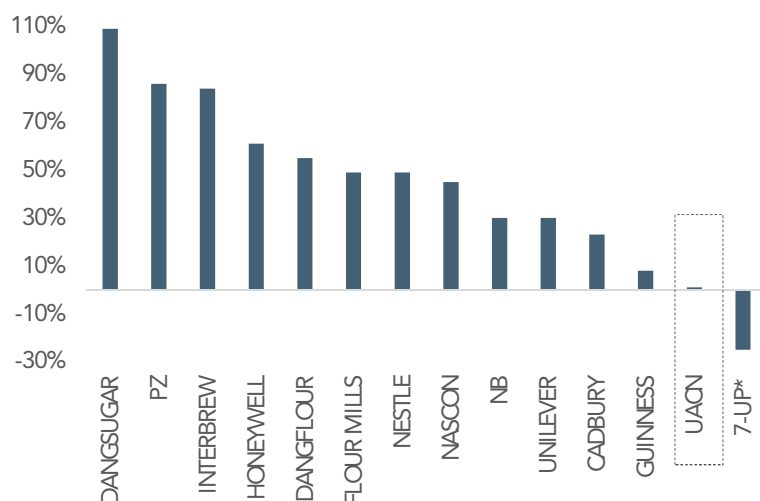


UAC of Nigeria Plc. | Company Note
The Fly in FMCG ointment?
(NEUTRAL: ₦17.92)

- Despite the bull run across naira equities, which supported strong rally in the FMCG space (YTD, Food: 45%, HPC: +45%, Brewers: +30%), the share price of UACN continues to remain sticky with sentiments largely sour. To our minds, the apathy reflects weak performance in the first half of the year (PAT: H1 17: -55%, Q2 17: -55%) as well as share dilution risk given expectation of equity capital raise by way of rights issue.

Figure 1: YTD return across selected consumer names


Source: NSE, ARM Research

Income Statement Data			
	2017 – 6M'm	2016 – 6M'm	%chg
Revenue	48,448	36,803	31.6%
PBT	1,635	3,933	-58.4%
Tax	440	1,306	-66.3%
PAT	1,195	2,627	-54.5%
Balance Sheet Data			
	2017-Jun 'm	2016-Dec 'm	%chg
Inventory	31,561	36,805	-14.2%
Receivables	23,191	15,187	52.7%
Cash	8,055	9,546	-15.6%
Payables	20,343	17,919	13.5%
Net Assets	74,090	76,466	-3.1%
Stock Data			
Price	₦17.00		
52 week range	₦11.25 – ₦20.38		
Market Cap. (N'm)	32,635		
1-month Avg. Vol	1,899,152		
Curr. PE	10.0x		
Bloomberg Ticker	UACN: NL		
Reuters Ticker	UACN. LG		

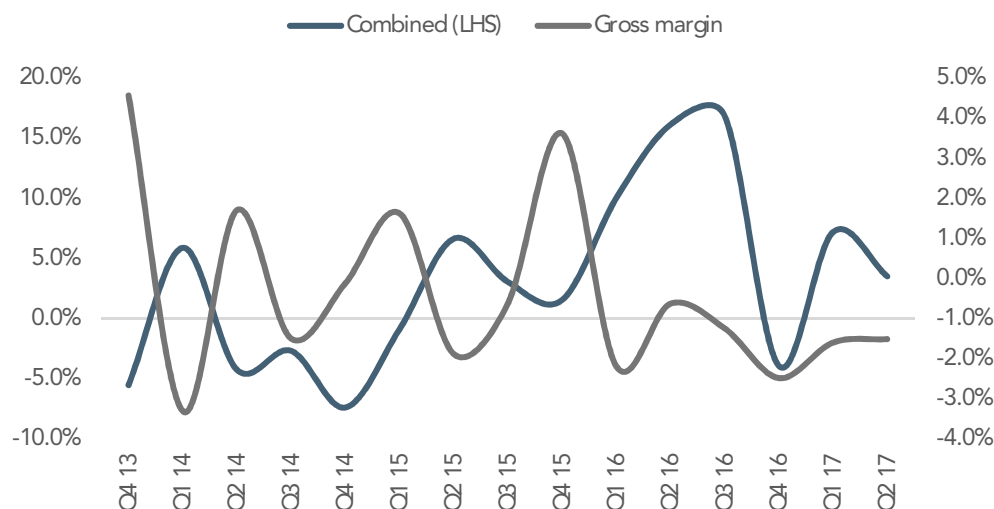
UAC of Nigeria Plc. - Share Price Trend

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Food inflation weighs on margin

