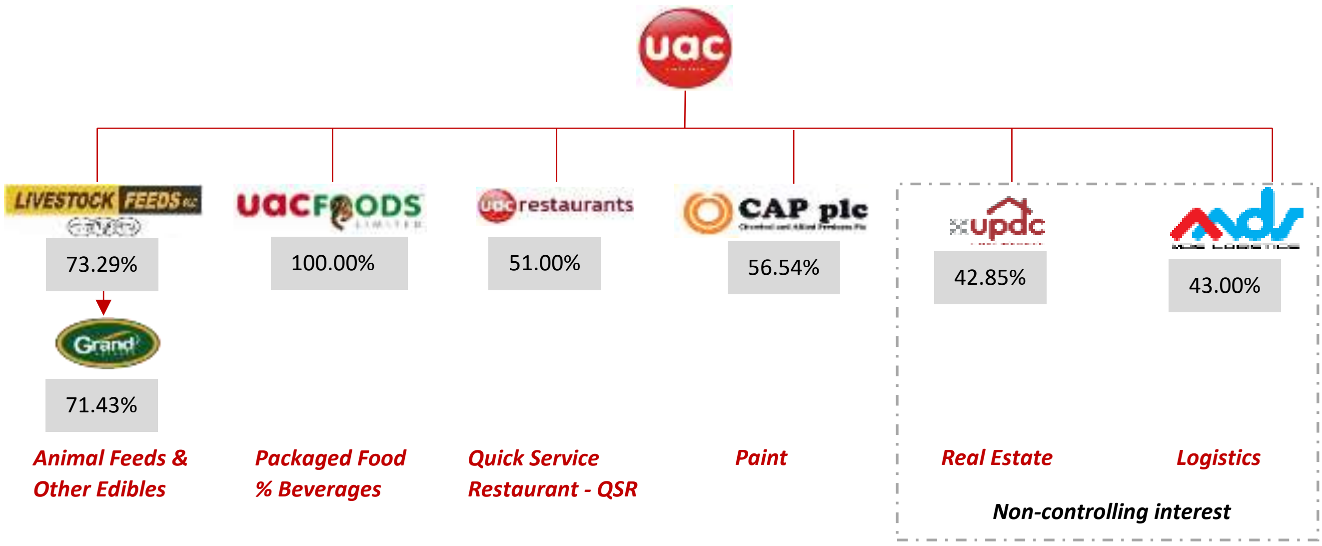
Going Steady with Restructuring

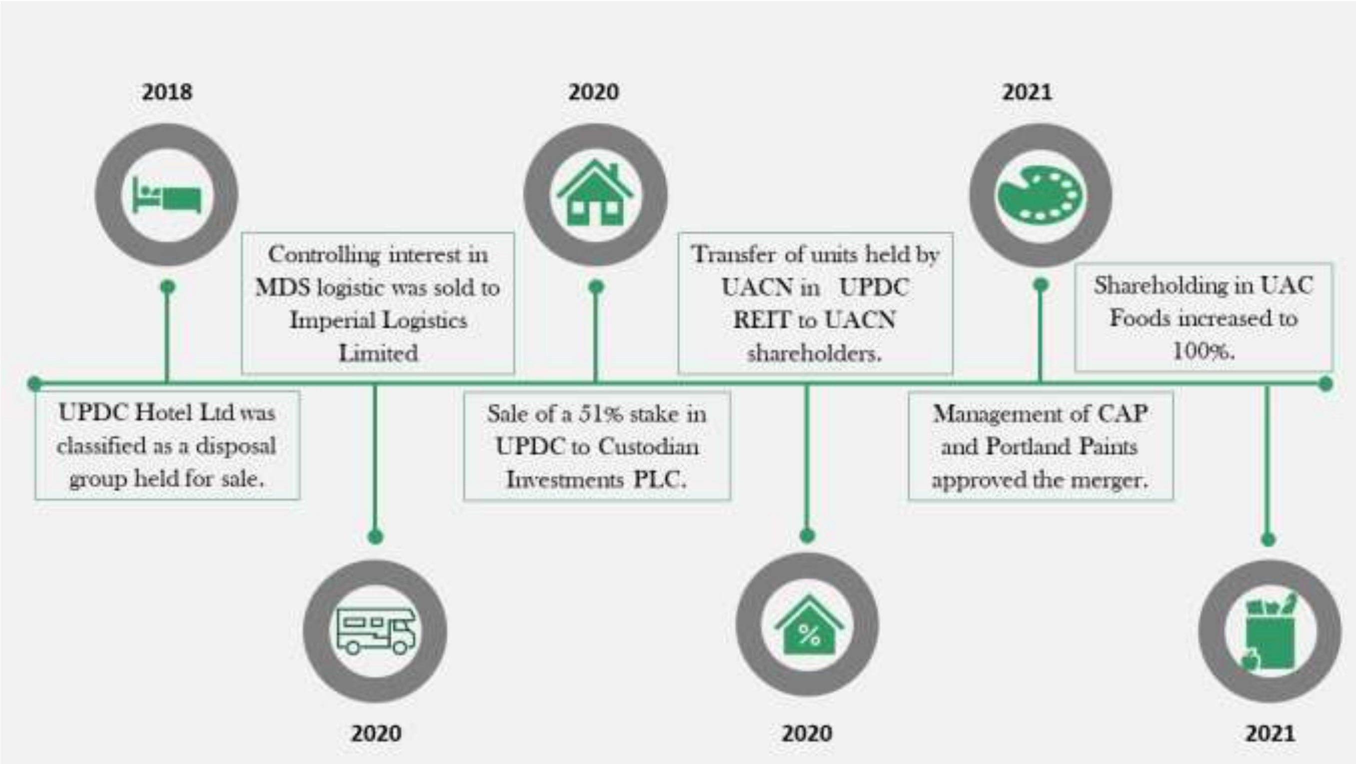
With over fourteen decades of active operations, United Africa Company of Nigeria **(UACN)** has reinforced its position as one of the leading conglomerates in Nigeria. Although the firm’s diversification strategy has contributed to its growth in the domestic scene, in recent years, it opted to streamline its activities and focus on playing the long game in its core competence areas.

The firm operates from eleven manufacturing sites, multiple logistics, and several distribution hubs across the country. Over the years, the company has evolved into a holding structure operating four key subsidiaries in strategic growth sectors- **Food, Animal Feeds, Paint, and Quick Service Restaurant (QSR).**



The Transition to a Leaner Company

Since 2011, **UACN** has undertaken several restructuring initiatives to streamline its business. Some of these include, the initial divestment of 49% stake in UAC food to Tiger Brands Ltd in 2011, the sale of 49% shareholding in MDS logistics to Imperial holdings in 2013, and the acquisition of majority stake in Livestock Feeds and Portland Paints in 2013. In recent times, the firm has taken even further steps to simplify its operations, as seen in the case of the merger between Portland Paint and CAP and its real estate divestments. The firm’s overall objective is to drive strategic focus on its primary business segments, leverage the business core strength, and minimize complexities to achieve improved performance.



UPDC

Trailing a long history of losses and underperformance, the firm classified its holdings in UPDC Hotels Limited (UHL) as held for sale in 2018. Another turning point was the sale of a 51% stake in UAC Property Development Company (UPDC) to Custodian Investments Plc. Consequent to the sale, UACN's holding in UPDC declined to 42.85%. Hence, UPDC's reclassification as an investment in associate.

UPDC's financial performance has closely mirrored the real estate sector's GDP. For eighteen consecutive quarters, the domestic real estate sector GDP contracted year-on-year *– from Q1:2016 till Q3:2020* (*save for the marginal growth of 0.93% recorded in Q1:2019*). The outbreak of the COVID-19 pandemic further exacerbated the sector's woes, resulting in a contraction of **21.99%** and **13.40%** in Q2:2020 and Q3:2020, respectively. The lockdown restriction, which was implemented to curb the spread of the virus, contributed largely to the sector's underwhelming performance.
Internally, the firm battled with significantly high leverage, most of which were short-term debts. The firm also had limited investment in potential income-generating assets- a combination of these factors fuelled UACN's divestment decision.

