.

Most of Unilever's near-term challenges are cyclical. The emerging-markets slowdown will likely affect Unilever more than most, but long-term drivers (including population growth, above-average urbanisation rates, and per capita income growth) remain in place, and we think Unilever can sustain a 5% organic sales growth rate in the medium term. We believe the shares are fairly priced.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2013	2014	2015	*Forecast 2016*	*Forecast 2017*	*5-Year Proj. CAGR*
Revenue	*1.3*	-3.0	-2.7	10.0	*-0.8*	*4.4*	*3.5*
EBIT	*2.5*	7.7	9.9	-9.1	*3.8*	*7.5*	*5.6*
EBITDA	*2.8*	6.0	8.3	-5.5	*2.5*	*6.3*	*5.0*
Net Income	*4.0*	10.9	11.3	-8.9	*4.3*	*8.6*	*6.2*
Diluted EPS	*4.4*	10.6	12.9	-8.9	*5.6*	*8.6*	*6.6*
Earnings Before Interest, after Tax	*2.1*	1.6	-10.8	17.3	*-10.1*	*27.0*	*6.2*
Free Cash Flow	*-16.1*	-15.8	1.0	-30.5	*38.0*	*-1.9*	*11.8*

Profitability	3-Year Hist. Avg	2013	2014	2015	*2016*	*2017*	*5-Year Proj. Avg*
Operating Margin %	*15.7*	15.3	17.3	14.3	*15.0*	*15.4*	*15.6*
EBITDA Margin %	*18.1*	17.6	19.6	16.9	*17.4*	*17.8*	*17.9*
Net Margin %	*10.0*	9.7	11.1	9.2	*9.7*	*10.1*	*10.2*
Free Cash Flow Margin %	*9.4*	10.5	10.9	6.9	*9.6*	*9.0*	*9.8*
ROIC %	*19.8*	20.5	21.5	17.5	*13.4*	*18.4*	*18.5*
Adjusted ROIC %	*38.4*	40.4	41.9	33.0	*24.6*	*33.9*	*33.7*
Return on Assets %	*10.5*	10.6	11.1	9.8	*9.9*	*10.6*	*11.1*
Return on Equity %	*34.5*	32.8	36.9	33.8	*33.4*	*34.3*	*34.2*

Leverage	3-Year Hist. Avg	2013	2014	2015	*2016*	*2017*	*5-Year Proj. Avg*
Debt/Capital	*0.46*	0.43	0.47	0.48	*0.46*	*0.41*	*0.38*
Total Debt/EBITDA	*1.37*	1.26	1.28	1.58	*1.40*	*1.21*	*1.07*
EBITDA/Interest Expense	*15.99*	14.19	17.32	16.47	*15.17*	*16.99*	*18.73*

Valuation Summary and Forecasts

	2014	2015	*2016(E)*	*2017(E)*
Price/Fair Value	0.89	0.98	—	—
Price/Earnings	19.0	23.0	*22.9*	*21.0*
EV/EBITDA	9.8	13.0	*12.9*	*12.1*
EV/EBIT	11.1	15.4	*15.0*	*13.9*
Free Cash Flow Yield %	3.8	4.6	*3.1*	*4.7*
Dividend Yield %	3.3	2.8	*2.8*	*2.9*

Key Valuation Drivers

Cost of Equity %	7.5
Pre-Tax Cost of Debt %	5.8
Weighted Average Cost of Capital %	7.2
Long-Run Tax Rate %	25.0
Stage II EBI Growth Rate %	4.5
Stage II Investment Rate %	5.0
Perpetuity Year	20

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	EUR Mil	Firm Value (%)	Per Share Value
Present Value Stage I	23,011	18.1	8.00
Present Value Stage II	56,471	44.3	19.63
Present Value Stage III	47,970	37.6	16.68
Total Firm Value	**127,452**	**100.0**	**44.31**
Cash and Equivalents	2,302	—	0.80
Debt	-14,236	—	-4.95
Preferred Stock	—	—	—
Other Adjustments	-3,831	—	-1.33
Equity Value	**111,687**	**—**	**38.83**
Projected Diluted Shares	2,876		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

