

UAC of Nigeria Plc. | Earnings Report

9 months ended 30th September, 2016

Cost containment and one-off asset sales prop earnings
(NEUTRAL: ₦20.01)

- Last Friday, UAC of Nigeria Plc. (UACN) released its unaudited 9M 16 results wherein revenue rose 4.8% YoY to ₦57.7 billion, while UACN reported PAT of ₦4.3 billion vs a ₦75million loss in 9M 15. The 9M 16 reading is an improvement from the H1 16 results as continued cost containment and savings from finance costs combined with gains on investment disposal over Q3 16.

Cost savings and investment disposals swing earnings higher

- Over Q3 16, UACN's earnings rose for the first time in seven quarters on the back of operating efficiencies and one-off gains. Notably, PBT surged three-fold YoY to ₦2.4 billion while an 83pps YoY contraction in effective taxes to 27.4% underpinned a PAT of ₦1.7 billion (Q3 15 post tax loss: ₦75 million). Over the period, UACN reported a ₦746 million profit from the sale of investment which largely underpinned a threefold YoY jump in other gains to ₦1.3 billion. Impact of the foregoing alongside absence of impairment charges (vs. ₦473 million in Q3 15) helped magnify effect of cost cutting measures over the period. In particular, UACN scaled back on its borrowings (-17.8% YoY to ₦27.2 billion) which helped temper impact of monetary tightening on finance charges (-2.7% YoY to ₦475 million).

Income Statement Data			
	2016 – 9M'm	2015 – 9M'm	%chg
Revenue	57,703	55,074	4.8%
PBT	6,297	4,950	27.2%
Tax	1,955	789	147.8%
PAT	4,342	(75)	N/A

Balance Sheet Data			
	2016-Sept 'm	2015-Dec 'm	%chg
Inventory	27,297	25,283	8.0%
Receivables	17,510	14,594	20.0%
Cash	13,094	9,183	42.6%
Payables	18,506	14,941	23.9%
Net Assets	75,544	74,142	1.9%

Stock Data	
Price	₦18.68
52 week range	₦16.40 – ₦29.10
Market Cap. (N'm)	35,882
1-month Avg. Vol	26,107,242
Curr. PE	10.41x
Bloomberg Ticker	UACN: NL
Reuters Ticker	UACN. LG

UAC of Nigeria Plc. - Share Price Trend

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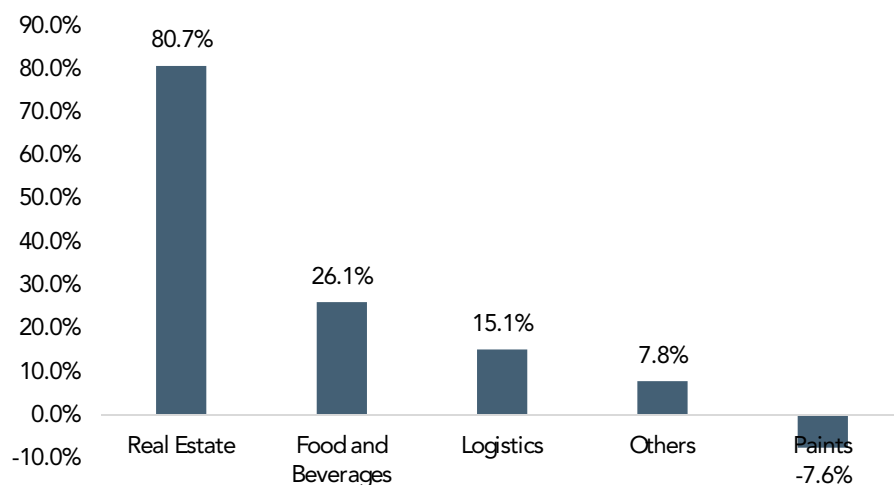
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- This combined with effect of higher cash balance (+56.9% YoY) on interest income (+10.6% YoY) helped drive net finance cost 2.6% YoY lower to ₪475 million. Furthermore, amidst an 8.3% YoY cutback in S&D expenses which dragged OPEX-Sales ratio 1.2pps lower YoY to 13.9%, UACN reported its fastest EBIT margin expansion (+77bps YoY to 6.7%) in 15 quarters.

