

Unilever Nigeria Plc.

Announces Plan to Raise Capital Through Rights Issue

In a press release yesterday, Unilever Nigeria Plc (UNILEVER) announced that the following resolutions will be considered, and if thought fit, passed in its upcoming Annual General Meeting: (1) that the Authorized Share Capital of the company be increased to N5 billion (from N3.03 billion) by the creation of additional 3.95 billion new ordinary shares of 50 kobo and **(2) to raise up to N63 billion by way of Rights Issue**, subject to obtaining regulatory approval. The AGM is scheduled to hold on Thursday, 11 May, 2017.

The Rights Issue ...

Pending further details, we estimate that if the Rights is executed at the current market value of N33.25, the N63 billion proposed capital raise equates to new 1.89 billion ordinary shares that would be offered to existing shareholders (assuming all current shareholders take up their rights) of the company. This potentially increases the overall shares outstanding in favour of UNILEVER to 5.68 billion (from 3.78 billion). The stock price lost 5% yesterday following the announcement, in what we consider negative investor reaction in view of the potential dilutive impact of the additional share offering on (1) share holding and possibly, (2) dividend payment.

... What For?

In the notice of the AGM, it was stated that in addition to the above resolutions, the Directors of UNILEVER will seek shareholders authorization to **“apply any outstanding convertible loan, shareholder loan, or other loan facility due to any person, towards payment for any shares subscribed for by such person under the Rights Issue”**. As at the end of 2016FY, UNILEVER had N20.92 billion outstanding in debt, mainly comprising (1) N15.15 billion intercompany loan, (2) N5 billion commercial bank loan, and (3) N702.7 million facility from the Bank of Industry (BoI). Note that 98% of the outstanding debts are short term.

Of the above mentioned loan facilities, in line for conversion to equity via the proposed Rights Issue is the intercompany loan. UNILEVER obtained an intercompany loan of USD59.7 million (N18.81 billion) from Unilever Finance International AG in Q3-16 to (1) clear the backlog of unpaid USD-denominated obligations to suppliers and (2) refinance expensive local short term debts. Unilever Finance International AG is also a member of the Unilever Group. This latest move by the Unilever Group can be likened to the recent proposed conversion of Diageo's USD95 million loan to its Nigerian subsidiary, Guinness Nigeria Plc (GUINNESS), into equity stake via Rights Issue.

In addition to the debt-equity swap, our hunch is that part of the proceeds of the Rights Issue will be utilized for (1) the repayment of outstanding commercial bank loans (priced at 14% as at end-2016), (2) the settlement of backlogs of trade payables, as well as (3) working capital and capital expenditure investments.

On the repayment of borrowings, the current option being considered by the management of UNILEVER can be taken for a bold attempt to (1) guide against potential FX losses attached to the USD facility (we estimated N2.9 billion) in the event that the NGN/USD devalues to N352, the mid-point of the IMF's suggested fair value and (2) improve the company's deteriorating coverage and leverage ratios. We expect total debt will be reduced from N20.92 billion to only the N702.7 million due to the BoI, potentially driving down interest expense to a record low of N70 million.

The total payables of the FMCG companies under our coverage rose from N207 billion to N373.1 billion, between 2015 and 2016, following the devaluation of the Naira.

SELL

Target Price (N)	21.06
Current Price (N)	33.25
Implied Return (%)	-36.65

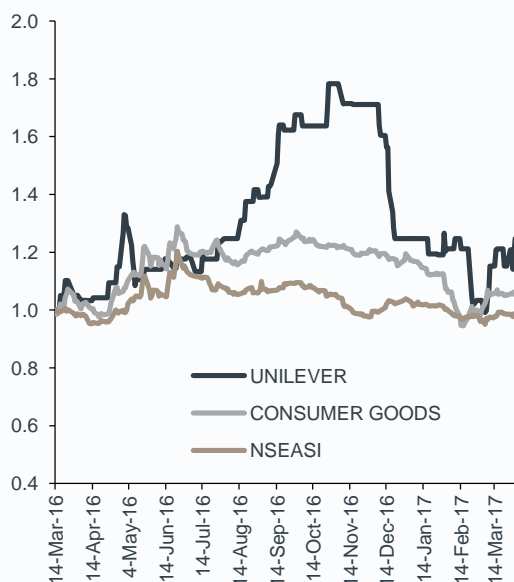
Company Data

NSE Code	UNILEVER
Bloomberg Code	UNILEVER:NL
Reuters Code	UNILEVER.LG
Sector	CONSUMER GOODS
Market Cap. (N'bn)	125.79
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

