

Q2 Ended June 30, 2014

Benefitting From Strategic Partnerships

1.0 Q2 2014 Performance Analysis:

The unaudited Q2 result of UACN Plc for the period ended June 30, 2014 shows that its Turnover (T/O) increased by 7.79% to N40.26bn, compared with N37.35bn recorded in the corresponding period of 2013. The key drivers for the increase in the turnover is the increased contributions from the following subsidiaries: UAC foods (Turnover up 10%), Grand Cereals (3%) and CAP (16%) as well as the Portland Paint consolidation (Turnover up 6%). The cost of sales during the period under review also increased by 11.35% to N31.08bn from N27.92bn recorded in Q2 2013. This was on the back of rising input cost in certain categories. The administrative, selling and distribution expenses increased by 10.31% to N5.38bn in Q2, 2014. The increase in the administrative, selling and distribution expenses was as a result of the increased spending on sales/marketing activities in order to stay afloat in the competitive market and the execution of a new sales model by Portland Paints.

The other operating income stood at N2.29bn as at Q2 2014, representing an increase of 67.98% compared with N1.36bn recorded in Q2 2013. The bulk of the other income came from the Real Estate Investment Trust (REIT) investments, which stood at N1.47bn in Q2 2014. The Profit Before Tax (PBT) stood at N5.06bn, representing a marginal decrease of 1% from N5.11bn recorded in the corresponding period of 2013. The tax provision also decreased by 9.14% to N1.58bn from N1.74bn, leading to a Profit After Tax (PAT) of N3.48bn in Q2 2014 from N3.37bn in the corresponding period of 2013, representing a growth of 3.19%.

The company's profit margins decreased in Q2 2014 compared with Q2 2013. This is a reflection of rising input costs and stiff competition

Table 1:	BUY
Current Price	N58.00
Fair Value	N68.02

The turnover in Q2 June 2014 increased by 7.79% to N40.26bn.

The company's profit margins decreased in Q2 2014.

Table 2: Financial Performance (N'mn)

	Q2 2014	Q2 2013	%Δ	FY 2013
T/O	40,256	37,345	7.79	78,714
EBIT	6,085	5,918	2.82	15,267
PBT	5,062	5,113	(1.00)	14,011
PAT	3,481	3,374	3.19	9,949

Table 3: Half Year Result Highlights (N'mn)

	Q2 2014	Q1 2014	Q4 2013	Q3 2013	Q2 2013
Turnover	20,367	19,889	18,240	22,761	18,303
PBT	2,438	2,624	5,406	3,386	3,311
PAT	1,510	1,971	4,215	2,292	2,127

The PBT Margin in Q2 2014 decreased over the Q2 2013 and is also lower than that of the Financial Year ended December (FY), 2013 figure. The PBT margin decreased to 12.57% in Q2 2014 from 13.69% in Q2 2013, and down from 17.80% in FY 2013. Also, the PAT margin currently stands at 8.65%, down from 9.03% in the corresponding period of 2013, and also down from 12.64% as at FY 2013. This result also indicates that the percentage of T/O, PBT, and PAT in the Q2 March 2014 to the audited T/O, PBT and PAT for the period ended June 2014 are: 51.14%, 36.13% and 34.99%, respectively. Given the run rate, the company is expected to exceed its previous year's top line performance but will need to put in place measures to manage costs in order to meet last year's bottom line. The company declared a dividend of N1.75 per share for FY 2013, a growth of 9.38% from N1.60 declared in FY 2012.

The company will need to manage costs in order to meet last year's bottom line.

