

**Unilever Nigeria Plc. | Company Note**
**Rights Issue: Dilution to take centre stage**
**(SELL: ₦30.94)**

- Yesterday, Unilever gained shareholders' approval to raise ~~₦~~63 billion through the issuance of ordinary shares on such conditions and time the directors may deem fit. The rights approval was obtained after company's shareholders assented to the creation of additional shares of 3.95 billion (current: 3.8 billion shares) new ordinary shares of 50 kobo each ranking in all respects *pari passu* with the existing shares of the company.
- Importantly, the terms of the issue authorize the directors of the company with the right to apply outstanding convertible loans or other loan facility towards payment for any shares subscribed for under the rights issue. This is in line with our prior prognosis for the parent company to convert its outstanding debt (FY 16: ₦18.5 billion) to equity. In our view, the rights issue provides Unilever UK with a more efficient window to increase its holdings in its Nigerian subsidiary after its less than successful bid in 2015. Given Unilever UK's increased share buyback activity (FY 16: +1.53 pps YoY to 60.06%), we expect the rights issue to be fully subscribed. Thus, using current pricing, we

Income Statement Data			
	2017 – 3M'm	2016 – 3M'm	%chg
<b>Revenue</b>	22,172	16,782	32.1%
<b>PBT</b>	2,180	1,419	95.6%
<b>Tax</b>	577	378	53%
<b>PAT</b>	1,603	1,041	93.4%
Balance Sheet Data			
	2017 – Mar	2016 – Dec	%chg
<b>Inventory</b>	9,116	9,878	-8%
<b>Receivables</b>	26,638	18,946	41%
<b>Cash</b>	21,428	12,474	72%
<b>Payables</b>	41,838	32,477	29%
<b>Net Assets</b>	13,293	11,689	14%
Stock Data			
<b>Price</b>	₦36.01		
<b>52 week range</b>	₦27.73 – ₦49.86		
<b>Market Cap. (N'm)</b>	136,236		
<b>1-month Avg. Vol</b>	758,508		
<b>Curr. PE</b>	38.82x		
<b>Bloomberg Ticker</b>	UNILEVER:NL		
Unilever Nigeria Plc- Share Price Trend			


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project a 44% increase in Unilever's shares outstanding to 5.5 billion.

### **Debt reduction positive for earnings**

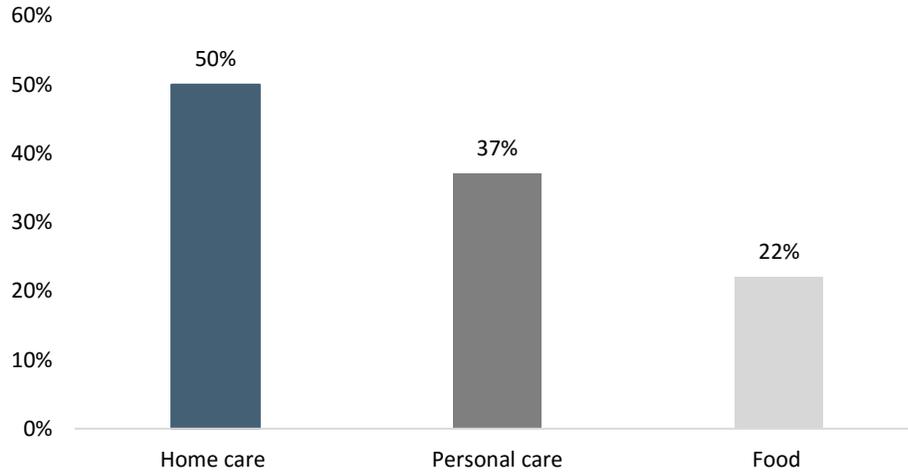
- In the event that Unilever's rights issue is completed in FY17 and executed at current pricing of ₦36.01, we project an improvement in the company's debt -to equity ratio to 0.1x (FY 16: 1.8x) and interest coverage ratio to 39x (FY 16: 2x).
- Overall, given the expected decline in Unilever's gearing ratio and consequently interest expense (-87% to ₦297 million), we expect the rights issue to consolidate the company's cost containment and price increase measures as it hopes to sustain earnings growth in an environment riddled with challenges. In addition, the conversion of foreign loans (entirely from the parent company) should also delink earnings from FX volatility. Thus, we estimate Unilever's FY 17 earnings at ₦10.2 billion (prior: ₦8.8 billion) which is 3x higher YoY. Nevertheless, given the potential increment in shares outstanding, FY 17 EPS is forecasted to decline to ₦1.85 (from ₦0.81 in 2016).

