

UAC of Nigeria Plc. (UACN.NL)

Rating	NEUTRAL
Price	₦6.90
FVE	₦7.80
52-week range	₦4.30- ₦11.15
Market Cap. (₦bn)	19,881
1-month Avg. Vol	2,009,795
Curr. PE	1.92x

UACN.NL – Share Price Trend



Analyst(s)

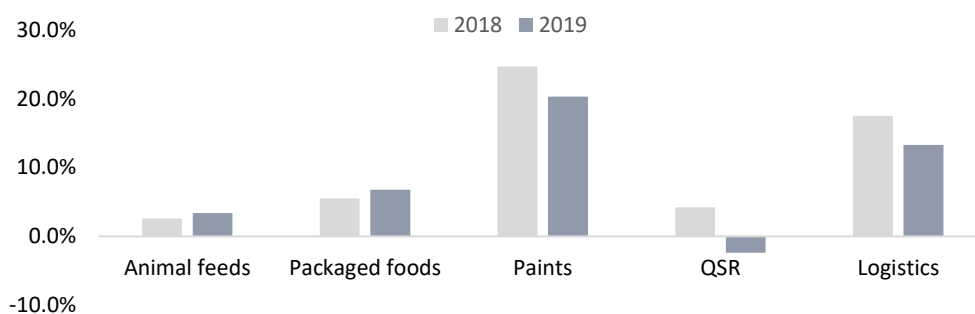
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Stock Report

Slow revenue growth and sticky Opex to hamper earnings

UAC of Nigeria's Q1 numbers further confirms our concern on the company's business structure and increase in OPEX. On the business structure, our worry centers around its key business (animal feeds) which account for over 60% of overall revenue, happens to be its least margin. Also, the company's investment to drive future growth with the key focus being human capital since 2018 led to elevated operating expense with OPEX to sales moving from an average of 12% pre 2018 to 16% at the end of 2019. Therefore, the key question remains at what point will investors start the reap the fruits from the investment.

Figure 1: Operating margin across various business segment



Source: Company financials, ARM Research

Our take: In Q1 20, PAT from continued operations declined by 42% YoY to ₦1.15 billion – mirroring the unimpressive topline and 14% jump in operating expense. Over the rest of the year, we are unoptimistic of a rebound in earnings owing to (i) Reduced economic activities due to the lockdown which will affect more of its non-essential services (i.e paints) (ii) slow growth in its animal feeds business, despite the boarder closure which should ordinarily help segment sales (iii) Input cost pressure from the technical devaluation which took place in Q1 20, with the paint business expected the feel the greater impact (iv) sticky operating expense given a large chunk of the increase in 2019 has to do with changes to the management staff.

- **Revenue growth will remain meagre:** Over Q1 20, while the reported 2.9% YoY decline in revenue is due to the re-classification of its investment in MDS logistics – we believe even the implied growth of 4.7% which excludes its logistics business is poor. For context, given the boarder closure implemented last year which led to shortage of frozen poultry, we expected that to support the domestic market for poultry and in turn feeds. However, that never played

out in the Q1 numbers with animal feeds growing by a meagre 3% YoY. Also, we believe its paints segment will face more of the heat from the slowdown in economic activities and UAC's brand falls within the premium segment. That said, the duo casts a doubt on an improvement in overall revenue this year. We therefore cut our revenue estimate to ~~₹~~80.4 billion which translates to a 4.2% YoY decline (Excluding the logistics business, we expect a mild growth of 1.5% YoY).

- ***Sticky opex will further pressure earnings:*** UAC embarked on a management overhaul strategy in a bid to re-structure and improve the company's performance in the medium to long term. This has taken the company OPEX to sales from a 5-year average of 12% pre 2017 to 16% as at FY 19. While the strategy comes off as a good one, our concern is how long it will take for shareholders to start reaping the benefits from this investment. For us, we believe a double-digit growth in revenue or tight lid on cost will be the only way to achieve this, however we do not see it happening this year. That said, we maintained 2019 opex to sales ratio which translates to a 4% decline in operating expense to ~~₹~~13 billion and expect gradual reduction in the ratio as revenue starts to improve beyond this year. The impact of our adjustments translates to a decline in profit form continued operations to ~~₹~~4.0 billion (-31.4% YoY).
 - ***Valuation:*** We cut our FVE to ~~₹~~7.80 (Previously: ~~₹~~8.96), which from current pricing translates to a 13% upside and a **NEUTRAL** rating. Upside to our estimate will be the company's ability to pass on increased cost to final consumers and aggressive sales, particularly in its food business.
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Summary of Results and Forecasts - ₦'000

ANNUAL

Income Statement (₦'m) *	2018A	2019A	2020F	2021F	2022F
Revenue	76,558	83,955	80,401	82,813	86,150
COGS	61,652	66,510	63,999	65,422	67,197
Gross Profit	14,906	17,446	16,402	17,391	18,953
Operating Cost	10,805	13,587	13,012	13,354	13,353
Operating Profit	4,976	5,781	3,967	4,614	6,177
Interest Income	3,373	2,774	2,658	2,547	3,731
Interest Expense	617	451	447	452	456
PBT	7,732	8,105	6,177	6,709	9,451
Tax	2,237	1,996	1,654	1,797	2,531
PAT	5,495	6,109	4,523	4,913	6,921
Balance Sheet (₦ '000) *					
Fixed Assets	22,791	22,436	21,833	21,161	20,039
Stocks	30,526	19,422	19,853	20,392	21,266
Trade debtors	10,234	7,026	7,237	7,528	7,851
Liabilities					
Trade Creditors	15,438	7,699	7,870	8,084	8,431
Non-current Liabilities	10,170	16,036	16,046	16,056	16,067
Total liabilities	56,885	38,274	38,493	38,754	39,111
Shareholders' fund	74,208	71,660	74,824	79,281	84,513
Key Ratios					
2018E	2019F	2020F	2021E	2022E	
Gross Margin	19%	21%	20%	21%	22%
EBIT Margin	7%	7%	5%	6%	7%
PBT Margin	NA	10%	8%	8%	11%
Net Margin	NA	7%	6%	6%	8%
EPS	(3.33)	(2.24)	1.10	1.19	1.68
P/E	NA	-2.76	5.64	5.19	3.69
EV/EBITDA	3.55	-0.47	-0.99	-1.35	-1.51
ROA	NA	5.36%	4.75%	4.95%	7%

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 reas portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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