- Whilst UACN's performance remained fettered, the earnings of other coverage consumer names have since picked up from the troughs of 2016 as companies raised prices to combat rising input cost, FX challenges and higher finance charges. Although UACN also raised its prices, we believe the discretionary nature of its products capped the extent of passthrough to top-line as volumes declined in key segments. Particularly, in addition to weaker volumes at UACN's Logistics subsidiary, pressures were also evidenced by reported lower income-induced slowdown in demand for animal feeds as well as continued sales contraction in real estate over Q2 17. Furthermore, given the company's heavy reliance on domestic farm products¹, particularly cereals and legumes whose prices have been rising, input cost continues to track higher (YoY: H1 17: +33%, Q2 17: +42%). Hence, notwithstanding the price-induced growth in the company's top-line (YoY: H1 17: +52%, Q2 17: +33.4%), gross margin still printed at a record low of 15.8% in H1 17 (Q2 17: 15%).

Figure 2: QoQ movements in prices of key inputs² and Gross margin



Source: Company's financials, FEWSNET, ARM Research

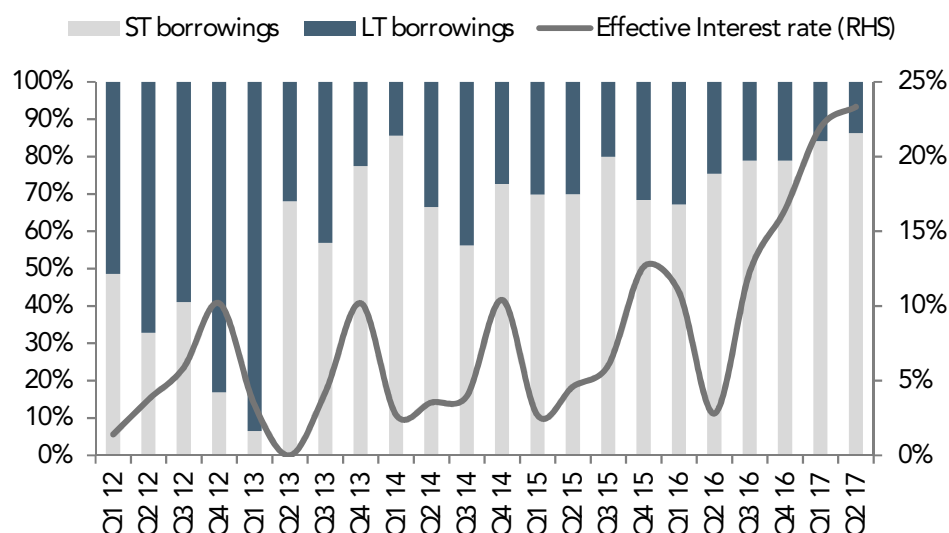
¹ Import-COGS ratio of less than 1%,

² It includes Sorghum, Maize, and Refined sugar in the proportion of 40%,40%,20% to account for use in the various business

Monetary tightening compounds earnings woes

- Another key drag on the company's performance was the elevated interest rate environment which raised the cost of refinancing its largely short tenured debts (86% of total borrowings). For context, whilst the company took advantage of lower interest rate environment to obtain ₦15.9 billion loans (59% of total borrowings) at 11% in 2016, the current interest rate environment left the company with little choice but to refinance the noted obligation at 24% in the current year. Consequently, bucking the trend across other consumer names, UACN's earnings came in at a record low of ₦1.2 billion in H1 17—and we see scope for further earnings deterioration.

Figure 3: Trend in effective interest rate (₦' billion)



Source: Company's financials, ARM Research

Expensive debt to keep earnings depressed

- Our outlook for the company's earnings is hinged on developments on monetary policy and food inflationary fronts. On the latter, whilst we expect supply-side shocks to food inflation to subside on the back of lower diesel prices, reduced market supplies in the wake of ongoing lean season should limit substantial pass-through to farm produce over Q3 17. Though improved market supply should temper input cost in the main harvest season of Q4, subsisting demand from neighbouring West African countries should put a floor to the downtrend. In sum, we expect input cost pressures to linger over the rest of the year. Elsewhere, though management guides to further

price hikes over the rest of the year, accompanying volume contraction should cap the scale of such price adjustments. Overall, we project a Gross margin of 16.6% over H2 17 (FY 17E: 16.2%).