UNILEVER's trade payable was at record high of N32.5 billion (vs. N22.5 billion in 2015) at the end of last year. We understand that the proportion of dollar in the payables mix of FMCG companies is significant. The management of PZ Cussons Nigeria (PZ) and Flour Mills of Nigeria Plc (FLOURMILL) for instance, told us that 100% of their payables are dollar-denominated, and risks the companies of significant FX losses if unsettled in the event that the NGN devalues further from current level.

Parent Company is Slow, but Surely Increasing its Stake

Unilever Overseas Holdings B.V., the parent company of UNILEVER, had offered in 2015 to increase its stake in the Nigerian subsidiary to 75% via the acquisition of 942,215,930 ordinary shares at N45. We note that from 50.04% in 2014, the parent company's stake in the local subsidiary has risen to 60.05% as at end of 2016, acquired via Tender Offer to other shareholders (in 2015) and open market purchases (in 2015 and 2016). The proposed Rights, at a relatively discounted price compared to the Tender Offer, offers Unilever Overseas Holdings B.V the opportunity to further increase its stake in the Nigerian subsidiary to between 63-64% (Cordros estimate), assuming 20-30% of the existing shareholders fail to take up their rights.

Overall, the decision to convert debt into equity, notwithstanding the current unpalatable Nigerian consumer story, stresses Unilever Global's commitment to further investment and growth in Nigeria. The company has in the past indicated it is working on backward integration plans, driving towards the realization of 100% local sourcing by 2020.

2016 Result and Outlook

UNILEVER released Q4-2016 and 2016 full year results two weeks ago. The full year result, boosted by the company's performance in the fourth quarter, significantly beat consensus. Revenue in 12 months grew by 17.8% while PAT increased by 157.6%. The Board recommended a 10 kobo/share dividend (vs. 5 kobo/share in 2015). Following Q2 and Q3 of almost no profits, UNILEVER reported a PBT of N2.60 billion in Q4, boosted by (1) price-driven revenue and margin growth and (2) decline in operating expenses, which more than offset downside from the increase in finance charges.

In the update note we released on the company last week, we made 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 concluded that the positives will be sufficient for UNILEVER to achieve low single-digit PBT growth to N4.44 billion in 2017F -- which compares favourably with the N1.43 billion we had forecasted. In line with the raised earnings expectation, we increased TP to N21.06, but retained SELL rating.

Is Nestle Nigeria Plc (NESTLE) the Next in Line?

NESTLE's total debt as at end of 2016FY was N50.7 billion, comprising N46.6 billion (USD147.8 million) of foreign intercompany loans and N4.1 billion of local borrowings. NESTLE has long-standing preference for USD-denominated facilities (averaging 75% of gross loans since 2011), which (1) are cheaper (7% weighted average as at 2016F), (2) guarantees the company of FX liquidity, but (3) bears significant risk of unrealized FX losses. In 2016FY, NESTLE reported N16.3 billion net forex loss following the devaluation of the NGN from N199 to N305. The company has consistently reported FX loss since 2014, following the crash in crude oil price which sparked currency crisis in Nigeria. Our estimate for NESTLE's potential FX loss is N7.2 billion, if the NGN/USD devalues to N352, the mid-point of the IMF's suggested fair value. In addition, although better than UNILEVER's, NESTLE's coverage and leverage ratios (interest cover of 10x and debt/equity of 164% in 2016FY) do not particularly appear impressive. While we agree that NESTLE is in a far better financial condition than UNILEVER and GUINNESS, there is a likelihood that of management considering the "trending" debt/equity swap option, at least, to eliminate the impact of FX volatility on the income statement.

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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Cordros Capital uses the following rating system:

BUY (OVERWEIGHT) - Over the next twelve months, we expect the stock to return at least 20% above the current market price.

HOLD (NEUTRAL) - Over the next twelve months, we expect the stock to range between <-10% and <+20% from the current market price.

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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