Price increases moderate input cost pressures

- In contrast to the preceding six quarters, Q3 16 revenue jumped 20.3% YoY to ₪20.9 billion—8% higher than our forecast. The improved turnover largely stemmed from the food and logistics businesses as well as top-line recovery at its real estate subsidiary after six consecutive quarters of revenue declines. Sales growth at these subsidiaries more than offset weakness at the paints business (CAP: -18% YoY to ₪1.3 billion, Portland: +39.3% YoY to ₪493 million) which continues to be impacted by softer construction activities. The upswing in food turnover largely reflected higher prices. Management also attributed improved sales in the segment to improved volumes at Grand Cereals Limited (GCL) which we believe reflects recovery in livestock demand as the bird flu pandemic receded¹. At the real estate business, sales growth largely stemmed from pickup in the sale of property stock (fourfold higher YoY to ₪905 million) while upswing in logistics business reflected sign up of new clients.

¹ The Poultry Site reports sizable reduction in the reported cases of bird flu virus (Q3 16: cases: -98% YoY to 2, deaths: -99% YoY to 4900)

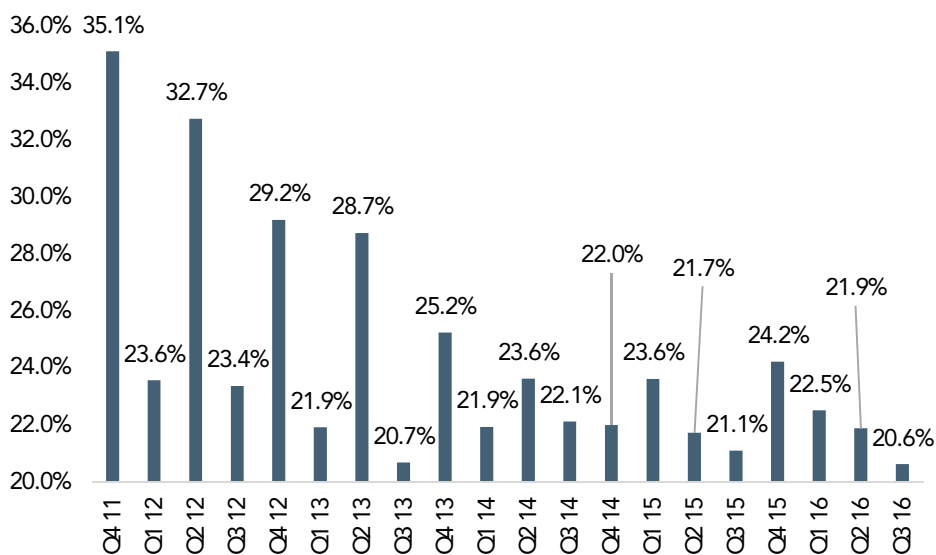
Figure 1: Q3 16 YoY revenue growth across UACN's businesses



Source: Company's financials, ARM Research

- As with food producers over Q3 16, UACN faced sizable input cost pressures as prices of key inputs tracked higher: flour (+34% YoY), refined sugar (+89% YoY), cereals and sorghum (more than doubled YoY). That said, relative to wider contraction at other FMCG companies thus far in Q3 16, UACN only reported a 47bps QoQ contraction in gross margin to 20.6% --(Q3 16E: 21.4%). We believe the much lower contraction reflects impact of price hikes earlier mentioned which helped UACN pass on some of the input cost inflation to customers.