### **Price hikes and operating efficiency bolster Q1 earnings**

- Extending the double-digit growth in the prior five quarters, Unilever recorded a 32.1% YoY rise in top-line to ₦22.2 billion reflecting solid sales across its three product segments: Home Care (+50% YoY), Personal Care (+37% YoY) and Food (+22% YoY). The strong top-line growth continues to reflect impact of price hikes across its product portfolio (QoQ: Royco: +19%, Knorr: +24%, Close-Up: +26%, Lux: +29%) as the company gradually pass-on impact of inflationary pressures to consumers.
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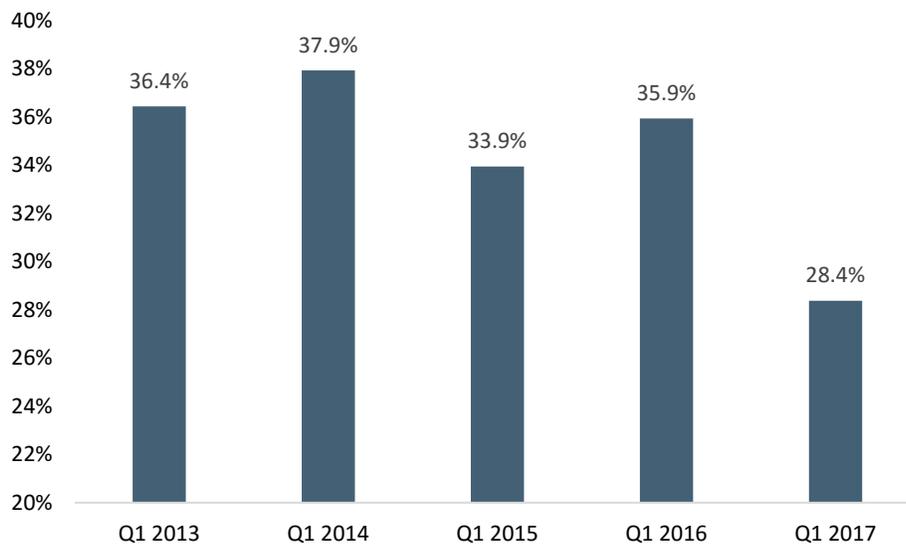
**Figure 1: YoY revenue growth across business portfolios**



Source: Company financials, ARM Research

- Despite the improved earnings, a noteworthy drag on the company's performance is the steep rise in COGS (+47.7% YoY to ₦6.3 billion) which drove gross margin to 28.4% (-7.6pps YoY). Given Unilever's high import-COGS ratio (FY 16: 62%), input cost pressures in the quarter likely reflected impact of weaker naira (-53.8%YoY), bullish prices of petrochemical inputs (+55% YoY) as well as higher CPO prices (+106% YoY).
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**Figure 2: Trend in gross margin**



Source: Company financials, ARM Research

- Furthermore, the company intensified its operating efficiency as cutback in Branding and Marketing (-45% YoY), Services (-31% YoY) and Overhead expenses (-11% YoY) kept OPEX (-14.1% YoY to ₪3.5 billion) in the negative territory for the fourth quarter running. Consequently, operating profit printed at its highest level in 22 months at ₪2.8 billion (+44.4% YoY).
- In addition, the company reported a mild increase in net finance cost (+18% YoY) as a nearly threefold YoY jump in interest income helped temper impact of a 33% YoY jump in borrowing cost. Sifting through the company's financials, we link the upsurge in interest income to higher cash balance (+333% YoY to ₪21.4 billion) which reflected improved working capital while finance charges tracked movement in borrowings<sup>1</sup> (+151% YoY to ₪25.4 billion). Overall, reflecting the positive impact of price induced revenue growth and cost cutting measures, Unilever extended its strong

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earnings rebound for the sixth consecutive quarter with Q1 17 bottom-line rising 53.9% YoY to N1.6 billion (PAT margin: +1pps YoY to 7.2%).