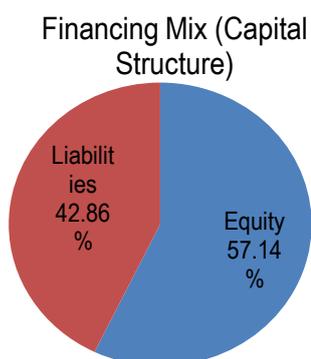
Table 4: Profitability Margins

	Q2 2014	FY 2013	Q2 2013
GP* Margin	22.78%	23.93%	25.25%
EBIT Margin	15.12%	19.40%	15.85%
PBT Margin	12.57%	17.80%	13.69%
PAT Margin	8.65%	12.64%	9.03%
*GP – Gross Profit			

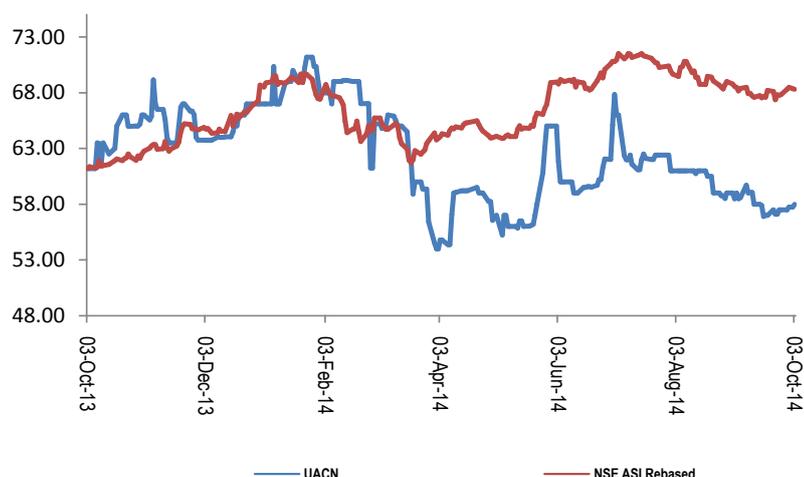
A cursory look at the balance sheet position as at Q2 2014 compared with the position as at FY 2013 shows a marginal increase in the company's fixed assets. The total fixed assets increased marginally by 1.74% to N36.39bn from N35.76bn in FY 2013. The stock decreased to N24.72bn from N26.62bn in FY 2013. The cash and bank balance marginally decreased by 1.95% from N8.89bn in FY 2013 to N8.72bn in Q2 2014. The trade debtors and other receivables also increased in Q2 2014 by 3.21% to N14.24bn from N13.80bn in the FY 2013. The trade creditors and other payables increased by 1.73% to N17.55bn from N17.25bn as at FY 2013. The working capital increased to N8.71bn from N6.86bn recorded in FY 2013, while net assets for the period decreased by 1.42% to stand at N70.31bn from N71.32bn as at FY 2013.

The total assets of the company which stood at N123.04bn as at Q2 2014 were financed by a mix of equity and liabilities in the ratio of 57.14% and 42.86% respectively. Our analysis of the liabilities shows that the short-term liabilities stood at N38.97bn, accounting for 73.90% of the total liabilities, the long-term liabilities stood at N13.77bn, accounting for 26.10% of the total liabilities. The long-term liabilities constituted mainly of long term borrowings, which increased by 62.1% compared with the FY 2013.

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UACN Vs NSE ASI Rebased (Oct . 2013- Oct. 2014)



2.0 Drivers of Performance:

UACN's performance was stunted by some social and economic factors which includes the following:

- High cost/scarcity of raw materials in one of the subsidiaries (Grand Cereals)
- The insecurity in the North which has reduced consumer confidence and demand and this has necessitated increased spending on sales and marketing in order to make up for the loss of market in the North.
- Also, UACN struggled with high finance costs as a result of UPDC's pricing, delayed debt finance and delayed take-off of projects.

UAC foods, Grand Cereals, CAP and Portland Paints were the major contributors to the increase in topline. The acquisition of Portland Paints was aimed at capturing the middle market in the paints industry and to increase its dominance in the paints market. UACN has recently increased its shareholding in Portland Paints to 64% from 51% it had after the acquisition. Also, the acquisition of Livestock Feeds (LSF) was fuelled by the need for geographical diversification. This is imperative due to the heightened security challenges in the Northern part of Nigeria. The current demand estimates by the company shows that the demand for animal feeds outweighs the supply. LSF has invested in a larger manufacturing plant of animal feeds in Ikeja, Lagos State. Livestock Feeds controls about 32% of the market share in the animal feeds market while Flour Mills controls about 41% of the market, other marginal players contribute the balance of 16%. The profit margins in the animal feeds business are thin, and profitability is volume driven.