UACN's Board of Directors approved the unbundling of its 24.34% interest in **UPDC** Real Estate Investment Trust to **UACN** shareholders. After a successful unbundling exercise, **UACN** will no longer own any **UPDC REIT** units, and **UACN's** shareholders will become direct holders of **UPDC REIT** units. Based on a formula of 226 units of UPDC REIT for every 1,000 **UACN** shares owned, the company (UACN) would recognize an unbundling liability to the tune of NGN3.90bn and a corresponding decline in its share premium. **The proposed**

initiative will enable shareholders directly access UPDC REIT and its broad portfolio of income-generating assets, ensuring that shareholders directly benefit from future UPDC REIT dividend payouts after the proposal's effective date. While shareholder's approvals have been sealed subject to the recent court-ordered meeting on the 20th of September 2021, completion is subject to SEC approvals as well as court sanctions.

CAP

On the 1st of July 2021, the Boards and Management of **CAP** and Portland Paints approved the merger of both companies *(surviving entity: CAP).* The merger is expected to drive cost efficiency amongst both businesses and eliminate duplicate costs. Furthermore, the formalized consolidation of both companies will broaden **CAP's** product portfolio and strengthen its footprint in the coating industry while leveraging Portland's forte in the marine coating segment.

Therefore, we view this consolidation as an opportunity for CAP Plc to further solidify its footprint in the coating industry despite the challenges posed by the sector. Cumulatively, we expect the paint segment contribution to UACN's topline to improve slightly to c.13.87% from a five-year average of 12.51%.

UAC Foods

On the 27th of August 2021, **UACN** management announced its recent agreement to take up Tiger Brands' 49% stake in UAC Food. By implication, **UACN** will now hold 100% of UAC Foods' shares. **Based on our assessment, this is consistent with the company's strategy to focus on its competence areas- one of which is the food and snacks market. In addition, this moves signals UACN's Management confidence in the prospects for its food business in the long term.**

Chart 1: UACN Holdings Before Restructuring

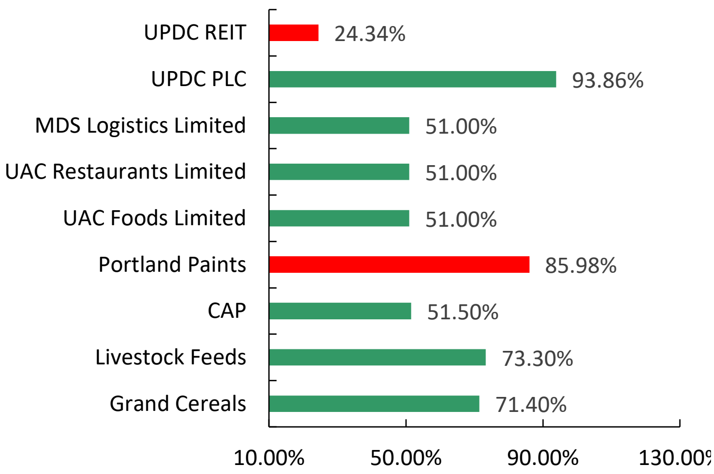
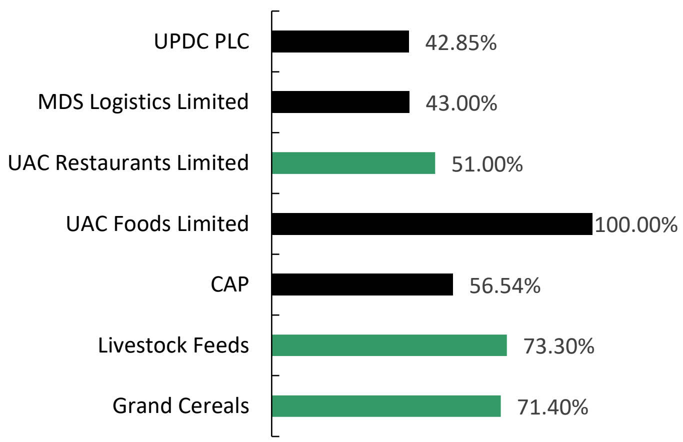


