

Unilever Nigeria Plc.

Upward Revision to Estimates; SELL Rating Retained

In this update note on Unilever Nigeria Plc (UNILEVER), we make adjustments for (1) finance charges, on potential savings from the refinancing of expensive local short term debts with cheaper USD loans, (2) continued impact on the top line and gross margin from pricing, and (3) operating expenses, which we expect to increase after the tight control achieved in 2016. Overall, we think the positives will be sufficient for UNILEVER to achieve low single-digit PBT growth of N4.44 billion in 2017F -- which compares favourably to the N1.43 billion we had forecasted. In line with the raised earnings expectation, we have increased TP to N21.06, but retain SELL rating.

A USD59.7 million loan facility was obtained in Q3-16 to refinance local short term bank overdraft and other facilities. Details of the USD facility, as revealed in the final 2016 account, show that (1) it is a one-year intercompany loan, with USD49.2 million drawn as at December 2016, (2) although larger in volume, it is priced cheaper than the refinanced NGN loan by up to 700bps, and (3) reduced UNILEVER's weighted average borrowing cost by about 620bps as at end-2016, compared to 2015. Although gross outstanding debt is currently at record level, we estimate finance charges to fall to N1.86 billion in 2017 (vs. N2.72 billion in 2016). *And while we agree that the USD debt exposes the P/L to unrealized FX loss, we are reminded that (1) the CBN appears "determined" to hold the line on the Naira and (2) most manufacturers (Lafarge Africa Plc – Listed – is a case in point) are now taking advantage of the derivative products offered by the central bank to hedge FX transactions. That said, the USD debt, clearly, could potentially result in estimated FX loss of N2.9 billion – if (1) unhedged and (2) the NGN/USD devalues to N352, the mid-point of the IMF's suggested fair value -- and compress PBT estimate to N1.54 billion.*

UNILEVER has further increased products prices in each of the last two months, with the aim to, by our hunch, realize historical average 36% gross margin. We understand that the PIs were taken both directly (such as for *CloseUp*, *Knorr*, and *Lipton*) and indirectly, through resizing products (such as for *Omo* and *Sunlight* detergents). Products in the Personal Care segment -- most affected by the weakened purchasing power -- were unaffected by the price increase.

The 2x price increase comes to us as a fundamental shift from the expectation coming into the year that pricing will -- unlike in 2016 -- have less of an impact on producers' revenue, given the modest outlook for inflation. For instance, a major company in the FMCG sector, which increased prices at one of the fastest pace in 2016, told us that it recently reduced its products prices in response to the appreciation of Naira exchange rate at the parallel market where it meets most of its FX requirements. Despite higher prices, we were told that UNILEVER reset key distributors' (KDs) turnover targets higher. When asked if the KDs have performed strongly in line with targets, to our ears, the answer was not in the affirmative.

It is too early to expect pricing will have the biggest impact on revenue this year, as the PIs have been accompanied with promotional activities, some of

SELL

Target Price (N)	21.06
Current Price (N)	35.00
Implied Return (%)	-39.81

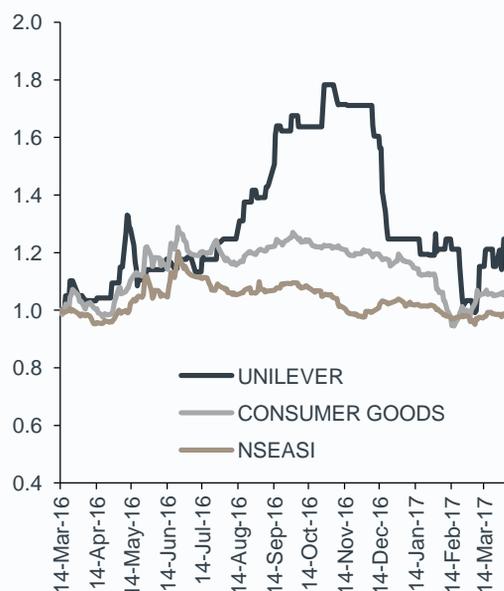
Company Data

NSE Code	UNILEVER
Bloomberg Code	UNILEVER:NL
Reuters Code	UNILEVER.LG
Sector	CONSUMER GOODS
Market Cap. (N'bn)	132.42
Free Float (%)	39.95

Ratios	Q4-2016	Q4-2015	2016FY
Gross margin	28.1%	37.4%	29.1%
Opex margin	15.2%	23.7%	20.9%
EBIT margin	13.5%	13.7%	8.3%
PAT margin	7.6%	6.4%	4.4%
RoAE	16.7*	37.1*	31.2%
EPS (N)	0.4	0.3	0.8

*Trailing

Price movement (UNILEVER vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros research

which are ongoing. KDs look for improved demand from the second half (in the absence of further PIs) at which time consumers might have adjusted to the latest price increases. As with most FMCG companies, UNILEVER closely controlled operating expenses in 2016 (achieved the first decline since 2008), where management deliberately scaled back brand and marketing spending (-25%), as bigger outlay may not have simultaneously translated to sales growth in a severely challenged consumer environment. But given we expect a relatively higher proportion of volume in the revenue mix this year, we look for higher spending on marketing and branding, potentially lifting opex (+15% Cordros estimate) from the decline recorded in 2016.

