Unilever Pakistan

Initiating Coverage

Recommendation: NEUTRAL

Fair Value: PRs2,126

Investment Consideration

Consumer sector – Bullish industry outlook
Despite current economic challenges faced in the country, we expect robust growth in consumer sector as a result of rising incomes and favorable demographics. Encouraging demand drivers include growing young population, rapid urbanization, and increased penetration of organized retail, all ensuing well for the FMCG sector in Pakistan. Going forward we expect Unilever to capitalize on favorable macroeconomic factors and post revenue growth of CAGR 11.5% in CY08-CY12E.

HPC- Backbone of profitability
The Home & Personal Care (HPC) segment continues to drive overall growth momentum registering 25% sales growth in CY07. The high margin segment constitutes over 50% of revenues and 70% of the bottom line. Going forward we expect HPC to be the main subscriber to ULEVER's profitability and forecast HPC revenues to grow by 17% CAGR in CY08-CY12E. In stark contrast sales for the mature tea segment continue to follow a declining trend (-5% in CY07), as Unilever faces stiff competition by organized and unorganized players in the tea market.

Ice cream – High Growth Potential
Unilever has the first mover advantage in the capital intensive ice cream segment. With around 65% market share, ULEVER is the only major operator in the industry. The company is in the process of increasing production capacity and strengthening its distribution channel. In CY07, sales were restricted by lost trade confidence, delay in factory expansion resulting in plant shutdowns, and adverse weather conditions. However, going forward with per capita consumption at a low 0.5 liters per annum tremendous growth potential exists in the ice cream segment. We expect segment revenue growth of CAGR 19% in CY08-CY12E.

Inflationary pressures squeezing margins
Margins continue to remain under pressure on the back of rising inflationary pressures pushing raw material costs north. HPC and Spreads segment margins have declined, as ULEVER has battled high prices of palm oil, a key ingredient of its HPC, Ice cream and margarine business. In the beverages segment, supply disruptions from Kenya have resulted in volatile international tea prices resulting in unstable segment margins. Going forward, we expect margins to remain under pressure, and forecast net margins of 7-7.5% during CY08-CY12E.

Recommendation
Unilever Pakistan Limited (ULEVER) is the largest FMCG player in Pakistan, with market leadership position in most of its Home and Personal Care and Food categories. At the current market price the scrip is trading at 11% premium to our price objective and at 2008E PE multiple of 16.3x. We are initiating coverage with a 'Neutral' recommendation on ULEVER, with the target price of PRs2,126.

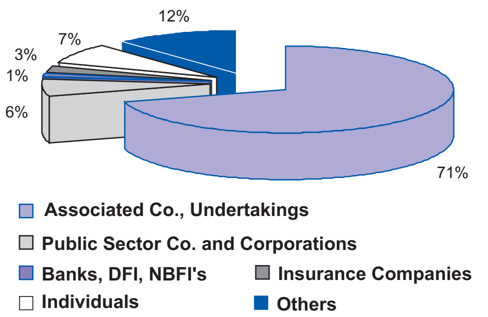
Table 1: Financial Highlights

	2005A	2006A	2007A	2008E	2009E	2010E
Net Income (PRs mn)	1,601	1,632	1,687	1,922	2,118	2,363
Earnings Per share (PRs)	120	123	127	145	159	178
Dividend per share (PRs)	120	122	123	140	155	172
Price / Earnings (x)	19.5	19.2	18.5	16.3	14.8	13.2
Price / Book (x)	16.8	17.0	15.7	14.1	12.7	11.3
Price / Sales (x)	1.8	1.5	1.3	1.2	1.1	0.9
Price / CF (x)	16.5	12.9	13.0	10.8	12.8	10.8
EV / EBITDA (x)	10.9	10.8	10.3	9.0	8.2	7.4
Dividend Yield (%)	5%	5%	5%	6%	7%	7%

Source: Company Reports & IGI Research

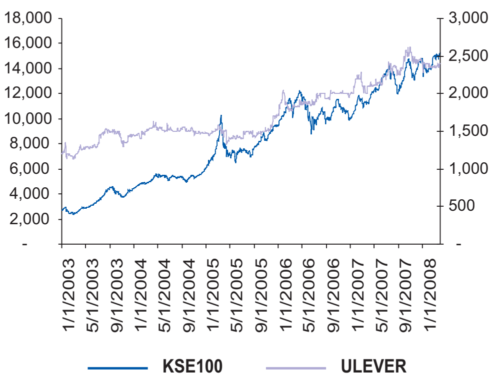
Bloomberg Code	*ULEVER PA*
Current Price (PRs per share)	*2,354.00*
Average daily Volume (shares)	*2,382.00*
Market Capitalization (PRs mn)	*31,293.79*
Paidup Capital (PRs mn)	*664.70*
Shares Outstanding (mn)	*13.29*
Weightage in KSE100 (%)	*0.8*
Average Price Per Share (PRs per share)	*1,392.52*
Free Float (%)	*18*

Chart 1: Shareholding Pattern



Source: Bloomberg & IGI Research

Chart 2: Price Performance



Source: Bloomberg & IGI Research

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IGI Securities

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All prices are as of March 28, 2008

Macroeconomic Environment

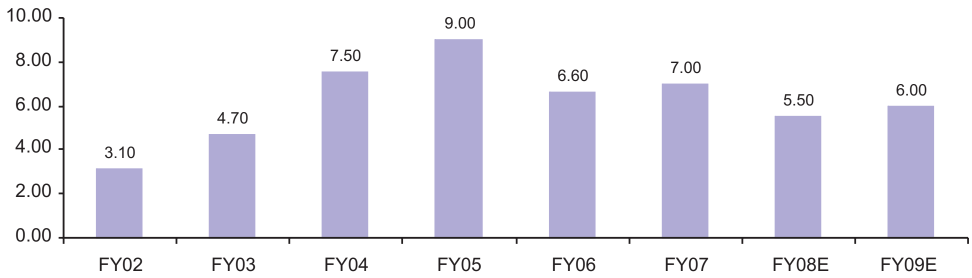
FMCG business growth is directly linked to the national economy. The key demand drivers include rising disposable incomes, rapid urbanization and the deepening penetration of organized retail. Moreover, favorable demographics are a key advantage for FMCG operators in Pakistan. With population growing at a rate of 2% per annum and 54% of population below 20 years of age, there is tremendous untapped potential. Our forecasts for ULEVER's sales are based on real GDP growth, per capita income, private consumption expenditure and retail and wholesale trade expenditure.

GDP Growth

Pakistan's economy has posted buoyant economic growth in the last five years, with real GDP CAGR of 7.1% during FY02-FY07.The cumulative effect of the benign economic climate and the rising per capita income, has led to growth in disposable income and private consumption expenditure. Against this backdrop, consumer spending has remained consistently upbeat with consumer sector riding on the wave of economic upturn. However, the recent macroeconomic complications have prompted the central bank to scale down the GDP growth target of 7.2%.