Chart 2: UACN Holdings After Restructuring



Source: UACN Financials, Meristem Research

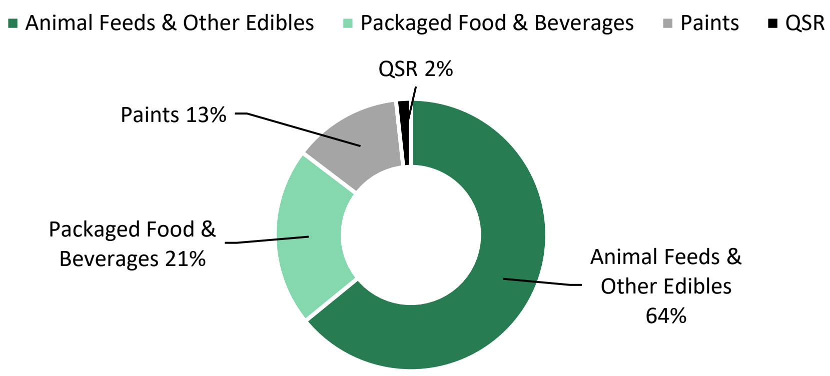
Financial Analysis: Grappling With Increasing Cost Pressure

The COVID-19 pandemic disrupted business operations across all industries in 2020. However, while several businesses struggled to keep their head above water, most food producers, healthcare, and technology-centered businesses, amongst others, managed to rake in a decent level of revenue by virtue of the essential nature of their operation.

In 2020, the firm's financial performance revealed the extent of the pandemic shock on its business operations. Although some of the firm's businesses *(food and animal feeds) were* exempted from lockdown restrictions, aggregate demand remained relatively weak.

Over the years, UACN has sustained a moderate revenue growth, expanding by a marginal Compounded Annual Growth Rate (CAGR) of 1.98% between 2015 and 2020. However, an industry-wide analysis reveals that **UACN** compares poorly relative to peer companies such as **FLOURMILL** 13.19% and **NESTLE** 13.67%. In our opinion, the sale of a sizeable percentage of its stake in the Logistics and Real Estate businesses has contributed to the slow revenue growth rate. Our analysis of the pre-divestment revenue revealed a three-year CAGR of 9.95% between 2015 and 2017, although still below it peers.

Chart 3: Five-Year Average Revenue Contribution



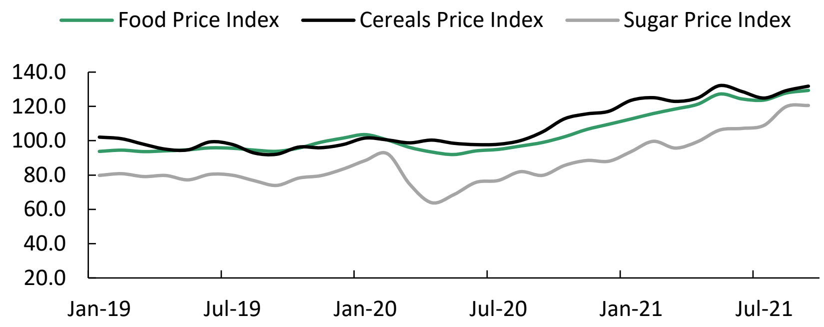
Source: *UACN's Financial Results, Meristem Research*

In its most recent financial report (9M:2021), revenue recovered strongly by 23.48% YoY to NGN71.37bn – the highest 9-Month revenue on record. The impressive topline growth can be attributed partly to the low base last year, upward price review in the animal feeds business, and improved volumes across its other divisions.

