

Unilever Nigeria Plc. (Unilever .NL)

Stock Report

Tougher operating environment: Will Unilever thrive?

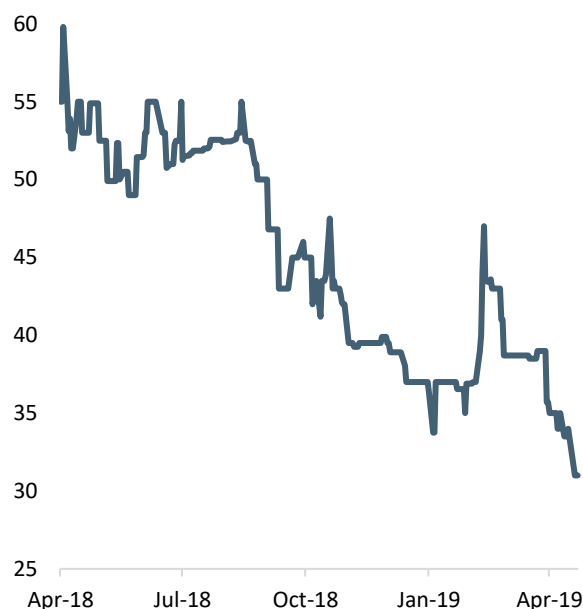
- Unilever's earnings for the first quarter of 2019 was rather disappointing, following decline in sales and pressure from input cost. For us, while we envisaged the poor sales outing in the home and personal care segment, the material decline in the food segment (-24% YoY) was rather surprising. To track back, sales in the food segment expanded by 19% YoY over 2018, with very little support from movement in prices. While the parent company attributed the drop-in sales to trade disruptions related to election uncertainty (a claim we hope to substantiate when Nestle Plc releases its Q1 19 numbers), we believe new competition from smaller brands is starting to take up some of the company's market share as our discussion with distributors revealed that ex-factory prices are unchanged during the review period. Coupled with input cost pressure, PAT dropped by 47.6% YoY to ₦1.5 billion (ARM Estimate: ₦2.6 billion).

- Surprisingly, food business struggled:** Over the review period, while the performance in the HPC (home and personal care) space didn't come as a surprise to us, as competition from peers like **Good Mama detergent, so Klin detergent** and **mama lemon dishwash liquid**, amongst other smaller products continued to place pressure on sales. However, new competition pulling a strong force in the food business came as a surprise. Reflecting the lull, credit sales increased by ₦21.3 billion in the period, closing at ₦51.5 billion. From our engagement with market participants, we understand that the Western Region which happens to be Knorr's major market has seen new players in the savoury and tea business. For clarity, small brands like **Mr. Chef, Terra cubes, Ginomax cubes, and Top tea** engaged in aggressive marketing and promotional offers which Unilever

Rating	OVERWEIGHT
Price	₦31.00
FVE	₦35.82
52-week range	₦30.60 - ₦55.0
Market Cap. (₦'bn)	238,908
1-month Avg. Vol	3,357,063
Curr. PE	17.32x

Quarterly EPS	Q1	Q2	Q3	Q4
2017 A	0.42	0.55	0.31	0.27
2018 A	0.50	0.49	0.32	0.33
2019 (E*)	0.26	0.39*	0.47*	0.41*

Unilever: NL - Share Price Trend



Analyst(s)

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hasn't done in recent times as it relied more on its brand equity. On this backdrop, revenue dropped by 25.5% YoY, with the HPC sales falling by 26.9% YoY, while food dipped by 24% YoY.