Figure 2: Trend in Gross margin



Source: Company's financials, ARM Research

Higher finance charges to weigh on Q4 earnings

- Going forward, price hikes and improved demand for livestock feed should sustain revenue growth at the food division while pickup in the sale of property stock and higher clientele base should sustain sales growth at the real estate and logistic divisions respectively. Improved turnover at these businesses should more than offset top-line weakness at the paints business which continues to be impacted by soft construction activities. Overall, we project an 18.5% YoY growth in turnover to ₦21.4 billion which results in FY 16E sales of ₦79.1 billion (+8.2% YoY).
 - Following the onset of the harvest season in the quarter which should apply downward pressure on cereal and sorghum prices we see tamer input cost pressures combining with higher prices in driving 2.7pps QoQ improvement in gross margins to 23.4%.
 - However, we estimate that input cost gains should be offset by higher borrowing costs (+28% YoY to ₦1 billion) as current monetary tightening, which has pushed naira yield curve 4.63pps higher, should result in more expensive refinancing of UACN's maturing ₦15.9 billion (59% of total borrowings) commercial paper debt (previously issued at 11%) in October 2016. Overall, we project a 7.6% YoY decline in Q4 16 PBT to ₦2.3 billion, with a lower effective tax rate (-12.1pps YoY to 32%) driving tamer fall in PAT (-2.6% YoY to ₦1.6 billion). Consequently, we project 2016E basic EPS to rise 15.2% to ₦3.09 while DPS of ₦1.00 should remain unchanged from prior year.
 - UACN's share price has declined 10% YTD underperforming the broader NSEASI (-4.7% YTD). Currently the stock trades at a P/E of 10.4x compared to its Bloomberg Middle East and Africa Peers at 19.3x. Last trading price of ₦18.68 is at a 7% discount to our **FVE of ₦20.01** which translates to a **NEUTRAL** rating.
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Summary of Results and Forecasts

QUARTERLY					
Income Statement (₹'mln)*	Q1 2016A	Q2 2016A	Q3 2016A	Q4 2016F	
Turnover	17,518	19,285	20,900	21,408	
COGS	13,593	15,046	16,589	16,407	
Gross Profit	3,925	4,239	4,312	5,002	
Operating Costs	2,526	2,775	2,910	2,827	
Operating Profit	1,399	1,464	1,402	2,175	
Net Finance Charges	563	-198	475	662	
PBT	1,767	2,167	2,364	2,333	
Taxation	447	859	649	747	
PAT	1,320	1,307	1,715	1,587	
ANNUAL					
Income Statement (₹'mln)	FY 2015A	FY 2016E	FY 2017F	FY 2018F	FY 2019F
Sales	73,146	79,112	82,569	92,430	103,795
COGS	56,581	61,634	63,991	70,709	78,365
Gross profit	16,565	17,478	18,578	21,721	25,430
Operating cost	10,201	11,037	11,229	12,293	13,493
Operating profit	6,364	6,440	7,349	9,428	11,936
Interest expense	1,566	1,360	1,243	1,547	1,700
Interest income	3,018	2,863	3,030	2,998	2,960
PBT	8,660	8,631	8,670	11,373	14,448
Tax	2,797	2,702	2,774	3,639	4,623
PAT	5,863	5,929	5,896	7,733	9,825
Balance Sheet (₹'mln)	FY 2015A	FY 2016E	FY 2017F	FY 2018F	FY 2019F
Assets					
Fixed Assets	35,439	34,612	34,253	35,091	36,786
Stocks	25,283	25,975	28,796	31,819	35,264
Trade debtors	14,594	14,025	15,688	16,637	18,683
Cash & Bank balance	9,183	11,443	11,226	11,060	9,546
Total Assets	128,655	129,910	133,621	138,070	143,548
Liabilities					
Trade Creditors	14,941	14,431	15,998	17,677	19,591
Short term borrowings	17,523	18,048	18,590	19,147	19,722
Long term liabilities	13,432	13,838	14,265	14,712	15,183
Total liabilities	54,513	54,934	57,469	60,155	63,114
Shareholders' fund	74,142	74,975	76,152	77,915	80,435
Key Ratios	FY 2015A	FY 2016E	FY 2017F	FY 2018F	FY 2019F
Valuation multiples					
Diluted EPS	1.56	1.84	1.75	2.29	2.92
P/E	11.99	10.15	10.68	8.14	6.41
P/B	0.48	0.48	0.47	0.46	0.45
EV/EBITDA	9.26	9.26	8.46	7.15	6.12
ROA	4.6%	4.6%	4.4%	5.6%	6.8%
ROE	7.9%	7.9%	7.7%	9.9%	12.2%
Debt/Equity	0.35	0.35	0.36	0.37	0.37
Gross margin	22.6%	22.1%	22.5%	23.5%	24.5%
EBIT margin	8.7%	8.1%	8.9%	10.2%	11.5%
PBT margin	11.8%	10.9%	10.5%	12.3%	13.9%
PAT Margin	8.0%	7.5%	7.1%	8.4%	9.5%
Interest coverage					

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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