

## UNILEVER: NL

Rating	<b>BUY</b>
Price	₦36.55
<b>FVE</b>	<b>₦49.19</b>
52-week range	₦33.55-₦65.00
Market Cap. (₦'bn)	281.68
1-month Avg. Vol	1,378,678
Curr. PE	17.6x

## PZ CUSSONS:NL

Rating	<b>SELL</b>
Price	₦11.30
<b>FVE</b>	<b>₦10.93</b>
52-week range	₦9.00-₦25.95
Market Cap. (₦'bn)	44.87
1-month Avg. Vol	515,593
Curr. PE	42.9x

### Analyst(s)

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## Nigerian Consumers

### Stock Report

### Unilever & PZ Cussons: More positive on Unilever

- In this report, we update our views on PZ and Unilever, making adjustment to our cost of sales to reflect expectation of lower petrochemical prices over 2019. Also, we changed our risk-free rate assumption to 15% (previously 14%) – reflecting the average 6-month yield on the generic 10-year bond yield. Having factored these changes in our model, we have a **BUY** rating on Unilever with a FVE of ₦49.19. On PZ however, we retain our **SELL** rating with FVE of ₦10.93.
- **Competition to hamper topline growth:** Over 2019, competition from imported goods is still expected to constrain revenue growth for sector players, as the relative stability in the foreign exchange market and FX accessibility continues to provide incentive for importers. We therefore expect revenue for PZ to decline by 4.8% over FY 19 to ₦76.7 billion. To buttress, PZ's products are not particularly key leaders in their segment. Beyond 2019, we expect gradual improvement in revenue. On Unilever however, we expect support from the food business to drive a revenue growth of 11.4% YoY to ₦111.0 billion over 2019, given its resilience over the last two years, having maintained a double-digit growth.
- On cost, our expectation of lower global crude oil prices over 2019 guides to lower petrochemical prices coupled with the CPO market remaining in a glut for most part of the year, we expect lower input cost over 2019. That said, we expect gross margin for Unilever to expand by 134bps to 32.8%. For PZ however, given the higher

petrochemical prices reported in the first half of its financial year<sup>1</sup> which compressed gross margin over the period. With the relative lower petrochemical prices over the second half, we see slight improvement in margin, which will moderate the rate of compression over full year 2019. We therefore expect gross margin to print at 26.7% - down by 366bps.

- Overall in the sector, we prefer Unilever as the foregoing coupled with its significant cash balance worth ₦46.8 billion forms our earnings estimate of ₦13.3 billion – up by 9.5% YoY and brings the EPS to ₦2.31. On PZ, while the operating performance would still remain weak – support from lower FX loss would drive earnings higher by 9.6% YoY to ₦2.0 billion with EPS of ₦0.51. That said, we have a fair value estimate of ₦49.19 on Unilever, implying a 34.6% upside from current market price, which translates to a BUY rating on the stock. On our numbers, Unilever trades at a P/E of 17.6x, which is a discount when compared to its Bloomberg MENA peer average of 19.6x. On PZ however, we have a SELL rating with FVE of ₦10.93. On our numbers, PZ trades at a P/E of 42.9x, which is a premium when compared to its Bloomberg MENA peer average of 32.2x.

**Table 1: Valuation Summary**

	Unilever Nigeria			PZ Cussons Nigeria		
	2019E	2018E	2017A	2019E	2018A	2017A
<b>Gross margin (%)</b>	32.8	31.5	31.9	26.7	30.4	36.0
<b>EBIT margin (%)</b>	13.5	13.9	14.3	5.7	10.4	17.1
<b>ROE (%)</b>	14.2	14.3	9.8	8.3	4.3	8.3
<b>Price/earnings (x)</b>	17.2	17.6	23.0	42.9	47.02	22.3
<b>EV/EBITDA (x)</b>	9.0	9.5	7.1	11.2	7.0	4.4

**Note: PZ financial year starts June.**

₦'million	Unilever Nigeria			PZ Cussons Nigeria		
	2019E	2018E	2017A	2019E	2018A	2017A
Revenue	110,962.9	99,583.6	90,771.3	76,668.6	80,552.8	78,215.7
Gross profit	36,438.0	31,368.8	28,943.3	20,470.5	22,767.9	24,087.7
EBIT	14,993.2	13,842.1	12,949.7	4,370.1	8,356.8	13,414.0
Net profit	13,252.7	12,102.6	7,450.1	2,021.8	1,845.2	3,323.7
EPS	2.3	2.1	1.8	0.5	0.5	0.8

Source: Company Financials

<sup>1</sup> From June to November 2018

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## Unilever Nigeria Plc (₦49.19, BUY)