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Morningstar Analyst Forecasts

Income Statement (EUR Mil)

Fiscal Year Ends in December

				Forecast	
	2013	2014	2015	*2016*	*2017*
Revenue	**49,797**	**48,436**	**53,272**	***52,858***	***55,181***
Cost of Goods Sold	29,065	28,387	30,808	*30,812*	*31,936*
Gross Profit	**20,732**	**20,049**	**22,464**	***22,047***	***23,244***
Selling, General & Administrative Expenses	13,215	12,069	14,949	*14,256*	*14,860*
Other Operating Expense (Income)	—	-305	—	—	—
Other Operating Expense (Income)	-113	-98	-107	*-123*	*-125*
Depreciation & Amortization (if reported separately)	—	—	—	—	—
Operating Income (ex charges)	**7,630**	**8,383**	**7,622**	***7,914***	***8,510***
Restructuring & Other Cash Charges	—	—	—	—	—
Impairment Charges (if reported separately)	—	305	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	*2,316*	*2,629*
Operating Income (incl charges)	**7,630**	**8,078**	**7,622**	***5,598***	***5,881***
Interest Expense	619	549	546	*608*	*577*
Interest Income	103	117	144	*106*	*111*
Pre-Tax Income	**7,114**	**7,646**	**7,220**	***5,095***	***5,415***
Income Tax Expense	1,851	2,131	1,961	*1,909*	*2,091*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	*2,316*	*2,629*
(Minority Interest)	-421	-344	-350	*-384*	*-396*
(Preferred Dividends)	—	—	—	—	—
Net Income	**4,842**	**5,171**	**4,909**	***5,119***	***5,556***
Weighted Average Diluted Shares Outstanding	2,924	2,883	2,883	*2,846*	*2,846*
Diluted Earnings Per Share	**1.66**	**1.79**	**1.70**	***1.80***	***1.95***
Adjusted Net Income	4,842	5,391	4,909	*5,119*	*5,556*
Diluted Earnings Per Share (Adjusted)	**1.66**	**1.87**	**1.70**	***1.80***	***1.95***
Dividends Per Common Share	1.13	1.22	1.27	*1.32*	*1.35*
EBITDA	**8,781**	**9,205**	**8,992**	***6,901***	***7,166***
Adjusted EBITDA	**8,781**	**9,510**	**8,992**	***9,217***	***9,795***

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Unilever NV UN (NYSE) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods

Morningstar Analyst Forecasts

Balance Sheet (EUR Mil)

Fiscal Year Ends in December	2013	2014	2015	Forecast 2016	Forecast 2017
Cash and Equivalents	2,285	2,151	2,302	*671*	*1,094*
Investments	—	—	—	—	—
Accounts Receivable	2,852	2,827	2,917	*3,046*	*3,183*
Inventory	3,937	4,168	4,335	*4,385*	*4,583*
Deferred Tax Assets (Current)	217	281	230	*319*	*319*
Other Short Term Assets	2,831	2,920	2,902	*3,248*	*3,386*
Current Assets	**12,122**	**12,347**	**12,686**	***11,669***	***12,565***
Net Property Plant, and Equipment	9,344	10,472	11,058	*11,601*	*12,567*
Goodwill	13,917	14,642	16,213	*16,213*	*16,213*
Other Intangibles	6,987	7,532	8,846	*8,755*	*8,573*
Deferred Tax Assets (Long-Term)	1,084	1,286	1,185	*1,458*	*1,458*
Other Long-Term Operating Assets	2,059	1,748	2,310	*1,896*	*1,963*
Long-Term Non-Operating Assets	—	—	—	—	—
Total Assets	**45,513**	**48,027**	**52,298**	***51,592***	***53,339***
Accounts Payable	6,995	7,636	8,296	*8,238*	*8,611*
Short-Term Debt	3,542	601	4,382	*1,837*	*1,961*
Deferred Tax Liabilities (Current)	1,254	1,081	1,127	*974*	*974*
Other Short-Term Liabilities	5,591	5,896	6,214	*6,301*	*6,567*
Current Liabilities	**17,382**	**15,214**	**20,019**	***17,350***	***18,113***
Long-Term Debt	7,491	11,614	9,854	*11,112*	*9,890*
Deferred Tax Liabilities (Long-Term)	1,669	1,695	1,865	*1,656*	*1,656*
Other Long-Term Operating Liabilities	4,156	5,241	4,478	*5,622*	*5,684*
Long-Term Non-Operating Liabilities	—	—	—	—	—
Total Liabilities	**30,698**	**33,764**	**36,216**	***35,740***	***35,343***
Preferred Stock	—	—	—	—	—
Common Stock	484	484	484	*484*	*484*
Additional Paid-in Capital	138	145	152	*152*	*152*
Retained Earnings (Deficit)	20,468	20,560	22,619	*24,327*	*26,383*
(Treasury Stock)	—	—	—	*-260*	*-260*
Other Equity	-6,746	-7,538	-7,816	*-9,515*	*-9,515*
Shareholder's Equity	**14,344**	**13,651**	**15,439**	***15,188***	***17,244***
Minority Interest	471	612	643	*663*	*752*
Total Equity	**14,815**	**14,263**	**16,082**	***15,852***	***17,996***