- Despite the improvement in Unilever's earnings outlook, the company remains expensive relative to peers trading at current P/E of 38.82x vs 29.69x for Bloomberg MENA peers. We have a **SELL** rating on the stock with an FVE of **N30.94**.

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<sup>1</sup> In FY 16, Unilever obtained a loan facility of \$59.7 million (N18.8billion) from Unilever Finance International AG to clear backlog of unpaid obligations to suppliers.

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## Summary of Results and Forecast

QUARTERLY					
Income Statement (₹'mln)*	Q1 2017A	Q2 2017E	Q3 2017E	Q4 2017E	
Sales	22,172	19,232	22,348	23,771	
COGS	15,879	13,283	15,729	16,375	
Gross profit	6,293	5,949	6,620	7,396	
Operating cost	3,543	3,297	3,831	4,207	
Operating profit	2,755	2,671	2,811	3,229	
Net finance cost	575	158	677	1,209	
Profit before taxation	2,180	2,513	3,488	4,438	
Tax	577	980	1,151	1,078	
Profit after taxation	1,603	1,533	2,337	3,360	
Earnings per share	0.42	0.41	0.62	0.89	
ANNUAL					
Income Statement (₹'mln)	FY 2014A	FY 2015A	FY 2016A	FY 2017F	FY 2018F
Sales	55,754	59,222	69,777	87,523	94,356
COGS	35,584	38,174	49,481	61,266	65,106
Gross profit	20,170	21,048	20,296	26,257	29,251
Operating cost	15,561	16,485	14,615	14,879	16,984
Operating profit	4,615	4,640	5,805	11,466	12,361
Net finance expense	1,742	2,869	1,699	1,153	623
PBT	2,873	1,771	4,106	12,619	11,737
Tax	461	579	1,035	3,786	3,756
PAT	2,412	1,192	3,072	8,833	7,981
Earnings per share	0.64	0.32	0.81	2.33	2.11
Dividend per share	0.10	0.05	0.10	0.35	0.32
Balance Sheet (₹'mln)	FY 2014A	FY 2015A	FY 2016A	FY 2017F	FY 2018F
<b>Assets</b>					
Fixed assets	24,831	27,369	29,272	32,035	34,502
Inventories	8,615	6,173	9,878	12,253	13,021
Trade debtors	8,544	10,143	18,946	21,881	23,589
Cash and other bank balances	1,335	4,435	12,474	23,561	29,117
<b>Total Assets</b>	45,736	50,172	72,491	91,651	102,151
<b>Liabilities</b>					
Trade Creditors	15,111	22,543	32,477	36,760	39,064
Borrowings	6,887	7,472	7,288	8,909	10,587
<b>Total liabilities</b>	31,371	34,698	53,513	63,544	65,581
Shareholders' fund	7,479	8,003	11,690	19,198	25,982
Key Ratios	FY 2014A	FY 2015A	FY 2016A	FY 2017F	FY 2018F
<b>Profitability margins</b>					
Gross margin	36.2%	35.5%	29.1%	30.0%	31.0%
Operating margin	8.3%	7.8%	8.3%	13.1%	13.1%
Net margin	4.3%	2.0%	4.4%	10.1%	8.5%
<b>Valuation multiples</b>					
EV/EBITDA	19.56	25.10	14.36	7.84	6.95
P/E	51.44	137.23	41.87	14.56	16.12
ROA	5.4%	2.5%	5.0%	10.8%	8.2%
ROE	32.3%	14.9%	26.3%	46.0%	30.7%

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>	Minimise exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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