Looking forward, we are optimistic about the performance of consumer sector considering the expected acceleration in retail & whole sale trade. Despite the cooling of overall growth momentum, GDP growth is expected to remain robust around the 5.5-6% level in the next few years.

Chart 3: GDP Growth (%)

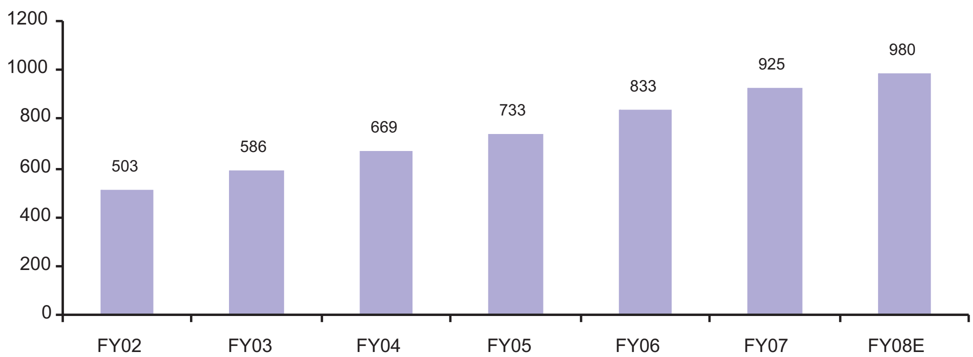


Source: Economic Survey of Pakistan & IGI Research

Per Capita Income

Per capita income, a key indicator of economic well-being, grew by an average 13% in FY02-FY07. Moreover, Pakistan's middle income group constitutes approximately 35mn consumers representing huge spending appetite. This coupled with rising income levels of higher income segment and largely untapped rural potential bodes well for overall consumer staples industry. Going forward, consumer sector is likely to benefit from growing income and rising consumerism.

Chart 4: Per Capita Income (US$)

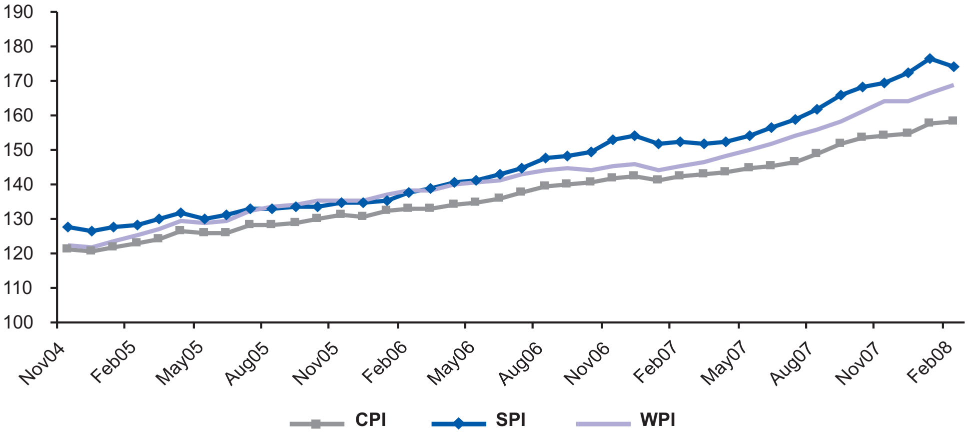


Source: Economic Survey of Pakistan & IGI Research

Inflation

The unprecedented rise in prices of oil, food and other essential items has kept an uptrend and has resulted in diminishing consumer purchasing power. According to SBP estimates, CPI inflation is expected to be over 7% in FY08. On the cost front, rising prices of raw materials, including palm oil and tea in the international market, are a key threat facing ULEVER. Hence, rising inflation is expected to put upward pressure on product prices and thus product affordability.

Chart 5: Monthly Inflation Trend (Base FY01=100)



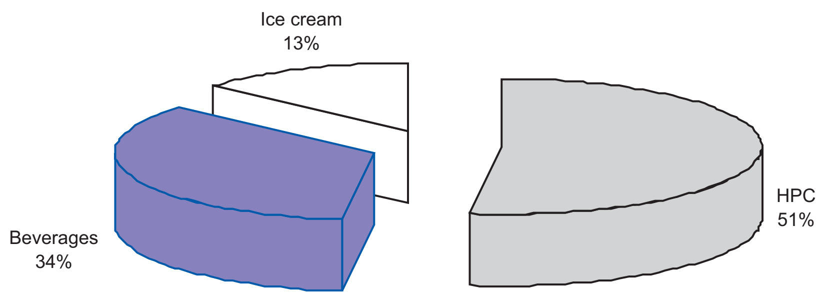
Source: FBS & IGI Research

Company Information

Unilever Pakistan Limited (ULEVER), the largest FMCG Company in Pakistan, is engaged in a diverse blend of business categories including Personal care, Personal wash, Beverages (Tea), Ice-cream, Spreads, among others. The company is the subsidiary of ULEVER Overseas Holdings Ltd with 70% majority shareholding. ULEVER has a fifty years history of operations and a strong distribution network. The company operates through 4 regional offices, as well as 4 wholly owned and 6 third party manufacturing sites across Pakistan.

The Home & Personal Care (HPC) is the back bone of profitability and continues to drive overall growth momentum. On the other hand, mature tea segment continues to remain under pressure and follows a declining trend as ULEVER faces stiff competition in the organized and unorganized players in the market, resulting in loss of market share. In the capital intensive Ice cream segment ULEVER has made significant investments in expansion project and strengthening its distribution network. Going forward, we expect HPC and Ice cream to be the main subscribers of growth and profitability. On the beverages front, strategy is to hold market share at best.

Chart 6: Revenue break down



Source: Company Reports & IGI Research

Market Position

ULEVER operates in an emerging market with varied consumer preferences. The market is highly responsive to economic conditions, inflation and social disruptions resulting in variations in sales revenues for the company. ULEVER faces intense competition from both organized and un-organized players. In the organized sector, competition includes multi-national FMCG companies like P&G, Colgate, Nestle, Reckitt Benckiser as well as local operators. Apart from the threat of legitimate competition, the company confronts the risk of losing market share to cheaper smuggled and counterfeit products.

In order to ascertain the industry size of organized segments we have used ULEVER's market share estimates and gross sales to compute the industry size. Based on our estimates the size of organized HPC, Tea and Ice cream segment is PRs39bn, PRs25bn, and PRs7bn and ULEVER holds around 35-40%, 35-39% and 60-65% market in terms of turnover.

ULEVER's key competitive advantage over other market participants is the retail reach of the company. ULEVER services 500,000 outlets with 50% through direct distribution and remaining via wholesalers. ULEVER is gearing up to increase its market share in the untapped rural economy, and has increased its coverage of retail shops in rural segment by 15,000 within 2 years.