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Unilever NV UN (NYSE) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods

Morningstar Analyst Forecasts

Cash Flow (EUR Mil)
Fiscal Year Ends in December

				Forecast	
	2013	2014	2015	*2016*	*2017*
Net Income	5,263	5,515	5,259	*5,502*	*5,952*
Depreciation	984	947	1,097	*1,213*	*1,104*
Amortization	167	180	273	*91*	*182*
Stock-Based Compensation	228	188	150	—	—
Impairment of Goodwill	—	305	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	—	—	—	*-724*	—
Other Non-Cash Adjustments	-554	-1,551	-92	—	—
(Increase) Decrease in Accounts Receivable	-917	82	2	*-129*	*-138*
(Increase) Decrease in Inventory	168	-47	-129	*-50*	*-198*
Change in Other Short-Term Assets	—	—	—	*-346*	*-138*
Increase (Decrease) in Accounts Payable	949	-27	847	*-58*	*372*
Change in Other Short-Term Liabilities	—	—	—	*87*	*266*
Cash From Operations	**6,288**	**5,592**	**7,407**	***5,587***	***7,403***
(Capital Expenditures)	-1,791	-1,893	-1,867	*-1,756*	*-2,069*
Net (Acquisitions), Asset Sales, and Disposals	1,081	1,622	-1,522	—	—
Net Sales (Purchases) of Investments	-377	-359	-334	—	—
Other Investing Cash Flows	-74	289	184	*1,558*	*-5*
Cash From Investing	**-1,161**	**-341**	**-3,539**	***-198***	***-2,074***
Common Stock Issuance (or Repurchase)	24	-1,347	-276	*-260*	—
Common Stock (Dividends)	-2,993	-3,189	-3,331	*-3,410*	*-3,500*
Short-Term Debt Issuance (or Retirement)	350	338	245	*-2,545*	*124*
Long-Term Debt Issuance (or Retirement)	925	-131	1,296	*1,258*	*-1,222*
Other Financing Cash Flows	-3,696	-861	-966	*-363*	*-308*
Cash From Financing	**-5,390**	**-5,190**	**-3,032**	***-5,321***	***-4,906***
Exchange Rates, Discontinued Ops, etc. (net)	84	-146	-541	*-1,699*	—
Net Change in Cash	**-179**	**-85**	**295**	***-1,631***	***423***

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Unilever NV UN (NYSE) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