- In addition, sustained monetary tightening should keep finance expense elevated. Whilst, management guides to disposing a ~~¥~~5 billion investment property over H2 17 and raising a ~~¥~~15.4 billion rights issue in Q4 17 to refinance its debt obligations, the late timing of the planned capital raise should taper potential impact on interest charges over the rest year. Hence, we project a 125% YoY jump in interest charges to ~~¥~~6.6 billion over FY 17. Leaving our OPEX largely unchanged at ~~¥~~10.8 billion, we project a 20% YoY contraction in earnings. The weak PAT outlook is despite expectations for sustained rise in revenue (FY 17: +20% YoY to ~~¥~~101.4 billion), and it largely reflects management's guidance of sustained price hike, as well as higher other gains (+17% YoY to ~~¥~~4.5 billion)—with the latter representing potential gains from property disposal.
 - UACN trades at a current P/E of 10.0x vs. 18.7x for its Bloomberg Middle East and Africa peers. We have a **NEUTRAL** rating on the stock with a **FVE of ~~¥~~17.92**.
 - In the scenario that UACN raises the ~~¥~~15.4 billion rights (47% of current market capitalization), our FVE for the stock comes to ~~¥~~10.24 as the dilutive impact of the rights offset potential decline in interest expense.
-

Summary of Results and Forecasts

QUARTERLY					
Income Statement (₹'mln)*	Q1 2017A	Q2 2017A	Q3 2017F	Q4 2017F	
Turnover	24,973	23,475	25,220	27,697	
COGS	20,844	19,950	21,253	22,900	
Gross Profit	4,129	3,525	3,967	4,797	
Operating Costs	2,493	2,703	2,675	2,938	
Operating Profit	1,636	823	1,292	1,859	
Net Finance Charges	1,227	1,269	1,278	841	
PBT	829	805	1,128	3,768	
Taxation	224	216	361	1206	
PAT	606	589	767	2,562	
ANNUAL					
Income Statement (₹'mln)	FY 2015A	FY 2016A	FY 2017E	FY 2018F	FY 2019F
Sales	73,771	84,607	101,365	120,042	135,076
COGS	56,963	67,251	84,946	97,234	106,710
Gross profit	16,809	17,356	16,418	22,808	28,366
Operating cost	10,666	10,722	10,809	12,484	13,508
Operating profit	6,143	6,634	5,609	10,324	14,858
Interest expense	1,568	1,562	2,022	1,627	1,692
Interest income	3,018	2,949	6,637	5,013	3,657
PBT	7,733	7,775	6,531	10,325	16,591
Tax	2,570	2,108	2,007	3,304	5,309
PAT	5,163	5,667	4,524	7,021	11,282
Balance Sheet (₹'mln)	FY 2015A	FY 2016A	FY 2017E	FY 2018F	FY 2019F
Assets					
Fixed Assets	35,439	35,271	35,020	34,940	36,406
Stocks	25,283	36,805	38,202	43,755	48,019
Trade debtors	14,594	15,187	20,289	21,608	24,314
Cash& Bank balance	9,183	9,546	9,956	12,608	15,731
Total Assets	128,655	138,230	144,113	152,812	163,656
Liabilities					
Trade Creditors	14,941	17,919	21,223	24,309	26,677
Short term borrowings	17,523	24,748	23,510	24,216	24,942
Long term liabilities	13,432	10,153	9,889	10,140	10,403
Total liabilities	54,513	61,764	63,567	67,608	70,967
Shareholders' fund	74,142	76,466	80,547	85,204	92,689
Key Ratios	FY 2015A	FY 2016A	FY 2017E	FY 2018F	FY 2019F
Valuation multiples					
Diluted EPS	1.57	1.95	1.60	2.41	3.88
P/E	10.84	8.70	10.61	7.04	4.38
P/B	0.51	0.42	0.40	0.38	0.35
EV/EBITDA	9.71	8.96	6.30	6.54	4.90
ROA	4.0%	4.1%	3.1%	4.6%	6.9%
ROE	7.0%	7.4%	5.6%	8.2%	12.2%
Debt/Equity	0.35	0.39	0.35	0.35	0.33
Gross margin	22.8%	20.5%	16.2%	19.0%	21.0%
EBIT margin	8.3%	7.8%	5.5%	8.6%	11.0%
PBT margin	10.5%	9.2%	6.4%	8.6%	12.3%
PAT Margin	7.0%	6.7%	4.5%	5.8%	8.4%
Interest coverage	2.04	2.25	0.85	2.06	4.06

Source: ARM Research

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6 month period (minimum) to the review date. We adopt a 5 point rating system for this category of stocks and a 3 point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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