Market share analysis of various business segments reveals Beverages (Tea) is turning out to be a growing concern as ULEVER continues to lose ground to competitors. In the HPC segment, ULEVER is the leading player in personal wash and detergents among others and has gained market share in key categories. By gaining early-mover advantage ULEVER controls high growth ice cream market and is investing aggressively to maintain its market dominance with around 65% of market share. The biggest challenge in safeguarding market position is low cost, under-invoiced and smuggled products available in the market. According to industry sources, 40% of local tea consumed and a large portion of HPC products are smuggled into the country. This coupled with unprecedented rise in inflation causes consumers to opt for these substitutes resulting in loss of market for ULEVER.

Table 2: ULEVER: Market Share Analysis

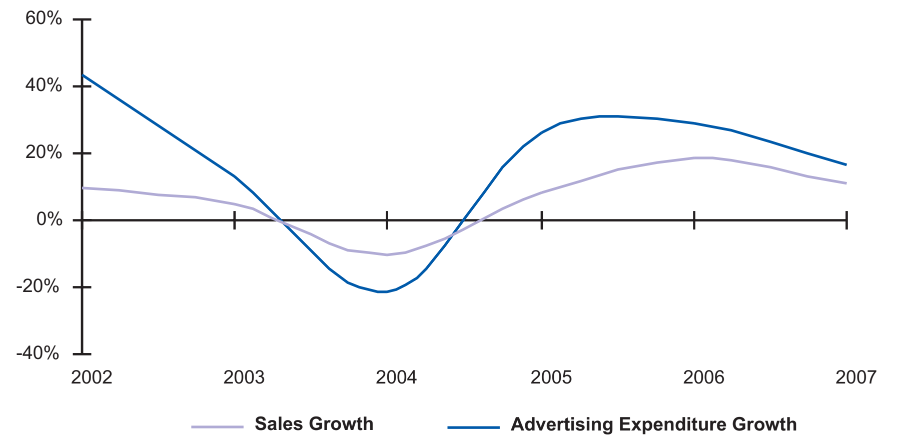
	2005	2006	2007
Home and personal care			
Personal wash	52%	50%	49%
Shampoo	33%	40%	42%
Detergent	18%	30%	40%
Skin Care	34%	40%	41%
Ice cream	55%	65%	65%
Beverages	45%	41%	39%

Source: IGI Research Estimates

Building Brand Equity

ULEVER has a strategy of investing in brands in an effort to maintain awareness and develop brand equity. There has been double digit growth in advertising and sales promotions expenditure which totaled PRs2.6bn in CY07. The main focus has been investing in the HPC business, constituting over 60% of the total advertising expenditure. However, the growth in sales has lagged the growth in advertising spend which has been twice the revenue growth, indicating that investments in brands have been unsuccessful in leveraging sales growth. In our opinion, this is mainly attributed to the fact that major investments have been directed toward re-launching and re-energizing established brands like Lux, Surf and Brooke Bond rather than new products. Going forward, we expect double digit growth in the advertising expenditure which is likely to remain 11-12% of net sales.

Chart 7: Sales vs Advertising Expenditure (%)



Source: Company Reports & IGI Research

Restructuring – Path to Growth

Ever-rising cost of doing business and intensifying competition has adversely impacted profitability. In an effort to improve its operating margins the company is undergoing a restructuring process focused on cost cuts, overheads reduction and greater outsourcing. By 2010, ULEVER plans to uplift its operating margins to 15% globally, with the help of streamlined business operations. In CY07, the company reported 372mn in restructuring costs reducing the profit margin by 1.6%. This was mainly attributed to ULEVER's decision to close down the Karachi Tea Factory in an effort to boost ailing tea business by reducing staff costs and reorganizing supply chain. Going forward, we expect decline in profitability as a result of restructuring charges in the near term; however, in the long run the company is braced for restructuring benefits. In our analysis, although we have incorporated restructuring charges of average PRs230mn in CY08-CY10E, these non-recurring charges do not affect sustainable earnings and thus our price objective.

Rural Market - A world of opportunity

The under penetrated rural market offers tremendous growth potential as rural population constitutes around 60% of the total population. In the past few years, favorable structural changes, such as double digit growth in agricultural credit, increased penetration of television cable media have boosted demand for FMCG products. ULEVER and others are capitalizing on this emerging trend by targeting central and southern Punjab where the effect is most pronounced. In order to cater to rural segment ULEVER is offering value packs in small sizes in lieu of standard packs. However, the key risk in this segment is high price sensitivity. With rapid inflation pushing product prices up, consumers are likely to switch to cheap local substitutes.

Table 3: Population by Urban / Rural

% of total population	1990	1995	2005	2010E	2015E
Urban	31.9	34.3	37.0	43.3	47.0
Rural	68.1	65.7	63.0	56.7	53.0
Total (mn)	109.4	123.6	159.2	179.6	202.2

Source: Euromonitor International & IGI Research

Emerging International Retailers

Pakistan has emerged on the radar screen of international retailers and the market is becoming increasingly lucrative for entrants in the wholesale and retail business. With high GDP growth, rising incomes and supportive government policies to attract foreign investments, Pakistan has surfaced as one of the top emerging markets for global retailers. Moreover, Pakistan has one of the least concentrated retail market in the world with state-owned Utility Stores Corporation (USC), holding around 0.3% of the market share. Going forward, penetration of USC is expected to increase as 300 more stores will be opening up shortly and ULEVER expects 100% growth in the segment. In this attractive setting, global retailers SHV Makro and Metro Cash & Carry have started operations in Pakistan and plan to open up 30 and 10 stores respectively in the medium term. Carrefour, the international French retailer, is also set to open its first outlet in Karachi and plans to set up 5-6 hyper markets in major cities. Rapid urbanization coupled with increased penetration of organized retail bodes well for ULEVER. In our forecasts we have incorporated an incremental growth adjustment of 3-5% in revenues based on increased penetration of retail.

Business and Regulatory Environment

Businesses classify Pakistan’s tax environment largely benign as compared to regional developing economies of the same size, however the 1% tax on turnover is a serious concern which leads to more than 100bps decline in net profit margin. From a business environment perspective, the government has been unable to control smuggled products which are hurting ULEVER in terms of sales volumes and profitability. Going forward, with this trend the adverse impact on sales volumes is likely to persist.

Changing Consumer Life Styles

Changing consumer life styles have a benign impact on the demand of ready-to-go products. As urban life styles change at an increasing pace, two income households have led to increased premium on time and supplemented incomes, resulting in rising demand for packaged products. Consumers are generally becoming more quality conscious, fully aware of leading brands in the market. This particularly bodes well for large operators like ULEVER which spend huge sums on brand promotion via different media sources.