2.1 Strategic Focus:

One major strong point for UACN is its strategic partnerships in its subsidiary companies. UACN currently has strategic partnerships with the following: Tiger Brands Limited for UAC Food, Imperial Logistics for MDS Logistics Limited and Famous brands for UAC Restaurants. These partnerships and their initiatives are yielding significant operational efficiencies and have ability to reposition UAC Group for sustainable growth. UACN's continuous efforts to engage in products innovation; retail execution strategies launched in H1 and pursuit of cost efficiencies should sustain returns in H2.

UAC Foods, Grand Cereals, CAP and Portland Paints were the major contributors to the increase in topline.

The company has embarked on a number of initiatives that will position the company for sustainable growth.

Also its intention to grow volumes; tackle margin challenges across key subsidiaries; leverage on technology; conclude integration process for new acquisitions and the management of enterprise risk should position the company on the path of sustained growth.

3.0 Business:

UACN is a leading diversified company, operating in the food and beverage, real estate, paints and logistics sectors of the economy. UACN's business portfolio includes the following companies: UACN Property Development Company PLC (UPDC) - 46%, UAC Foods Limited (UFL) – 51%, MDS Logistics (MDS) -51%, UAC Restaurant Limited (UACR) – 51%, Grand Cereals Limited (GCL) – 64.9%, Chemical and Allied Products PLC (CAP Plc) – 50.1%, Warm Spring Waters Nigeria Limited (WSWNL) – 76%, UNICO CPFA Limited – 87% and the newly acquired Livestock Feeds Plc -51% and Portland Paints and Products Nigeria Plc (PPPN) – 64.7%.

UACN is a leading diversified company, operating in the food and beverage, real estate, paints and logistics sectors of the economy.

UACN has evolved into a holding company with regional and international partnerships.

UACN's strategic partnerships are aimed at enhancing operational excellence, delivery capabilities and positions as well as consolidating and building its market share in a competitive and fast growing market.

UACN has evolved into a holding company with regional and international partnerships. The partnerships are: UAC Foods Limited, a business partnership between Tiger Brands Limited holding 49% of the equity and UAC controlling 51%; MDS Logistics Ltd, a joint venture with Imperial Logistics, which holds 49% equity with UAC holding the majority stake of 51%; UAC Restaurants Ltd, where Famous Brands holds 49% of the equity, while UACN holds the remaining 51%. UACN also operates successful joint ventures in the real estate business and technical collaborations in its paint business. In 2013, UACN deepened its play in the paints and feeds markets by acquiring 51% equity in LSF, and 64.7% equity in PPPN, the makers of Sandtex Paint. UACN's strategic partnerships are aimed at enhancing operational excellence, delivery capabilities and positions as well as consolidating and building its market share in a competitive and fast growing market. UACN's brand portfolio includes brands such as Gala Sausage Roll, Mr Biggs, Village Kitchen, Snaps, Funtime Coconut Chips, Supreme Ice cream, Delite Fruit Juice, Swan Natural Spring Water, Gossy Warm Spring Water, Dulux, Grand Soya Oil, Grand Groundnut Oil, Grand Maize Flour, Vital Feeds, Livestock Feeds and Sandtex.