Company/Ticker	Price/Fair Value	Price/Earnings 2015	2016(E)	2017(E)	EV/EBITDA 2015	2016(E)	2017(E)	Price/Free Cash Flow 2015	2016(E)	2017(E)	Price/Book 2015	2016(E)	2017(E)	Price/Sales 2015	2016(E)	2017(E)
Nestle SA NESN CHE	0.98	28.6	26.7	23.5	15.6	14.9	14.0	22.8	27.5	23.8	4.2	4.2	4.0	2.6	2.7	2.5
Procter & Gamble Co PG USA	0.96	20.8	23.1	23.1	13.7	14.5	14.9	19.5	18.6	31.1	3.4	3.9	3.2	3.0	3.5	3.6
L'Oreal SA OR FRA	1.06	25.5	25.4	23.8	16.6	16.6	15.7	28.7	27.8	24.1	3.7	3.8	3.6	3.4	3.6	3.4
Colgate-Palmolive Co CL USA	0.99	30.4	25.0	23.1	15.0	16.2	15.2	26.3	25.1	24.3	NM	NM	NM	3.7	4.3	4.1
Henkel AG & Co KGaA HEN3 DEU	1.21	23.2	23.1	22.2	14.5	15.1	14.1	23.6	96.7	62.2	3.3	3.8	3.7	2.5	2.9	2.7
Average		25.7	24.7	23.1	15.1	15.5	14.8	24.2	39.1	33.1	3.7	3.9	3.6	3.0	3.4	3.3
Unilever NV UN US	**1.03**	**23.0**	**22.9**	**21.0**	**13.0**	**12.9**	**12.1**	**21.8**	**31.9**	**22.9**	**7.8**	**8.1**	**7.1**	**2.3**	**2.3**	**2.2**

Returns Analysis

Company/Ticker	Last Historical Year Total Assets (Mil)	ROIC % 2015	2016(E)	2017(E)	Adjusted ROIC % 2015	2016(E)	2017(E)	Return on Equity % 2015	2016(E)	2017(E)	Return on Assets % 2015	2016(E)	2017(E)	Dividend Yield % 2015	2016(E)	2017(E)
Nestle SA NESN CHE	116,352 CHF	12.8	13.5	14.1	20.9	21.9	22.9	14.0	16.6	18.1	6.8	7.8	8.4	3.0	2.9	3.4
Procter & Gamble Co PG USA	— USD	9.3	10.4	13.3	18.2	20.8	25.2	10.9	17.9	25.3	5.1	8.2	11.9	3.4	3.3	3.3
L'Oreal SA OR FRA	33,711 EUR	13.1	12.6	13.3	18.7	17.9	18.8	15.1	13.9	15.4	10.0	9.7	10.8	1.8	1.5	1.9
Colgate-Palmolive Co CL USA	11,958 USD	26.4	29.7	31.6	33.6	38.1	40.5	327.2	-610.1	-620.1	10.9	20.6	21.8	2.5	2.3	2.4
Henkel AG & Co KGaA HEN3 DEU	22,323 EUR	15.6	13.7	13.6	44.2	41.3	45.5	6.2	6.7	6.9	3.6	3.8	3.7	1.3	1.2	1.2
Average		15.4	16.0	17.2	27.1	28.0	30.6	74.7	-111.0	-110.9	7.3	10.0	11.3	2.4	2.2	2.4
Unilever NV UN US	**52,298 EUR**	**17.5**	**13.4**	**18.4**	**33.0**	**24.6**	**33.9**	**33.8**	**33.4**	**34.3**	**9.8**	**9.9**	**10.6**	**2.8**	**2.8**	**2.9**