However, from a consumer expenditure perspective, the general trend in outlay is towards basic necessities and spending levels remain well below developed nations. About 55% of expenditure is targeted towards food and beverages. The expenditure on household goods is around 2-3% level. This reveals that ULEVER's target market in the key HPC and Ice cream largely encompasses relatively small portion of the population.

Table 4: Consumer Spending

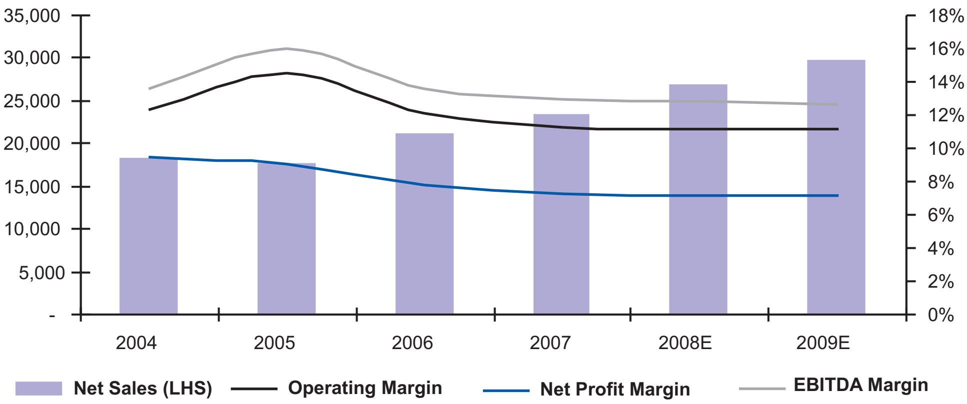
% of total consumer expenditure	1995	2000	2005	2010E	2015E
Food & Beverages	55.37	55.45	55.51	54.71	55.19
Clothing	9.3	8.43	7.66	7.38	7.15
Housing	11.63	9.54	9.98	10.58	10.95
Household Goods	1.41	2.60	2.59	2.54	2.56
Education	3.7	4.11	4.23	4.4	4.53
Transport	5.47	5.9	6.02	5.97	5.56
Others	13.12	13.97	14.01	14.42	14.06

Source: Euromonitor International & IGI Research

Financial Performance

ULEVER operates in a dynamic FMCG market with distinct consumer preferences, ever rising competition and surging input costs. The company has phenomenal distribution reach and is a market leader across most of its categories. ULEVER's top-line growth has improved from CY05 onwards; however, at the cost of net operating margins. The declining margins are largely attributed to rising raw material costs and losing volume to competitors and smuggled substitutes. Going forward we expect ULEVER to register top line growth of CAGR 11.5% and profit margin of 7-7.5% in CY08-CY12E. The growth is expected to be mainly driven by aggressively marketing new variants in existing business segments as the company does not intend to introduce any new category in the near future.

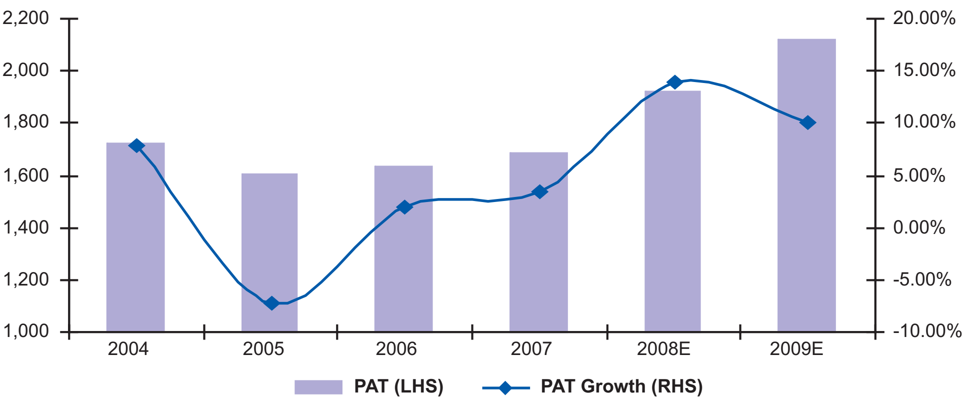
Chart 8: Trend in Sales and Margins **(PRsmn)**



Source: Company Reports & IGI Research

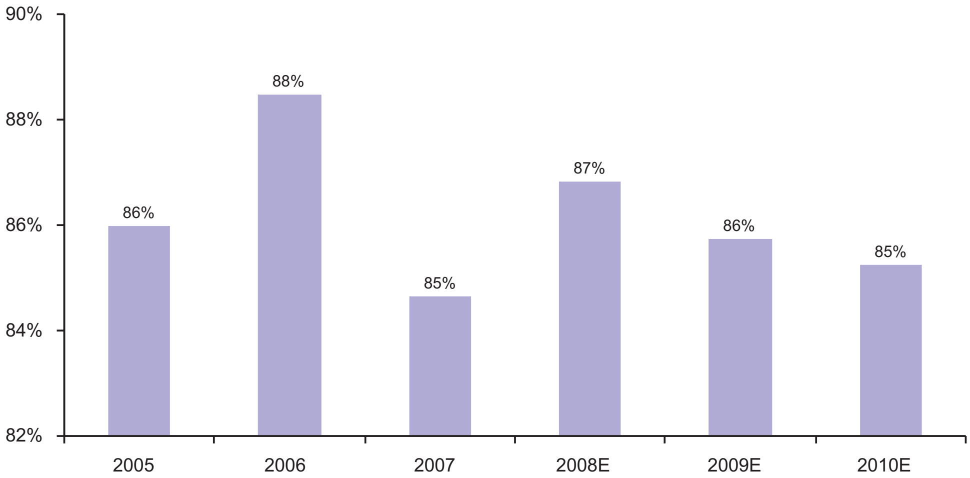
Analysis of profit margins over time reveals a declining trend in ULEVER operating and net margins. Amidst the downturn operating margins were posted at 11.3% in CY07, a decline of 90bps compared to CY06. The margin crunch is mainly attributed to aggressive advertising and marketing spend, ongoing restructuring expenditure, inability to boost sales volumes due to tough competition and ever-rising cost of inputs. Going forward we expect pressure on margins to persist as the afore-mentioned factors are not likely to subside in the near term. We forecast EBITDA margins at 12-13%, operating margins at 11% and net margin at 7-7.5% in CY08-CY12E.

