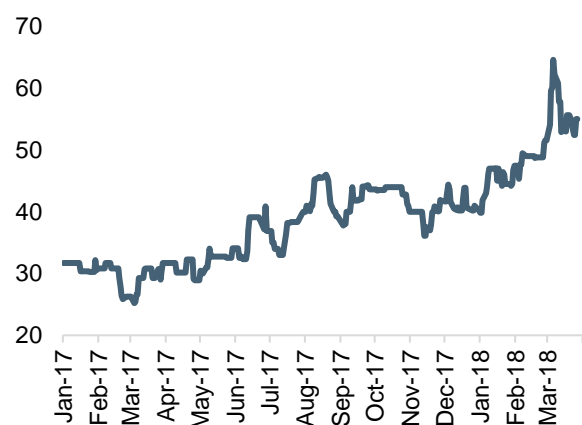




Rating	SELL
Price	₦59.80
FVE	₦33.56
52-week range	₦28.73-₦65.00
Market Cap. (₦'bn)	343
1-month Avg. Vol	257,555
Curr. PE	29.3x

Quarterly EPS	Q1	Q2	Q3	Q4
2016 A	0.28	0.01	0.12	0.37
2017 A	0.42	0.55	0.30	0.50
2018 F	0.49	0.50	0.46	0.52

UNILEVER:NL - Share Price Trend



Analyst(s)

Feyisike Ilemore
oluwafeyisike.ilemore@arm.com.ng

Unilever Nigeria Plc. (UNILEVER.NL)

Stock report

Dilution recaps stretched valuation

- Unilever Nigeria (Unilever) sustained earnings recovery in its full year 2017 results with a record after-tax earnings of ₦7.5 billion, representing a 142.5% YoY increase from the prior year and translating to EPS of ₦1.78 (FY 16: ₦0.81; FY 15: ₦0.32). With a payout ratio of 28% (versus 12.3% in FY 16), the company proposed a final dividend of ₦0.50 which translates to a dividend yield of 0.8% based on current pricing.
- In terms of earnings driver, higher revenue (+30.1% YoY to ₦90.8 billion) was the major driver, which more than offset input cost pressures to drive a 280bps expansion in gross margin to 32%. Q4 17 standalone performance was also positive as EPS rose 36% to ₦0.50 underpinned by sizeable increase in operating profit (+46.5% to ₦3.5 billion) reflecting higher revenue, and finance income (+17.7% to ₦1.0 billion). Going forward, higher petrochemical prices from the sustained rise in crude oil price remains a key factor in Unilever's earnings even as we expect Crude Palm Oil (CPO) to moderate in 2018. Nonetheless, expected increase in revenue from a mix of price and volume as well as an expected rise in finance income should offset these pressures which drive our expectation for earnings to rise 57.5% YoY to ₦11.7 billion. However, due to the dilutive impact of the additional shares (1.96 billion ordinary shares) from the rights issue in Q3, our EPS forecast of ₦2.04 represents a 14.6% YoY increase from FY 17.

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- Unilever Nigeria has gained +45.9% Year-to-Date (YTD), stronger than the return on the personal care segment (+34.7% YTD) and NGSE All Share Index (+6.8% YTD). On our 2018 numbers, Unilever trades at a P/E of 29.3x relative to Bloomberg Middle-East and Africa (MENA) peers of 28.6x. We retain our SELL rating on the stock with our FVE estimate of ₦33.56.
 - Robust earnings over 2017 was price-induced with revenue rising 30.1% to ₦90.8 billion. Looking through provided breakdowns, the increase in revenue largely stemmed from its Home & Personal Care (HPC) which accounted for 53% of aggregate revenue with a 43.5% YoY growth to ₦47.9 billion. This isn't surprising to us given that major cost pressures faced by the company during the year arose from higher petrochemical and CPO prices which are key inputs in the production of detergents and soaps domiciled in the HPC segment. Precisely, petrochemical prices track Brent prices which rose 24% on average over 2017. Also, Domestic CPO prices were higher 40% over 2017. Consequently, the company hiked pricing on its HPC products to support margins. Over the full year period, the food segment rose 17.8% YoY to ₦42.9 billion supported by its resilient seasoning brand – Knorr, in our view.
 - It appears Unilever was able to fully offset cost pressures with higher product prices as overall Cost of Goods Sold (COGS) rose slower than revenue by 25% to ₦61.8 billion. Consequently, gross profit rose 42.6% to ₦28.9 billion with related margin expanding 280bps to 32% – albeit, below 5-year trend level of 35%. The contraction in operating expenses to sales ratio of 335bps, following a slower increase in operating expenses (+9.3% YoY to ₦16 billion) than revenue, bolstered operating margin by 595bps to 14.3%, above 5-year trend level of 11%.
 - Unilever finished the year with a cash position of ₦50.5 billion, representing a fourfold increase from prior year while cash at bank was at ₦25 billion. We recall that 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. On the FCY loan, during the year, the company repaid the outstanding balance of ₦34 billion, which reduced its loans and borrowings position by 97% to ₦674 million with debt-to-equity ratio moderating to 0.89% (vs. 179% as at FY 16).
 - Isolating Q4 17 performance revealed an EPS of ₦0.50 (+36.4% YoY). As with earlier quarters, the increase in EPS stemmed from 8.7% YoY growth in revenue to ₦21.6 billion. Over H2 17, domestic CPO prices entered a moderation phase in line with the resumption of imports of crude CPO products as well as declining global CPO prices. We believe this
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offset higher petrochemical prices to drive a 1.2% decline in COGS over Q4 17. The foregoing drove a 659bps expansion in gross margin during the period to 34.7%, the highest quarterly gross margin during the year while gross profit rose 34% to ₦7.5 billion. Reflecting the boost to its cash position from the rights issue as well as the favorable yield environment of 2017, finance income printed higher at ₦1.0 billion (+17% YoY). In addition, finance expense at ₦430 million represented a decline of 56.2% YoY and 65.7% QoQ, reflecting the repayment of its FCY loans. The combination of this in addition to higher operating profit underpinned Q4 17 earnings growth.