- Another concern for us was the input cost booked over Q1 19. Cost of sales declined by just 17.7% YoY (compared to revenue decline of 26%) with cost to sales touching a record high of 79.9% (3-year average: 70%). Our discussion with stakeholders revealed that increase in prices of key raw materials – which includes Tallow used in production of the bar soap, sulphuric acid and packaging materials – and impact of FX devaluation necessitated the increase in production cost. For clarity, following the convergence of the NIFEX to NAFEX in October, the company now sources FX within a range of ₦360/\$ – ₦365/\$, compared to the prior year where it was sourced within the range of ₦320/\$ - ₦330/\$. Consequently, gross profit dropped by 45.8% YoY to ₦3.9 billion with related margin at 20.1% (-755bps YoY). Though operating expense moderated and net finance income more than doubled, poor performance from the topline left the net profit lower by 48% YoY to ₦1.5 billion. On the balance sheet, following the increase in trade receivables, the company cash position dropped to ₦38.3 billion (FY 18: ₦57.1), while its debt position was unchanged at ₦4.2 billion.
 - ***Intense Competition and cost pressure to drag earnings.*** Given the new business landscape, we cut our 2019 sales expectation and made upward adjustment to our cost estimate to reflect the pressures over Q1 19. On sales, while our views on HPC highlighted in our FY 18 report (See report: ***We downgrade to an Overweight rating***) is unchanged, our understanding of the new competition in the food segment with “Top tea”, a competition to Lipton reducing its price this year, amongst smaller imported brands. Also, the entry of ***Gino max cubes, Mamador seasoning cube and DAN-Q cubes*** also gaining traction, we reduced our growth estimate in the food segment. That said, we expect overall sales to rise by 3.2% YoY to ₦95.9 billion (previously 7%). Elsewhere, we increased our cost to sales ratio to 72% to reflect the impact of higher raw material prices and higher currency sourcing cost, which guides contraction in margins over 2019 by 238bps YoY to 28%.
 - Notwithstanding the moderation in operating expense over Q1 19 as the company relied on its brand equity which did not play out well over the period, we envisage new promotional offers in coming months in a bid to drive sales. That said, we leave our operating expense unchanged with OPEX to sales at 20%. The troika of slower growth in sales, increased raw materials cost and operating expenses drove the changes to our PAT estimate over 2019 to ₦8.5 billion (-7.3% YoY, previously: ₦11.6 billion) with related EPS at ₦1.47 (Previous: ₦2.01).
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- Overall, we cut our FVE on Unilever by 13.8% to **N35.82** (previously N41.56), which compared to current price translates to an **OVERWEIGHT** rating. UNILEVER trades at FY 19E P/E of 24.1x, compared to Bloomberg MENA peer average of 16.9x.

Summary of Results and Forecasts - Naira (N)

ANNUAL					
Income Statement (N'm) *	2017A	2018A	2019F	2020F	2021F
Revenue	85,193	92,900	95,896	103,686	110,702
COGS	57,679	64,675	69,045	72,580	75,277
Gross Profit	27,514	28,225	26,851	31,106	35,425
Operating Cost	15,267	18,952	18,766	20,290	21,760
Operating Profit	12,231	9,198	8,277	10,868	13,727
Interest Income	1,565	4,027	4,301	4,103	1,886
Interest Expense	-3,201	-603	-314	-445	-428
PBT	10,596	12,622	12,264	14,525	15,185
Tax	3,526	3,490	3,802	4,503	4,707
PAT	7,070	9,132	8,462	10,023	10,478
Balance Sheet (N '000) *					
Fixed Assets	29,881	29,678	32,783	70,651	69,522
Stocks	11,479	13,929	14,051	14,771	15,320
Trade debtors	27,621	30,188	40,276	49,769	53,137
Liabilities					
Trade Creditors	33,409	38,611	34,523	36,290	37,639
Non-current Liabilities	8,481	5,887	6,255	6,691	7,146
Total liabilities	36,695	43,167	39,967	41,730	43,074
Shareholders' fund	75,908	82,790	84,085	86,089	88,185
Key Ratios	2017A	2018A	2019F	2020F	2021F
Gross Margin	32%	30%	28%	30%	32%
EBIT Margin	14%	10%	9%	10%	12%
PBT Margin	12%	14%	13%	14%	14%
Net Margin	8%	10%	9%	10%	9%
EPS	1.69	1.59	1.47	1.74	1.82
P/E	24.23	23.28	24.32	20.53	19.64
EV/EBITDA	7.44	13.17	13.59	14.16	9.48
ROA	7.30%	7.22%	6.38%	7.39%	7.50%
ROE	9.31%	9.31%	11.03%	10.06%	11.64%

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