Chart 9: Profit After Tax **(PRsmn)**



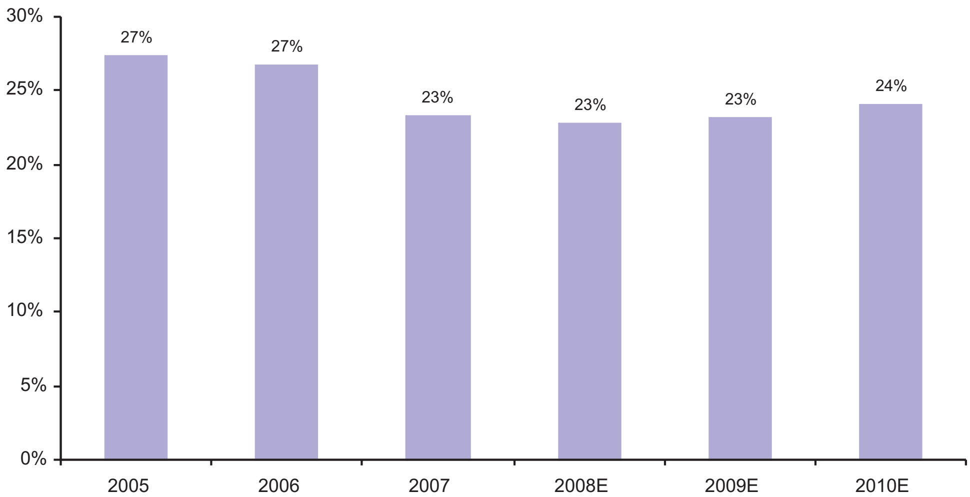
Source: Company Reports & IGI Research

Chart 10: Return on Equity



Source: Company Reports & IGI Research

Chart 11: Return on Assets



Source: Company Reports & IGI Research

ULEVER's profitability has been stagnant as earnings have lagged the growth in turnover. The miniscule growth in the bottom-line is mainly attributed to declining margins as a result of cost pressures, rapid growth in distribution expenditure and restructuring costs. The profit after tax (PAT) posted staggered growth of 3.3% in CY07 as ice cream sales were restricted by delays in factory expansion and declining volume in the tea business.

The return-on-assets (ROA) has averaged 27%, however it declined to 24% in CY07. This was attributed to decline in profitability and increase in asset base as a result of expansion in the ice cream business. Going forward, we expect net margin to be flat at best while the asset turnover is likely to increase on the back of sales growth resulting in ROA to stabilize.

Table 5: Dupont Analysis

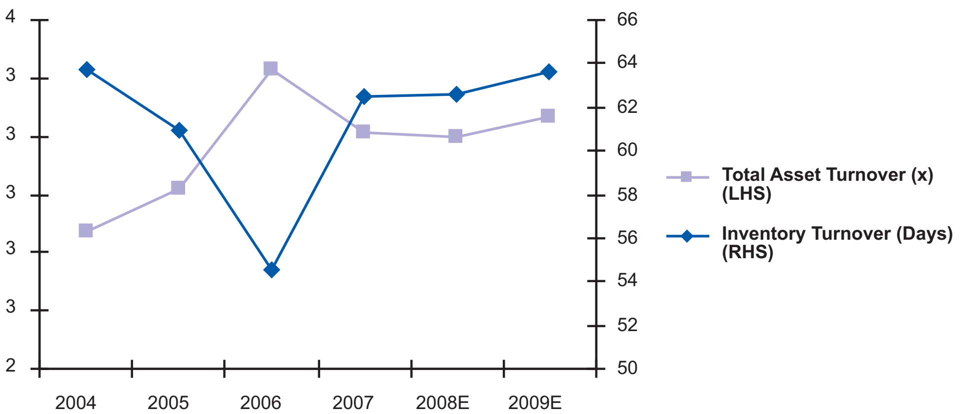
	2005A	2006A	2007A	2008E	2009E	2010E
Net Profit Margin	9%	8%	7%	7%	7%	7%
Total Asset Turnover	3.0	3.3	2.9	3.0	3.1	3.2
Leverage Factor	3.1	3.5	4.1	4.0	3.8	3.7
ROA	27%	27%	23%	23%	23%	24%
ROE	86%	88%	85%	87%	86%	85%

Source: Company Reports & IGI Research

Efficiency Ratios

The inventory turnover in days, a measure of sales efficiency depicts how quickly the company is able to sell off its inventory. The rising trend in the inventory turnover days is indicative of the declining operational efficiency as the growth in sales has lagged growth in average inventory. ULEVER's cash cycle is effectively represented by the inventory turnover as the company has negligible credit purchases and sales. The total asset turnover (TAT) has been flat at 3x, and going forward we expect the trend to continue and expect TAT to increase at a relaxed pace.

Chart 12: Operational Efficiency

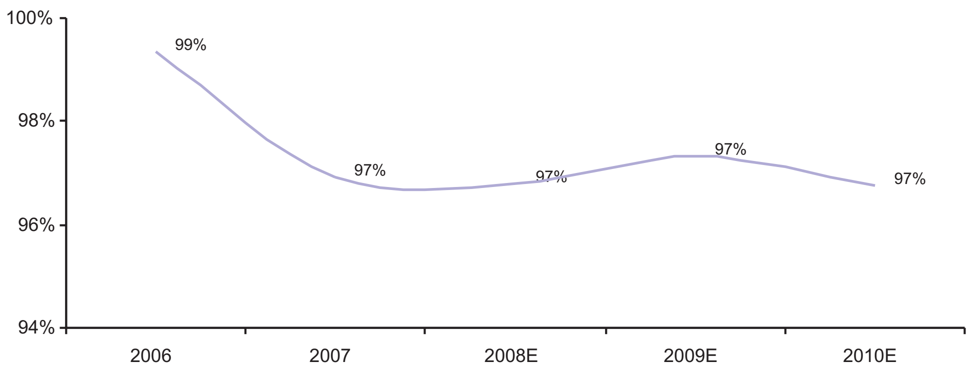


Source: Company Reports & IGI Research

Dividend Payout

ULEVER has a policy of maximum dividend payout averaging 100% and dividend yield 5-6% in the last 5 year. ULEVER's stable earnings and continuous dividend stream makes the company a classic defensive stock. This provides investors an effective hedge against volatile market downturn and can aid in reducing the overall risk of the portfolio. Taking into account the growth of FMCG sector, the scrip is a good bet for investors looking for modest capital appreciation and steady dividends. On the flip side, the growth in dividends has lagged inflation growth which implies a decline in real payout; low retention rate may also signal lack of available growth avenues, and tax consequence of dividends reduces overall return.

Chart 13: Dividend Payout **(%)**



Source: Company Reports & IGI Research

Industry Outlook

ULEVER predominately operates in growth segments except for the mature tea and soap business. However, even in the mature soap business ULEVER has been able to post robust growth and high margins. The growth segments offer prospects of sustained above average profitability, however these also require hefty investment in product and brand development, thus pose the risk of losing market share amidst intensifying competition.