UNILEVER's linkage to FX via import channels remains substantial. And save for major improvement in the NGN/USD exchange rate (still at historical low level), or the moderation of raw material input prices, we are less convinced that the pricing decisions taken thus far are sufficient to realize 36% (vs. 31% Cordros estimate) gross margin. The company has in the past indicated plans to source 90% of its raw materials locally by 2020, but there has been no communication from management on specific internal measures with the potential to lower production costs in the interim.

Financial Statement (N'million).

Income Statement (N'm)						Profitability Ratios					
	2014a	2015a	2016a	2017f	2018f		2014a	2015a	2016a	2017f	2018f
Revenue	55,754	59,222	69,777	73,266	78,761	Gross profit margin	36.2%	35.5%	29.1%	31.0%	31.0%
Cost of sales	-35,584	-38,174	-49,481	-50,553	-54,337	EBITDA margin	11.7%	11.4%	12.0%	12.1%	12.1%
Gross profit	20,170	21,048	20,296	22,712	24,424	Operating profit margin	8.3%	7.8%	8.3%	8.1%	8.1%
Operating expenses	-15,561	-16,485	-14,615	-16,851	-18,123	PBT margin	5.2%	3.0%	5.9%	6.1%	6.3%
Other income/expense	6	78	124	81	88	Net profit margin	4.3%	2.0%	4.4%	4.2%	4.3%
Finance income	168	302	1,028	364	400	RoAE	28.7%	15.4%	31.2%	23.5%	21.5%
Finance costs	-1,910	-3,171	-2,726	-1,865	-1,865	RoAA	5.4%	2.5%	5.0%	4.1%	4.3%
Profit before tax	2,873	1,771	4,106	4,442	4,924	RoACE	12.1%	5.3%	11.6%	9.0%	9.3%
Tax expense	-461	-579	-1,035	-1,377	-1,526						
Profit after tax	2,412	1,192	3,072	3,065	3,397	Liquidity Ratios					
Financial Position (N'm)							2014a	2015a	2016a	2017f	2018f
PPE	24,831	27,369	29,272	30,500	33,478	Working capital (N'm)	-12,800	-13,690	-11,971	-10,543	-10,387
Intangible assets	1,398	1,169	940	980	1,075	Current ratio	0.6x	0.6x	0.8x	0.8x	0.8x
Other non-current assets	398.2	208.8	140.2	146	160	Quick ratio	0.3x	0.4x	0.6x	0.6x	0.6x
Employee loan receivable	128.3	128.0	111.7	116	128	Cash ratio	0.0x	0.1x	0.2x	0.2x	0.2x
Pension scheme surplus	409.7	290.4	484.6	505	554	Efficiency Ratios					
Non-current assets	27,165	29,165	30,949	32,247	35,395	Fixed assets turnover	2.2x	2.2x	2.4x	2.4x	2.4x
Inventories	8,615	6,173	9,878	10,293	11,298	Current assets turnover	3.0x	2.8x	1.7x	1.7x	1.7x
Trade and other receivables	8,544	10,143	18,946	19,740	21,667	Total assets turnover	1.2x	1.2x	1.0x	1.0x	1.0x
Employee loan receivable	77.22	85.20	72.92	75.98	83.39	Inventory turnover	4.6x	5.2x	6.2x	5.0x	5.0x
Assets held for sale	-	171.41	171.41	178.60	196.04	Receivables turnover	6.7x	6.3x	4.8x	3.8x	3.8x
Cash and cash equivalents	1,335	4,435	12,474	12,997	14,266	Payables turnover	2.0x	2.0x	1.8x	1.5x	1.6x
Current assets	18,571	21,008	41,543	43,285	47,511	Days inventory outstanding	80	71	59	73	73
Total Assets	45,736	50,172	72,491	75,532	82,906	Days collection/sales outstanding	55	58	76	96	96
Trade and other payables	15,111	22,543	32,477	32,788	36,818	Days payable outstanding	155	216	240	237	247
Current tax liabilities	213	160	503	506	544	Cash conversion cycle	-20	-87	-104	-68	-79
Bank overdraft	3,953	4,536	-	-	-	Solvency Ratios					
Loans and borrowings	12,061	7,427	20,501	20,501	20,501	Debt-to-capital ratio	0.7x	0.6x	0.6x	0.6x	0.6x
Deferred income	33	33	33	33	35	Net debt-to-equity ratio	-2.1x	-1.2x	-0.2x	-0.1x	0.0x
Current liabilities	31,371	34,698	53,513	53,828	57,898	Interest coverage	2.4x	1.5x	2.1x	3.2x	3.4x
Deferred tax liabilities	2,853	3,061	3,942	3,965	4,263	Investment Ratios					
Retirement benefit obligation	2,757	3,369	2,613	2,628	2,826	Earnings per share (N)	0.64	0.32	0.81	0.81	0.90
Long service awards	342	267	181	182	196	Dividend per share (N)	0.10	0.05	0.10	0.16	0.85
Other employee benefits	44	88	74	75	80	Payout	15.7%	15.9%	12.3%	20.0%	95.0%
Deferred income	128	96	63	63	68	Dividend yield	0.3%	0.1%	0.3%	0.5%	2.4%
Loans and borrowings	763	591	414	414	414						
Total non-current liabilities	6,887	7,472	7,288	7,328	7,847						
Total Liabilities	38,257	42,169	60,801	61,156	65,745						
SHF	7,479	8,003	11,690	14,376	17,161						

Source: Company Accounts, Cordros Research

Disclosures

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SELL (UNDERWEIGHT) - Over the next twelve months, we expect the stock to be more than 10% below the current market price.

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