- In the personal care segment, we have preference for Unilever Nigeria Plc as we perceive moderation in operating costs over 2019 following our expectation of lower petrochemical and CPO prices. Also, at current market price, the stock appears undervalued when compared to its peers. For context, the company trades at a P/E of 17.6x which is at a discount to MENA peer average of 19.6x and historical average of 20.5x. Also, with management guiding to a possible acquisition/introduction a product line in the food segment using its excess cash position of ~₦46.8 billion – following the sale of its spread business – we believe this will be positive for the company in the medium term and thus factored in the capex over 2020. We therefore retain our BUY rating on the stock with our FVE at ₦49.19, which implies a 34.6% upside from current market pricing.
  - ***Sale of spread business, amidst huge cash balance buoys earnings:*** Over nine months 2018, earnings improved by 1.1x to ₦9.4 billion stemming from reported net finance income and gains from the disposal of its spread business, which together added a total of ₦4.4 billion to the company's earnings. We recall the company tapped the equity market in Q3 17 and raised ₦57 billion via rights issue with proceeds earmarked to repay outstanding foreign currency denominated loans, purchase of needed raw materials and to meet other working capital requirements. Accordingly, the company's borrowings reduced to ₦4.3 million which is lower than ₦8.0 billion reported over 9M 17. With current cash balance at ₦47 billion, the company was able to report an increase in its finance income worth ₦2.5 billion (9M 17: ₦593 million). Over FY 18, we expect earnings to print at ₦12.1 billion with EPS of ₦2.11 (+18.2% YoY) with support from lower leverage, higher finance income and gains from sale of its spread business.
  - ***We expect improved core operating performance in 2019:*** Over 2019, revenue is expected to print at ₦111.0 billion (+11.4% YoY) with support mainly stemming from its food business. For context, notwithstanding the depressed consumer wallet and macro-economic landscape in 2018, the food business remained resilient, reporting double digit growth over the first nine months in 2018. The personal care segment however struggled, owing to increased competition from imported substitutes. Elsewhere, our expectation of a moderation in petrochemical prices in line with global crude oil prices guides to less pressure on cost over the period. That said, we expect input cost to increase by 9.3% YoY to ₦74.5 billion which translates to a gross profit of ₦36.4 billion with related margin at 32.8% (+134bps YoY). Further down, given our expectation of increased OPEX to ₦21.7 billion
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(+9.3% YoY) following increased marketing and distributions, we expect a milder increase in operating profit by 8.3% to ₦15.0 billion.

- On financing, its strong cash balance and our expectation of slight uptick in yields translates to a net finance income of ₦4.4 billion (+33.1% YoY). The foregoing coupled with gains from the topline translates to PBT of ₦19.2 billion and PAT of ₦13.3 billion, with EPS at ₦2.31. On our numbers, we have a dividend expectation of ₦0.72 which implies a 2019 dividend yield of 2% from current pricing. Currently, the company trades at a P/E of 17.6x, at a discount to MENA peer average of 19.6x. We therefore retain our **BUY** rating on the stock with our FVE of ₦49.19, which implies a 34.6% upside from current market pricing.

### Summary of Results and Forecasts - Naira (₦) - Unilever

ANNUAL					
Income Statement (₦' m) *	2017A	2018E	2019E	2020F	2021F
Revenue	90,771	99,584	110,963	121,445	131,729
COGS	61,828	68,215	74,525	81,565	85,165
Gross Profit	28,943	31,369	36,438	39,880	46,564
Operating Cost	15,976	19,817	21,667	23,714	25,865
Operating Profit	12,950	13,842	14,993	16,227	21,043
Interest Income	1,668	3,306	4,399	4,375	2,374
Interest Expense	-3,410	-339	-186	-186	-240
PBT	11,207	16,809	19,207	20,416	23,177
Tax	3,757	4,707	5,954	6,329	7,185
PAT	7,450	12,103	13,253	14,087	15,992
Balance Sheet (₦ '000) *					
Fixed Assets	29,881	29,482	29,843	30,235	30,509
Stocks	11,479	12,961	14,392	15,263	15,783
Trade debtors	27,621	44,813	39,276	36,513	38,339
Cash & other bank balances	50,494	45,419	62,525	78,915	91,346
Total Assets	121,084	134,284	147,646	162,536	177,587
Liabilities					
Trade Creditors	33,409	37,518	41,661	44,181	45,687
Non-current Liabilities	8,481	8,988	9,538	10,179	10,881
Total liabilities	36,695	40,794	44,935	47,453	48,957
Shareholders' fund	75,908	84,501	93,173	104,904	117,750
Key Ratios	2017A	2018E	2019E	2020F	2021F
Gross Margin	31.89%	31.50%	32.84%	32.84%	35.35%
EBIT Margin	14.27%	13.90%	13.51%	13.36%	15.97%
PBT Margin	12.35%	16.88%	17.31%	16.81%	17.59%
Net Margin	8.21%	12.15%	11.94%	11.60%	12.14%
EPS	1.78	2.11	2.31	2.45	2.78
P/E	23.00	17.56	16.04	15.09	13.29
EV/EBITDA	7.13	10.20	8.96	10.52	6.67
ROA	7.70%	9.48%	9.54%	9.31%	9.59%
ROE	9.81%	9.81%	14.32%	14.15%	13.43%