Growth Analysis

Company/Ticker	Last Historical Year Revenue (Mil)	Revenue Growth % 2015	2016(E)	2017(E)	EBIT Growth % 2015	2016(E)	2017(E)	EPS Growth % 2015	2016(E)	2017(E)	Free Cash Flow Growth % 2015	2016(E)	2017(E)	Dividend/Share Growth % 2015	2016(E)	2017(E)
Nestle SA NESN CHE	89,083 CHF	-3.0	1.2	5.0	-30.2	10.6	6.1	-40.5	11.3	13.8	-0.3	-19.3	16.4	-0.6	-0.9	16.6
Procter & Gamble Co PG USA	70,749 USD	-12.1	-7.7	1.2	-5.9	0.6	3.4	-2.7	-2.5	4.3	29.8	-23.0	94.7	6.2	3.5	7.5
L'Oreal SA OR FRA	25,257 EUR	12.1	3.0	5.2	12.8	5.9	5.8	19.4	7.4	6.9	37.5	28.8	2.9	0.1	-8.0	25.8
Colgate-Palmolive Co CL USA	16,034 USD	-7.2	-5.3	4.5	-1.3	3.1	6.3	-16.5	32.5	8.4	-4.3	10.6	4.1	4.9	0.3	8.0
Henkel AG & Co KGaA HEN3 DEU	18,089 EUR	10.1	1.0	8.3	17.9	14.6	7.5	18.8	18.3	4.5	-84.6	904.4	-131.5	7.4	12.2	-0.4
Average		0.0	-1.6	4.8	-1.3	7.0	5.8	-4.3	13.4	7.6	-4.4	180.3	-2.7	3.6	1.4	11.5
Unilever NV UN US	**53,272 EUR**	**10.0**	**-0.8**	**4.4**	**-9.1**	**3.8**	**7.5**	**-8.9**	**5.6**	**8.6**	**-30.5**	**38.0**	**-1.9**	**4.5**	**3.7**	**2.7**

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45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
		2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Nestle SA NESN CHE	8,343 CHF	49.8	50.4	49.8	17.9	19.3	19.6	14.3	15.6	15.8	9.4	10.4	11.3	11.3	9.7	10.6
Procter & Gamble Co PG USA	10,840 USD	48.4	49.6	50.8	24.0	26.1	25.8	19.6	21.4	21.8	15.3	16.0	16.2	15.4	18.6	11.5
L'Oreal SA OR FRA	3,440 EUR	71.2	71.3	71.4	21.1	21.6	21.7	17.4	17.9	18.0	13.6	14.1	14.2	12.0	12.8	14.1
Colgate-Palmolive Co CL USA	1,991 USD	58.6	59.8	59.9	27.0	28.6	29.0	24.2	26.3	26.8	12.4	17.2	17.5	14.1	17.0	16.8
Henkel AG & Co KGaA HEN3 DEU	774 EUR	48.2	48.6	48.9	17.1	19.0	18.7	14.6	16.6	16.5	4.3	5.0	4.8	10.5	3.0	4.3
Average		55.2	55.9	56.2	21.4	22.9	23.0	18.0	19.6	19.8	11.0	12.5	12.8	12.7	12.2	11.5
Unilever NV UN US	**4,909** EUR	**42.2**	**41.7**	**42.1**	**16.9**	**17.4**	**17.8**	**14.3**	**15.0**	**15.4**	**9.2**	**9.7**	**10.1**	**10.4**	**7.3**	**9.7**

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
		2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Nestle SA NESN CHE	21,230 CHF	38.8	39.7	43.0	28.0	28.4	30.1	22.0	28.4	32.9	1.3	1.3	1.4	2.1	2.1	2.2
Procter & Gamble Co PG USA	30,350 USD	48.6	53.4	41.1	32.7	34.8	29.2	27.2	29.4	25.4	1.8	1.8	1.8	2.1	2.2	2.0
L'Oreal SA OR FRA	782 EUR	3.3	5.1	2.2	3.2	4.9	2.1	385.6	275.3	290.2	0.1	0.2	0.1	1.4	1.4	1.4
Colgate-Palmolive Co CL USA	6,571 USD	-2,197.7	-1,349.8	-1,953.6	104.8	108.0	105.4	32.5	30.7	32.4	1.5	1.6	1.4	-40.0	-23.6	-35.6
Henkel AG & Co KGaA HEN3 DEU	884 EUR	6.5	25.0	28.6	6.1	20.0	22.2	44.8	76.1	24.0	0.3	1.0	1.1	1.6	1.9	1.9
Average		-420.1	-245.3	-367.7	35.0	39.2	37.8	102.4	88.0	81.0	1.0	1.2	1.2	-6.6	-3.2	-5.6
Unilever NV UN US	**14,236** EUR	**92.2**	**85.3**	**68.7**	**48.0**	**46.0**	**40.7**	**16.5**	**15.2**	**17.0**	**1.6**	**1.4**	**1.2**	**3.4**	**3.4**	**3.1**