Table 5: Company Summary

Ticker	UACN
Sector	Conglomerates
Sub-sector	Diversified Industries
Date of Incorporation	April 22,1931
Date of Listing	1974
Financial Year End	December
Number of Fully Paid Share	1,920,864,388
Current Capitalization(NGN)	111,410,134,475
NSE Capitalization (NGN)	13,572,347,588,449
% of NSE Capitalisation	0.82
52 Week high NGN	71.20
52 Week low NGN	54.00
YTD Return (%)	(10.82)
52 Weeks Average Volume Traded	977,053
Trailing EPS NGN	5.24
Trailing P/E Ratio (X)	11.08

Table 6: Directors' Shareholding as at December 31, 2013

Director	Position	Holdings
Senator Udoma Udo Udoma, CON	Chairman	24,563,108
Mr Larry Ephraim Ettah	MD/CEO	2,400,000
Mrs Awuneba Sotonye Ajumogobia	Non-Executive	925
Dr Umaru Alka	Non-Executive	Nil
Mr. Abdul Akhor Bello	Chief Financial Officer	124,388
Mr Joseph Ibrahim Dada	Director/Corporate Services	103,124
Dr. Okechukwu Enyinna Enelamah	Non-Executive	108,672
Mr. Babatunde Oladele Kasali	Non-Executive	10,000

UAC's food and beverage portfolio is made up of business units involved in the manufacturing and sales of food items, livestock feeds, bottled water, fruit juice, ice-cream and Quick Service Restaurants.

4.0 Product Analysis

UACN is a leading diversified company, operating in the food and beverage, real estate, paints and logistics sectors of the economy.

4.1 Food and Beverage

UACN's food and beverage portfolio is made up of business units involved in the manufacturing and sales of food items, livestock feeds, bottled water, fruit juice, ice-cream and Quick Service Restaurants. This portfolio forms the backbone of the business, contributing 43% to the group's PBT in Q2 2014. The subsidiaries involved in this sector include: UFL, UACR, GCL, LSF and WSWNL. The brands under these subsidiaries include:

- UAC Foods Limited: Gala Sausage rolls (which has been in existence since 1962 and is the market leader in the Sausage roll market), Funtime Chips, Funtime cake, Snaps Puffed Maize, Supreme Ice Cream-Scoop, Delite Juice, and Swan Water.
- UAC Restaurant Limited: Mr Bigg's and Village Kitchen
- Grand Cereals: Fine Grits, Grand Maize Flour, Richfil, Edible Oils (including Grand Pure Groundnut Oil, Grand Pure Soya Oil), Vital Feed range (Including Vital Fish feed, Vital inputs ,Vital Concentrate).
- Warm Spring Waters: Gossy, SWAN
- Livestock Feeds: Finished feeds brand

In this sector, UFL, GCL, and LSF recorded an increase in turnover in Q2 2014 of 10%, 3% and 24% respectively, compared with Q2 2013. UAC Restaurant, on the other hand, recorded a decrease in turnover of 19% in Q2 2014. There is a plan to sell off WSWNL in the 2nd quarter of 2014. Bottled water and Dairy products recorded a high level of consumer demand increasing the volumes sold. However, stiff competition from competitors like Eva water and Fan Milk, as well as security challenges and elevated input costs/scarcity of raw materials dampened overall business performance in this sector. Despite the tough market conditions, the food and beverage business still recorded an increased contribution to the group's overall PBT. LSF has the second largest market share for animal feeds controlling 32% of the market share with Flour Mills controlling 41%.

There are however, growth opportunities in this sector as demand for animal feeds currently outweighs the supply. The Ikeja factory upgrade is expected to give room for increase in volumes as profitability in this sector is volume driven. The combined market share of Livestock Feeds and Grand Cereals will consolidate UACN's market presence in the animal feeds sector thus adding significant scale to UACN's existing business. It also expects to reduce costs through economies of scale and collaborations in procurement and distribution. Major competitors in the food and beverage segments are: Chi Limited, Flourmill, Fan Milk, Dansa Foods, Nestle and Coca Cola.