Table 6: Industry Classification

Industry	Industry Classification	Indicators
Tea	Mature	Industry growth lagging GDP growth Low profit margins Reduced sales volumes
Ice Cream	Growth	0.5kg per capita yearly consumption Double digit revenue growth Large Capex and advertising spend
Soap	Mature*	*ULEVER Growth company within mature industry Lux sales doubled in 3 years High profit margins Introduction of liquid hand wash
Detergent	Growth	11% rise in Surf's market share Low penetration, 50% population uses laundry soap Double digit turnover growth
Shampoo	Growth	Lowest penetration in Asia 'Clear' Shampoo highest growth in comparable regions

Source: Company Reports & IGI Research

Home & Personal Care Industry

The HPC industry is very diverse with different products directed at wide-ranging target segments and income groups. The industry is highly concentrated with global players like ULEVER, P&G, Colgate Palmolive and others. The quantum of smuggled and under invoiced goods has significantly increased over the years with premium brands brought in from Indonesia and other regional countries. The low cost of these offerings and high trade margins make them attractive to both consumers and retailers. This has significantly hurt the volumes and margins of FMCG players in the market. This is especially hurting ULEVER's soaps and detergents business which constitute major portion of HPC sales.

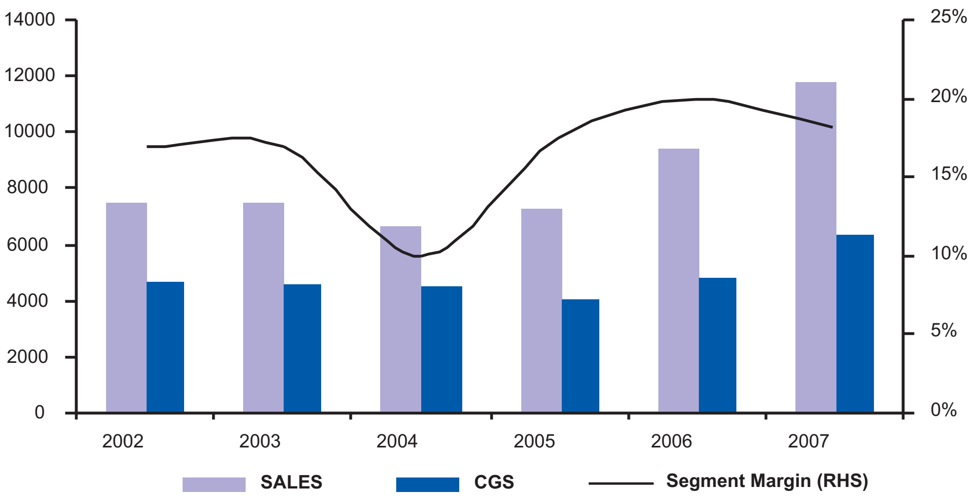
According to the management, detergent penetration is very low in Pakistan. About 50% of the population uses laundry soap for fabric wash. Similarly, shampoo penetration is one of the lowest in Asia. Hence, tremendous untapped potential exists in the detergent and shampoo market.

Soap industry in Pakistan produces approx. 75,000 metric tons of toilet soaps. Composition of soap is generally 80% fats and oil. Major raw material inputs include Tallow and Palm oil. In recent times, the prices of palm oil have surged 71% to US$800 per ton in Dec 2007 as compared to US$468 per ton in 2006. Furthermore, the prices are projected to touch US$978 by 4QCY08. As a consequence, the margins have declined and market players have revised soap and detergent prices to overcome cost surge.

Company Performance - HPC

The HPC segment continues to drive the top-line and profitability growth. The high margin segment constitutes over 50% of the top-line and is the key focus of the company's growth strategy. In CY06 and CY07 the company posted impressive turnover growth of over 25% attributable to higher volumes and price increases. Among the key brands in the HPC business Lux, Surf and Sunsilk continue to be the star performers with market leadership positions. Lux is the market leader in soap and according to company estimates has relative position of 2.5x the second biggest player. Surf has been a turnaround success in recent times and the detergent gained 11% increase in market share in CY07, and the company claims it is 40% bigger than the nearest competitor.

Chart 14: HPC



Source: Company Reports & IGI Research

In CY07, HPC sales grew by 25%; volumetric growth constituted 13% while the rest was price increase. Going forward we expect robust growth in HPC segment at CAGR 17% in CY08-CY12E. Despite impressive turnover in the HPC business, there has been significant pressure on margins and profitability. The unprecedented surge in palm oil, tallow prices, and other materials has resulted in declining margins. Going forward, higher raw material costs are a key risk to ULEVER's profitability.

Beverages (Tea)

Pakistan is the 3rd largest importer of tea in the world. The per capita consumption is approximately 1kg per annum. On average a tea drinking house hold consumes 4.85kg per annum with 5.4kg in urban centers and 4.6kg in rural centers. The tea requirements are met through imports from tea producing countries. According to CY07 estimates, the size of Pakistan's tea market was 140-170mn kg with 55% packaged and 45% loose or unpackaged tea.

The main source of black tea for Pakistan is Kenya with tea imports from Kenya constituting 85% of total tea imports. The packaged tea market is governed largely by a duopoly made of ULEVER and Tapal. Although, Tetley Clover entered the market in CY03, however, it has not made significant inroads in the organized market. Among other challenges, smuggling is a key threat facing players in the market. Tea smuggling is rising every year and has reached around 40% of local consumption with the majority of tea smuggled through the Afghan Transit Trade and India. The tariff structure on imported tea includes 15% sales tax, 6% income tax and 10% customs duty. The cheap supply of smuggled tea available hurts organized players in the market.

Supply disruptions from Kenya are another major challenge facing the tea industry. Political turmoil and adverse weather conditions in one of the largest tea exporters have lead to supply constraints causing international tea prices to soar. This in turn translates into squeezed margins for market players.

In order to counter over-reliance of Tea industry on supply from Kenya, import from regional producers including India and Sri Lanka are the available options. However, Pakistani consumers strongly prefer the taste and blend of tea imported from Kenya. Consequently, in view of high demand for Kenyan tea and persistent disruption in supply the tea prices are expected to remain volatile.

Going forward, the mature tea market is expected to grow, albeit, at a slow pace. According to the Food and Agriculture Organization (FAO) tea consumption is expected to grow at an average rate of 2.9% per year, fueled by a growing population and steadily increasing income levels.