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
		2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)	2015	2016(E)	2017(E)
Nestle SA NESN CHE	239,511 CHF	1.41	2.26	3.70	0.87	0.98	1.06	0.63	0.72	0.81	0.47	0.73	1.02	85.1	74.6	76.0
Procter & Gamble Co PG USA	236,398 USD	2.37	2.50	9.94	0.91	0.94	1.50	0.72	0.77	1.36	0.57	0.61	2.14	103.6	70.8	47.9
L'Oreal SA OR FRA	93,016 EUR	2.48	4.96	4.86	1.13	1.21	1.29	0.83	0.92	0.98	1.89	2.32	5.41	46.5	42.0	45.0
Colgate-Palmolive Co CL USA	64,615 USD	1.07	1.05	0.74	1.24	1.01	0.93	0.91	0.75	0.66	3.21	1.05	0.73	107.9	60.0	59.6
Henkel AG & Co KGaA HEN3 DEU	52,743 EUR	6.74	0.30	4.81	1.09	1.09	1.22	0.82	0.77	0.90	1.34	—	—	72.9	69.1	65.9
Average		2.81	2.21	4.81	1.05	1.05	1.20	0.78	0.79	0.94	1.50	1.18	2.33	83.2	63.3	58.9
Unilever NV UN US	**136,876** USD	**0.80**	**0.24**	**0.38**	**0.63**	**0.67**	**0.69**	**0.42**	**0.42**	**0.44**	**0.53**	**0.37**	**0.56**	**67.9**	**66.6**	**63.0**

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Research Methodology for Valuing Companies

Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. Moreover, we think analyzing valuation through discounted cash flows presents a better lens for viewing cyclical companies, high-growth firms, businesses with finite lives (e.g., mines), or companies expected to generate negative earnings over the next few years. That said, we don't dismiss multiples altogether but rather use them as supporting cross-checks for our DCF-based fair value estimates. We also acknowledge that DCF models offer their own challenges (including a potential proliferation of estimated inputs and the possibility that the method may miss short-term market-price movements), but we believe these negatives are mitigated by deep analysis and our long-term approach.

Morningstar, Inc. and its affiliates ("Morningstar", "we", "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our single-point star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality, no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

To assess the sustainability of excess profits, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working-capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes (EBI) and the net new investment (NNI) to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital (RONIC), and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until a perpetuity value is calculated. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total pres-

Morningstar Research Methodology for Valuing Companies

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ent value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term, market-value weights.

3. Uncertainty around that fair value estimate

Morningstar's Uncertainty Rating captures a range of likely potential intrinsic values for a company and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

- ►**Low:** margin of safety for 5-star rating is a 20% discount and for 1-star rating is 25% premium.
- ►**Medium:** margin of safety for 5-star rating is a 30% discount and for 1-star rating is 35% premium.
- ►**High:** margin of safety for 5-star rating is a 40% discount and for 1-star rating is 55% premium.
- ►**Very High:** margin of safety for 5-star rating is a 50% discount and for 1-star rating is 75% premium.
- ►**Extreme:** Stock's uncertainty exceeds the parameters we have set for assigning the appropriate margin of safety.

4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed which we believe is a reliable source.

For more detail information about our methodology, please go to http://global.morningstar.com/equitydisclosures

Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open. Our analysts keep close tabs on the companies they follow, and, based on thorough and ongoing analysis, raise or lower their fair value estimates as warranted.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

Five Stars ★★★★★

We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. Scenario analysis developed by our analysts indicates that the current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