4.2 Real Estate

This sector is made up of business unit involved in real estate development and management. It is managed by the subsidiary company UPDC Plc, the first company in the real estate sector to be quoted on The Nigerian Stock Exchange (NSE); UPDC in Q2 2014 experienced margin pressures due to the unfavourable portfolio mix and elevated finance costs which saw its contribution to the group's overall PBT fall from 31% in Q2 2013 to just 17% in Q2 2014. Additionally, UPDC's finance costs are up on account of the delay in the refinancing of its debt and delayed take-off of projects leading to an increased cost of borrowing. UPDC has some key landmark residential developments including the following: Cameron Green, Thompson Avenue Apartments, Niger Towers, Vintage Gardens and Metro Gardens. There is also a hotel arm to UPDC; Golden Tulip, Festac. Moving forward, UPDC plans on including more flats, commercial and retail units in its portfolio as they have proven to be in high demand. Ongoing projects include UPDC metro city, APO-Abuja which includes 3 and 2 bedroom flats as well as housing units. There is also the Festac project called The Node, this will include Golden Tulip, Festival mall, which consists of retail space with 46 shops and a cinema and The Residence which consists of 2 wings of Apartments and 1 wing of offices. A number of other private estate developers and managers have emerged providing major competition for UPDC. Some of them are: Lekki Gardens Estate Limited, ARM Properties and etc

Moving forward, UPDC plans on including more flats, commercial and retail units in its portfolio as they have proven to be in high demand.

4.3 Logistics

This is made up of business unit involved in rendering logistics and supply chain services including warehousing, transportation and redistribution services. MDS Logistics is the UACN subsidiary in this sector. MDS link manufacturers with numerous customers in over 400 cities and villages connected by a network of distribution centres across Nigeria. MDS have a diverse portfolio of clients in the Telecommunication, Pharmaceuticals and Food and Beverages sectors. The company has been able to maintain its leadership position in the outbound segment of the third party logistics industry. This business segment has been challenged by reduced consumer demand. Despite these challenges MDS logistics recorded a 4% increase in turnover in Q2 2014. MDS completed and commissioned a new haulage workshop in 2014.

CAP prides itself as the leader in the Chemical/Paints sector of the Nigerian economy with excellent, first-class products and brands.

4.4 Paints

This is made up of business unit involved in the manufacturing and sales of paints products and other decoratives. CAP Plc and Portland Paints are the subsidiary companies in this sector. CAP prides itself as the leader in the Chemical/Paints sector of the Nigerian economy with excellent, first-class products and brands. The consolidation of Portland Paints gave a considerable boost to the paints category contribution to PBT in Q2 2014, contributing 26% in Q2 2014 up from the 18% contributed in Q2 2013 making it the second largest contributor to the group's overall PBT. The complete portfolio in paints holds the following products:

- CAP: Dulux Trade brands, Dulux Emulsion Brands, Dulux Wood Care Brands, Dulux Watershield Brands, Caplux Paint brand.
- Portland Paints: Sandtex Paints, Portland Bathrooms, Hempel Marine/Protective Coatings.

The acquisition of Portland paints has consolidated UACN's position as the leading paint manufacturer in Nigeria in both the luxury and standard segments. CAP has a strong market share in the top-tier of the paints market, with little market share in the middle-tier market. The acquisition of Portland paints was aimed at capturing this middle-tier market.

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5.0 SWOT Analysis:

<p>5.1 Strengths:</p> <ul style="list-style-type: none"> ❖ Strong brand name ❖ Synergies created from their strategic international and regional partnerships ❖ Diverse business portfolio ❖ Good knowledge and expertise of the domestic market ❖ Diversified product line ❖ Wide product distribution network ❖ Strong management 	<p>5.2 Weaknesses:</p> <ul style="list-style-type: none"> ❖ Rising input costs ❖ Possible impact of double taxation
<p>5.3 Opportunities:</p> <ul style="list-style-type: none"> ❖ Large market size in Nigeria and neighbouring countries ❖ Stable macroeconomic environment ❖ Government's efforts to fight counterfeit food products especially through the National Agency for Food and Drug Administration and Control (NAFDAC) ❖ Growing middle class in Nigeria 	<p>5.4 Threats:</p> <ul style="list-style-type: none"> ❖ Security challenges in the Northern region ❖ Intensive competition in its market segments ❖ Inadequate physical infrastructure in the country ❖ High finance cost