Table 7: Tea Forecasts

	'000 tons		Growth % per year	
Consumption	**2000A**	**2010E**	**1990-2000**	**2000-2010**
World	2214	2413	2.2	0.8
Pakistan	109	150	0.7	2.9
Production				
Kenya	236	304	1.7	2.3
India	815	1070	1.2	2.5

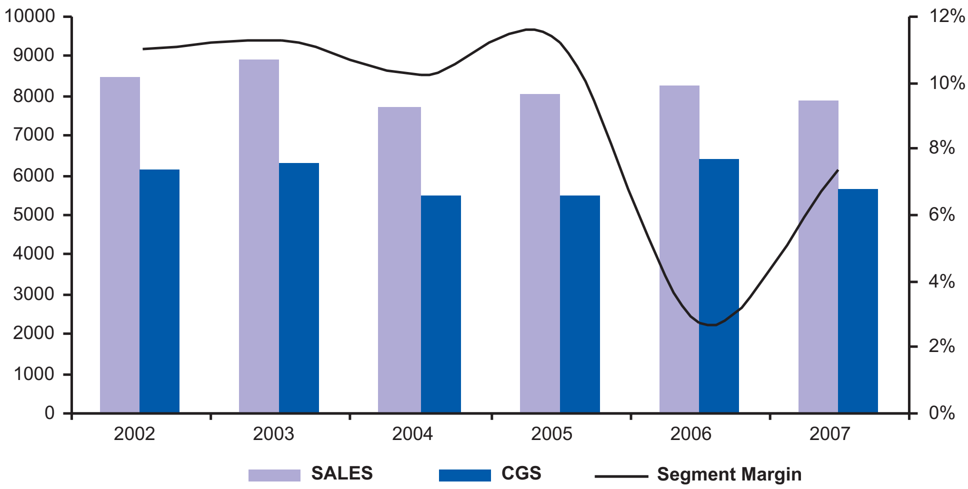
Source: FAO & IGI Research

Company Performance - Tea

The mature tea segment continues to follow a declining trend as ULEVER faces stiff competition in the tea market. ULEVER continues to lose sales volume to Tapal in organized sector and to small local brands in rural areas that are using cheap smuggled tea. Supply disruptions as a result of political turmoil and drought in Kenya ensue in squeezed margins. The company's strategy is to defend losing market share as no growth is expected in beverages segment. ULEVER had two production facilities for tea located in Karachi and Khanewal. Recently, ULEVER has closed down the Karachi tea factory in view of low demand and sales volumes. This is expected to result in restructuring charges in the short run, however, in the long run the company is expected to benefit in terms of cost efficiencies and reduced overheads.

In the backdrop of losing market share, the contribution of tea business to total turnover has declined over the years (34% in CY07). Gross margins have been volatile as a result of fluctuating international tea prices, which declined in CY06 (22%) and recovered in CY07 (30%) as result of normalizing tea prices. Going forward, the tea segment is expected to remain under pressure. We forecast a flat outlook for the segment with decline in turnover of 5-6% each year.

Chart 15: Beverages



Source: Company Reports & IGI Research

Ice cream Industry

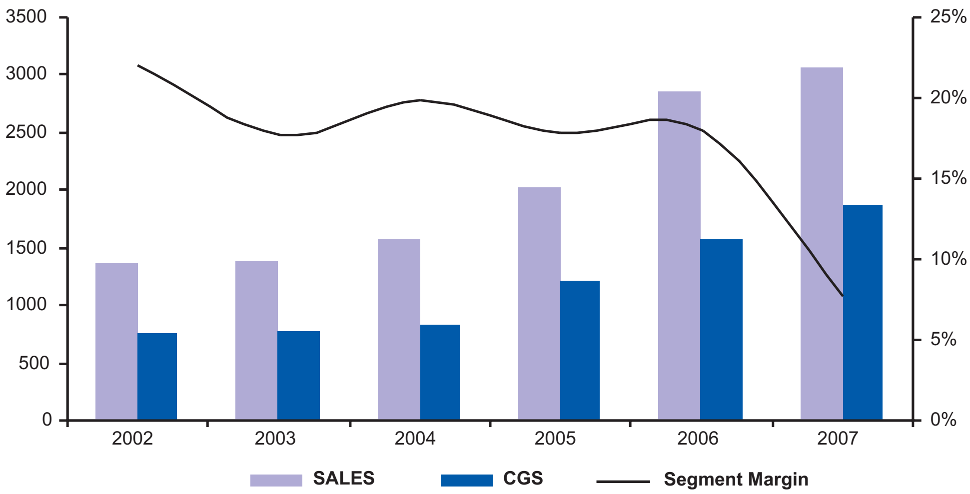
The ice cream industry is a virtual monopoly with UPL as the only major operator. In CY99 the company merged with Polka to become the largest ice cream manufacturer in the country. The only competition in the industry is from regional players like IGLOO and HICO. However, Engro has announced a plan to enter the Ice cream segment and the launch is expected in CY09. Engro is expected to become a serious rival post CY10.

From a consumer perspective ice cream is still considered a luxury item and not part of household budget. Currently, the average per capita consumption of ice cream is 0.5 liters per annum. Going forward, the low penetration levels coupled with high demand potential presents ice cream business as a big opportunity.

Company Performance - Ice cream

ULEVER has the first mover advantage in the capital intensive ice cream segment. The company is in the process of increasing production capacity and strengthening distribution channel. In a two phase expansion plan the company plans to increase its production capacity by 50% at the cost of PRs1.2bn. The first phase was completed in CY07, taking the total capacity to 69mn liters. Moreover, the key success factor in the ice cream business is a robust cold chain. Hence, ULEVER is making capital expenditure on increasing its freezer penetration and plans to increase it to 50,000 units as compared to 40,000 units currently. In an effort to increase penetration in ice cream business ULEVER plans to invest PRs700mn in CY08.

Chart 16: Ice Cream



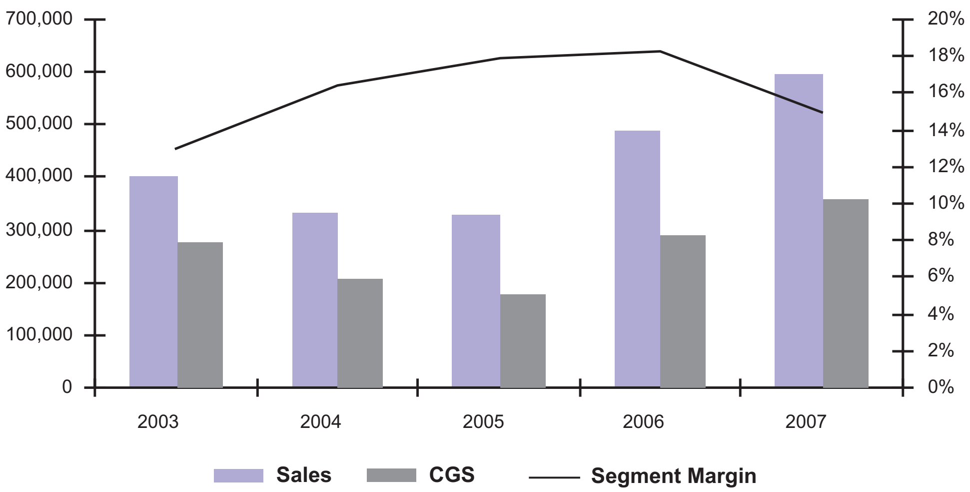
Source: Company Reports & IGI Research

In CY07, ice cream sales contributed 13% to the total revenue with growth of 8% over the past year. However, sales were mainly restricted by delays in factory expansions resulting in plant shutdowns, early monsoon and winter seasons and loss of trade confidence. Going forward we expect sales to grow by CAGR of 19% in CY08-CY12E.