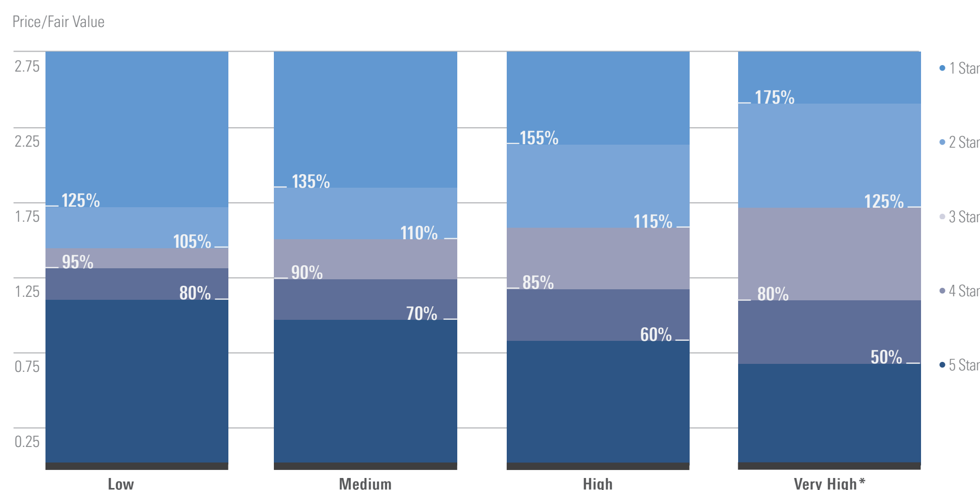
Four Stars ★★★★

We believe appreciation beyond a fair risk-adjusted return is likely.

Three Stars ★★★

Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

Morningstar Research Methodology for Valuing Companies



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

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Two Stars ★★
We believe investors are likely to receive a less than fair risk-adjusted return.

One Star ★
Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. Scenario analysis by our analysts indicates that the market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

Other Definitions:

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Stewardship Rating: Represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Quantitative Valuation: Using the below terms, intended to denote the relationship between the security's Last Price and Morningstar's quantitative fair value estimate for that security.

- **Undervalued:** Last Price is below Morningstar's quantitative fair value estimate.
- **Farily Valued:** Last Price is in line with Morningstar's quantitative fair value estimate.
- **Overvalued:** Last Price is above Morningstar's quantitative fair value estimate.

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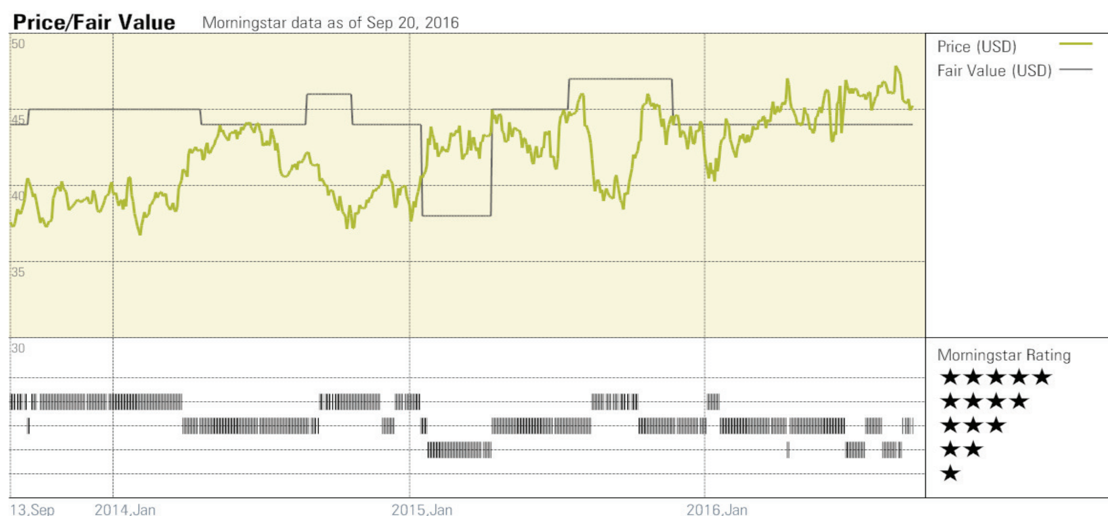
Unilever NV UN (NYSE) | ★★★

Last Price	Fair Value	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods



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45.25 USD	44.00 USD	Low	Wide	Stable	Standard	Consumer Packaged Goods

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