6.0 Forecast:

Our Forecast Drivers:

We considered the following factors in arriving at our 5-year forecasts:

- The competitive position of the company in the industry and strong brand name.
- The diversified business portfolio
- The strategic acquisitions of Portland Paints and Livestock Feeds
- The various new real estate projects that will soon be completed
- Growing demand in Nigeria for food and beverages
- The company's strategic international and regional partnerships
- Stable macroeconomic indicators

Taking the foregoing factors into consideration we estimate Turnover of N89.80bn, N103.16bn, N118.91bn, N135.70bn and N154.87bn for the periods ending December 2014, 2015, 2016, 2017 and 2018 using a revenue growth margin of 14.1%, 14.9%, 15.3% for 2014, 2015, 2016 respectively and 14.1% for 2017 and 2018. We estimate EBIT of N17.41bn, N20.06bn, N23.12bn, N25.37bn and N28.18bn, and EBITDA of N19.40bn, N22.23bn, N25.45bn, N27.83bn and N30.75bn for 2014, 2015, 2016, 2017 and 2018 respectively using EBIT margins of 19.40% for 2014, 19.45% for 2015 and 2016, 18.70% and 18.20% for 2017 and 2018 respectively. Our PBT forecasts for the periods are: N16.69bn, N19.61bn, N23.05bn, N25.29bn and N28.10bn. Adjusting for tax, our PAT forecasts are N11.35bn, N13.33bn, N15.68bn, N17.20bn and N19.10bn. PAT Margin for the period are 12.64%, 12.92%, 13.18%, 12.67% and 12.34% for 2014, 2015, 2016, 2017 and 2018 respectively. Our forecast final dividend for the FY 2014 is N2.06 per share.

We estimate a dividend per share of N2.06 for the FY 2014.

Table 7 : Comparable Analysis (Nbn)

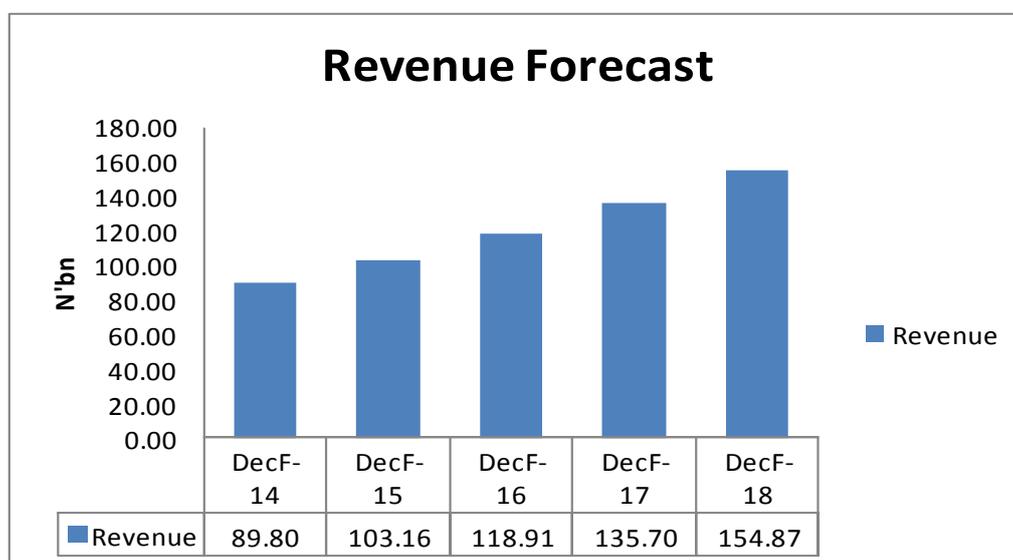
Company	T/O	GP	EBIT	PBT	PAT	GP Margin %	EBIT Margin %	PBT Margin %	PAT Margin %	ROE %	ROA %
UACN	78	18	15	14	9	23.93	19.4	17.8	12.64	23.17	7.96
Transcorp	18	14	10	9	6	76.35	54.45	47.98	36.96	11.95	4.66
Flour Mill*	332	43	19	8	5	13.14	5.83	2.48	1.62	6.72	1.81