Other Segment

Apart from the 3 major business categories, other segment comprises of margarine business. With Blue Band the company is the market leader in spreads with double digit revenue growth and in CY07 gained 3% market share. The key risks facing the segment are squeezed margins as a result of surging palm oil prices and announcement by Dawn Bread to enter the market. Spreads on average constitute 2% of revenues and going forward they are likely to be 2-3% of net revenues.

Chart 17: Spreads



Source: Company Reports & IGI Research

Valuation

Table 8: Relatvie Comparison (2008E)

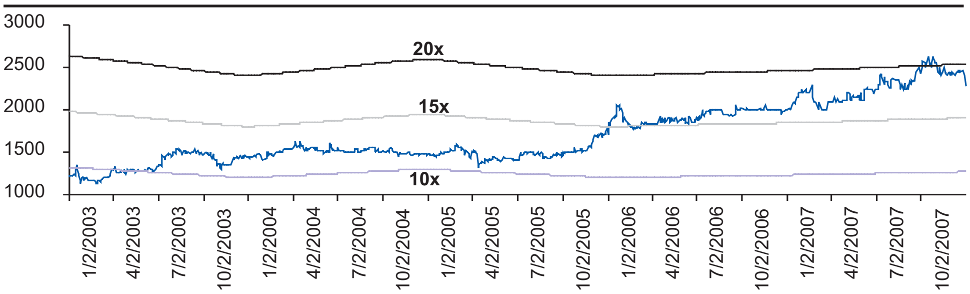
	ULEVER	NESTLE	HULV
EPS	145	48	9
P/E	16	34	26
P/S	1.2	2.2	3.0
Net Profit Margin (%)	7	7	13
Dividend Yield (%)	6	2	3

Source: Bloomberg & IGI Research

At the current market price, ULEVER is trading at Price-to-Earnings (P/E) multiple of 18.5x and 16.3x, based on CY07A and CY08E earnings. On an EV/EBITDA basis, it is trading at 10.3x and 9x respectively. In relative valuation, the stock looks cheap as compared to peers like Nestle (P/E: 34) and Hindustan Lever (P/E: 26). However, valuation based on future outlook with relatively flat revenue growth and squeezed margins makes the scrip expensive at current levels and we maintain a neutral rating.

For our valuation of ULEVER we have used DCF analysis. We have used a required return of 14%, market risk premium of 7%, adjusted beta of 0.5 and a terminal growth rate of 5%. We value ULEVER at PRs2,126 as the fair price per share. Currently the scrip is trading at 11% premium to our fair value. We suggest a 'Neutral' recommendation on ULEVER.

Chart 18: PE Band



Source: Bloomberg & IGI Research

Table 9: FCFF Valuation

	CY07	CY08E	CY09E	CY10E	CY11E	CY12E
CFO	2,405,564	2,908,981	2,444,523	2,885,274	2,893,632	3,489,392
Add: Interest Expense	107,437	57,642	57,664	57,690	57,722	57,760
Less: Capital Expenditure	(1,713,886)	(877,914)	(361,481)	(359,343)	(412,905)	(410,511)
FCFF	799,115	2,088,709	2,140,705	2,583,621	2,538,449	3,136,640
WACC	14%	14%	14%	14%	14%	14%
PV of Cash Flows		1,890,968	1,700,185	1,800,120	1,551,581	1,681,311
Terminal Value	36,634,843					
PV of Terminal Value	19,637,117					
PV of Future Cash Flows	28,261,282					
Shares outstanding (mn)	13.29					
Target Price	**2,126**					
Assumptions						
Risk free rate	10.35%					
Beta	0.52					
Market risk premium	7%					
Required Return	14%					

Table 10: Sensitivity Analysis

		WACC			
		12%	**13%**	**14%**	**15%**
Terminal growth rate	3%	2,237	2,004	1,815	1,654
	4%	2,451	2,169	1,946	1,760
	5%	2,726	2,376	**2,126**	1,887
	6%	3,093	2,642	2,307	2,042

Table 11: Valuation Summary

	CY05A	CY06A	CY07A	CY08E	CY09E	CY10E	CY11E	CY12E
Income Statement								
Net Sales	17,671	20,988	23,332	26,789	29,613	33,017	36,402	40,125
Gross Profit	6,854	7,743	9,083	10,171	11,638	13,052	14,178	15,779
Operating Profit	2,559	2,550	2,639	3,001	3,297	3,669	3,931	4,339
Profit Before Tax	2,482	2,486	2,530	2,913	3,208	3,580	3,842	4,250
Proift After Tax	1,601	1,632	1,687	1,922	2,118	2,363	2,536	2,805
Balance Sheet								
Total Assets	5,807	6,430	8,084	8,824	9,462	10,247	11,025	12,312
Total Liabilities	3,944	4,585	6,090	6,610	6,991	7,474	8,003	8,812
Net Equity	1,863	1,845	1,994	2,215	2,471	2,773	3,022	3,500
Current Assets	3,437	3,686	4,092	4,355	5,078	5,950	6,783	8,129
Current Liabilities	3,574	4,237	5,588	6,030	6,505	7,001	7,493	8,255
Capital Expenditure	510	684	1714	878	361	359	413	411
Ratios Analysis								
Gross Profit Margin	39%	37%	39%	38%	39%	40%	39%	39%
EBITDA Margin	16%	14%	13%	13%	13%	13%	12%	12%
Net Profit Margin	9%	8%	7%	7%	7%	7%	7%	7%
Return on Equity	86%	88%	85%	87%	86%	85%	84%	80%
Return on Assets	27%	27%	23%	23%	23%	24%	24%	24%
Current Ratio	1.0	0.9	0.7	0.7	0.8	0.8	0.9	1.0
Inventory Turnover(x)	6	7	6	6	6	6	6	6
Total Asset Turnover(x)	3.0	3.4	3.2	3.2	3.2	3.4	3.4	3.4
EV/EBITDA	10.9	10.8	10.3	9.0	8.2	7.4	6.9	6.1
EV/Sales	1.8	1.5	1.3	1.2	1.1	0.9	0.9	0.8
Dividend yield	5%	5%	5%	6%	7%	7%	7%	8%
Per Share Data								
EPS	120	123	127	145	159	178	191	211
DPS	120	122	123	140	155	172	175	185
BVPS	140.2	138.8	150.0	166.6	185.9	208.7	227.4	263.4
Price/Earnings (x)	19.5	19.2	18.5	16.3	14.8	13.2	12.3	11.2
Price/Book (x)	16.8	17.0	15.7	14.1	12.7	11.3	10.4	8.9
Price/Sales (x)	1.8	1.5	1.3	1.2	1.1	0.9	0.9	0.8

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I, Ahmed Raza Khan, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject, securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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