Higher revenue and finance income to bolster earnings in 2018

- Going forward, we expect modest price hikes on its HPC brands to support revenue as the company makes up for lingering cost pressures from expected higher petrochemical prices in line with the increase in the price of crude oil into 2018. Given this, we forecast a 10% YoY increase in HPC revenue to ₦52.7 billion. On the other hand, we expect revenue from its food segment to be volume-led and project a 6% YoY increase to ₦45.4 billion. Given the above, we forecast an 8.1% YoY increase in FY 18E sales to ₦98.1 billion.
 - On cost, despite expectation of a further moderation in domestic CPO prices in line with international prices and increased imports, we see pressures on COGS from higher petrochemical prices as stated above. Our house view is for crude oil price to average \$60/bbl. over 2018 which is 12% higher than the average of \$53 over 2017. In that light, we project COGS to rise 6.7% YoY to ₦66 billion. Net impact of this and our revenue expectation translates to an 11.2% YoY increase in gross profit to ₦32.2 billion with related margin expected to expand 91bps to 32.8% (FY 17: 31.9%).
 - Given the need to drive volumes in the face of relatively higher product prices, we foresee an increase in marketing and branding spend over 2018. This coupled with our expectation of a rise in admin expenses drives our FY 18E operating expenses forecast of ₦17.7 billion (+10.6% YoY). This translates to a 40bps increase in OPEX-to-sales ratio hence, our operating margin is forecasted to rise 55bps to 14.8%.
 - Over 2018, we do not foresee a material increase in loans and borrowings as we expect the company to take advantage of its ample cash for working capital needs and investment opportunities. Hence, with our modest loans forecast of ₦667 million, we forecast finance expense of ₦117 million in FY 18. Also, supported by robust cash, we forecast finance income
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to increase 70% YoY to ₦2.8 billion translating to a net finance income of ₦2.7 billion (versus ₦1.7 billion net finance expense in FY 17).

- Cumulative impact of our adjustments translates to a 54% and 57.5% YoY expansion in FY 18E PBT and PAT to ₦17.1 and ₦11.6 billion. Considering additional shares from the rights issue, EPS translates to ₦2.04 (+14.6% YoY). We have raised our FVE to **₦33.56 (previous: ₦21.94)** following changes to the constituent of our peer companies for relative valuation. Irrespective, relative to last trading price, our FVE is at a 44% discount with the company's 2018 P/E at 29.3x (vs. 28.6x for MENA peers) while FY 18 expected ROE of 13.8% is below 5-year average of 27%. Thus, we retain our **SELL** rating on the stock.

Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦' m) *	2016A	2017A	2018E	2019E	2020E
Revenue	69,777	90,771	98,134	101,796	105,595
COGS	49,481	61,828	65,946	67,694	69,693
Gross Profit	20,296	28,943	32,188	34,102	35,902
Operating Cost	14,615	15,976	17,664	18,730	19,852
Operating Profit	5,805	12,950	14,543	15,422	16,103
Net finance Cost	(1,699)	(1,743)	2,716	2,715	2,542
PBT	4,106	11,207	17,260	18,137	18,645
Tax	1,035	3,757	5,523	5,804	5,966
PAT	3,072	7,450	11,737	12,333	12,678
Balance Sheet (₦ '000) *					
Fixed Assets	29,272	29,881	33,742	37,650	41,612
Stocks	9,878	11,479	13,189	13,539	13,939
Trade debtors	18,946	27,621	26,496	27,485	28,511
Cash & other bank balances	12,474	50,494	62,106	68,320	74,835
Total Assets	72,491	121,084	137,143	148,604	160,506
Liabilities					
Trade Creditors	32,477	33,409	39,568	40,617	41,816
Non-current Liabilities	7,288	8,481	9,002	9,549	10,112
Total liabilities	53,513	36,695	42,844	43,891	45,087
Shareholders' fund	11,690	75,908	85,298	95,164	105,307
Key Ratios	2016A	2017A	2018E	2019E	2020E
Gross Margin	29.1%	31.9%	32.8%	33.5%	34.0%
EBIT Margin	8.3%	14.3%	14.8%	15.2%	15.3%
PBT Margin	5.9%	12.3%	17.6%	17.8%	17.7%
Net Margin	4.4%	8.2%	12.0%	12.1%	12.0%
EPS	0.81	1.78	2.04	2.15	2.21
P/E	67.74	30.85	26.92	25.62	24.92
EV/EBITDA	26.67	10.56	16.33	14.96	13.88
ROA	5.0%	7.7%	9.1%	8.6%	8.2%
ROE	26.3%	9.8%	13.8%	13.0%	12.0%

Source: ARM Research *unless otherwise stated

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