*Source: Company Annual Reports, FSDH Research, *Year end is March 2014*

Table 8: FSDH Research Earnings Forecast for UACN (2014-2018)

	14-Dec	15-Dec	16-Dec	17-Dec	18-Dec
Turnover(N'mn)	89,800	103,155	118,910	135,704	154,869
EBIT(N'mn)	17,418	20,060	23,123	25,371	28,180
EBITDA(N'mn)	19,404	22,231	25,451	27,832	30,754
PBT(N'mn)	16,691	19,607	23,053	25,294	28,095
Tax(N'mn)	5,341	6,274	7,377	8,094	8,990
PAT(N'mn)	11,350	13,333	15,676	17,200	19,104
Dividend Payment(N'mn)	3,964	4,656	5,475	6,007	6,672
EBIT Margin (%)	19.40	19.45	19.45	18.70	18.20
EBITDA Margin (%)	21.61	21.55	21.40	20.51	19.86
PBT Margin (%)	18.59	19.01	19.39	18.64	18.14
PAT Margin (%)	12.64	12.92	13.18	12.67	12.34
EPS(N)	5.91	6.94	8.16	8.95	9.95
DPS(N)	2.06	2.42	2.85	3.13	3.47
Earnings Yield (%)*	8.69	10.21	12.01	13.17	14.63
Dividend Yield (%)*	3.03	3.56	4.19	4.60	5.11
P/E Ratio(x)*	11.51	9.80	8.33	7.60	6.84
Number of Shares (mn)	1,921	1,921	1,921	1,921	1,921
Dividend Payout (%)	34.92	34.92	34.92	34.92	34.92

***At Our Fair Value of N68.02**



7.0 Valuation

In arriving at a fair value for the ordinary shares of UACN, we used the Discounted Free Cash Flow (DCF) model. We applied a terminal growth rate of **6.54%**, which is the latest real GDP growth rate for the Nigerian economy as at Q2, 2014. We used a beta value of **0.74x** based on the 5-year daily historical returns on the company share price and the Nigerian Stock Exchange All Share Index (NSE ASI). We used the yield of **12.46%** on the approximately 5year tenor-to-maturity of the 7% FGN Bond October 2019 as our risk free rate, and market premium of **10.40%**, which is the equity market premium used for Nigeria based on its credit rating. Applying foregoing parameters on the Capital Asset Pricing Model (**CAPM**), the cost of equity generates **20.14%**. The company has long term debt, with the weighted after tax cost of the debt estimated at 8.81% using a tax rate of 32%. The Weighted Average Cost of Capital (WACC), which is our discount rate, was estimated at 19.57%. Using **1.92bn** shares in issue, the weighted average of the **DCF** model generates **N68.02** per share, which is our fair value.

The fair value for UACN Plc is N68.02

The current market price of UACN Plc share is N58.00. The highest and the lowest closing price in the last 52 weeks are N71.20 and N54.00 respectively. The 2014 forward earnings yield and dividend yield based on our fair value are: 8.69% and 3.03% respectively. The fair value offers an upside potential of 17.27% in terms of capital appreciation from the current level. We therefore place a **BUY** on the shares of UACN Plc at the current price of N58.00 as of October 08, 2014 for capital appreciation.

For enquiries please contact us at our offices:

Lagos Office: 5th-8th floors UAC House, 1/5 Odunlami Street, Lagos. Tel: 234-1-2702881-2.

Port Harcourt Office: Mainstreet Bank Building, (2nd floor, 5 Trans Amadi Road, Port Harcourt. Tel: 234-802 408 1331.

Abuja Office: Abia House, Plot 979, 1st Avenue, Off Ahmadu Bello Way, Cadastral Zone AO, Central Business District, Abuja. Tel: 09-8700465

Website: www.fsdhgroup.com **Email:** research@fsdhgroup.com

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