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## PZ Cussons Nigeria Plc (₦10.93, SELL)

- **A Woeful operating performance:** Prominent in its H1 19 results is the pressure stemming from its input cost. Over H1 19, sales declined by 14.8% YoY to ₦35.1 billion as competition from imported substitutes continue to put strain on the company's volumes. Notwithstanding the double-digit decline in volumes amidst moderation in CPO prices, input cost only declined by 8.9% YoY to ₦26.2 billion as increased petrochemical prices<sup>2</sup> more than offset the declines occasioned by moderation CPO prices and slower sales volume. Furthermore, the management noted that the increased cost of transportation incurred in clearing its raw materials from the port further amplified the pressure on cost. Consequently, gross margin contracted by 480bps to 25.2%, which is the lowest observed in the last five years. While operating expense declined over the period by 16% YoY to ₦7.1 billion, the dismal performance from topline accentuated decline in operating income by 55.6% YoY to ₦1.7 billion.
- **Saved by Lower FX Loss:** On the positive, FX loss which has been a significant pressure point for earnings in the last two years declined by 80% YoY to ₦525 million over the review period. The moderation largely mirrors relative stability in the foreign exchange market with NIFEX rate depreciating by just 10% over H1 19. The foregoing coupled with lower effective taxes supported 107% YoY growth in earnings to ₦1.2 billion.
- For the rest of FY 19, while we expect an improved performance over the second half of its 2019 financial year, which is the peak season, we believe operating profit will come in weaker than the prior year, as competition with imported substitutes guides to weaker revenue of ₦76.7 billion (-4.8% YoY). Further down, while lower petrochemical, CPO prices as well as the stable foreign exchange suggests reduced pressures on its input cost, we believed the feed though will be neutered by the compression in margins over the first half of the financial year – wherein petrochemical prices were elevated. Consequently, cost of sales is expected to tick up slightly to ₦56.2 billion. Adjusting our numbers for lower FX loss ( -75.6% YoY to ₦1.3 billion) guides to an increase in earnings with 2019 PAT estimate of ₦2.0 billion (+9.6% YoY). Over our forecast horizon, we expect earnings to pick up slightly owing to the slow recovery in topline, with our 5-year CAGR at 2.3%. We have FVE of ₦10.93 on PZ, which translates to a **SELL** rating based on last trade price. On our numbers, PZ trades at a P/E of 42.9x, which is a premium to its Bloomberg MENA peer average of 32.2x.

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<sup>2</sup> Crude oil prices rose by 33.5% YoY to \$74.7

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## Summary of Results and Forecasts - Naira (₦) – PZ Cussons

ANNUAL					
Income Statement (₦' m) *	2017A	2018E	2019E	2020F	2021F
Revenue	78,216	80,553	76,669	78,510	80,292
COGS	50,268	56,097	56,198	55,742	56,205
Gross Profit	27,948	24,456	20,471	22,768	24,088
Operating Cost	14,733	16,228	16,867	17,665	18,628
Operating Profit	13,414	8,357	3,757	5,260	5,620
Interest Income	486	181	223	138	149
Interest Expense	290	832	141	508	381
PBT	4,811	2,314	3,137	4,904	5,565
Tax	1,125	386	813	1,271	1,442
PAT	3,687	1,927	2,324	3,633	4,123
Balance Sheet (₦ '000) *	2017A	2018E	2019E	2020F	2021F
Fixed Assets	28,514	28,430	29,223	30,025	30,835
Stocks	26,710	26,040	28,099	26,756	25,292
Trade debtors	17,222	15,053	14,567	14,917	16,058
Cash & other bank balances	8,022	14,260	13,389	16,429	19,709
Total Assets	90,088	88,616	90,090	91,461	93,676
Liabilities					
Trade Creditors	39,723	40,205	40,463	40,134	40,467
Non-current Liabilities	2,584	2,525	2,543	2,578	2,616
Total liabilities	44,950	43,507	44,169	43,828	44,157
Shareholders' fund	45,138	45,109	45,921	47,633	49,519
Key Ratios	2017A	2018E	2019E	2020F	2021F
Gross Margin	35.73%	30.36%	26.70%	29.00%	30.00%
EBIT Margin	17.15%	10.37%	4.90%	6.70%	7.00%
PBT Margin	6.15%	2.87%	3.29%	6.23%	6.71%
Net Margin	4.71%	2.39%	2.30%	4.36%	4.70%
EPS	0.84	0.46	0.39	0.75	0.83
P/E	22.34	42.91	27.45	24.19	17.92
EV/EBITDA	4.40	4.40	7.16	13.16	10.04
ROA	4.48%	2.16%	1.98%	3.77%	4.08%
ROE	8.33%	4.27%	3.88%	7.32%	7.77%

Source: ARM Research \*unless otherwise stated

## 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
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	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
<b>UNDERWEIGHT</b>	Minimize exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio
<b>RESTRICTED</b>	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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