Production costs have remained a pain point, encroaching into the firm's margins, mainly due to the escalation of key production inputs costs. Although **UACN** sources c.84.28% of its production inputs locally (*shielding it slightly from forex pressures*), domestic inflation has pressured the costs of key raw materials upwards *(flour, sugar, soya bean, etc.).* For flour, sugar, and other commodities, the prices are directly impacted by events in the global market.

According to the FAO Food Price Index, Sugar Price Index averaged 120.6points as of September 2021 relative to 79.8points recorded in the same period last year. In the same vein, the Cereals Price Index also averaged 167.7points in September 2021 (vs. to 105.7point in September 2020).

Chart 4: Selected Food Price Index



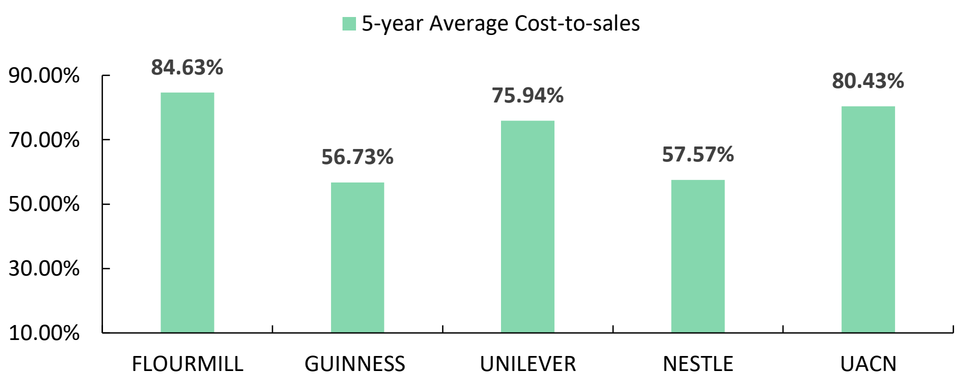
Source: Food and Agriculture Organization, Meristem Research

On the domestic scene, the decline in maize production yield, pest invasion, herders' attack, the pandemic disruption, amongst other challenges, have widened the supply gap, triggering a surge in the price of maize *(+50% per ton).* As a result, the cost of producing several maize derivatives (*especially poultry feeds*) has risen to the pressures from maize prices.

The Central Bank of Nigeria (CBN) intervened in the maize market through the Anchor Borrowers Program (ABP) to ease the maize cost and production pressures. According to the CBN, approximately NGN554.61bn has been disbursed to smallholder farmers since 2015. The scheme has supported farmers in improving maize production from 2 metric tons per hectare to 5 metric tons per hectare. In addition to this, the APEX bank intends to disburse additional loans to c.120,000 maize farmers before the end of 2021. We expect this move to increase the supply of maize, although marginal compared to the existing supply gap.

UACN's cost-to-sales ratio has averaged 79.90% in five years, peaking at 82.11% peaking at 82.11% in 2017FY - a reflection of the significant cost pressures witnessed in the industry.

Chart 5: 5-year Average Cost to Sales



Source: Company Financials, Meristem Research

Typical of most companies in the industry, net margin has remained at the single-digit level (*4.25% in 2020FY and 0.79% in 9M:2021*). Nonetheless, our five-year analysis shows that the firm ranks ahead of most of its peers with a net margin of 5.04% relative to – **FLOURMILL** 2.50%, **UNILEVER** 1.17%, etc.

Earnings quality, however, waned significantly in 9M:2021 as operating cash flow came in negative at **NGN6.71bn** relative to NGN563.12mn in net income. This resulted in a positive net operating accrual of NGN6.15bn. We also note that trade receivables for the period increased by 27.84% relative to the 23.48% growth recorded in revenue, further impacting the weak earnings quality. The firm's liquidity ratios - current and acid test ratio also declined to 1.49x and 0.67x in 9M:2021 from 2.11x and 1.28x from 9M:2020, majorly due to an increase in inventory and reduction of 25.36% of its trade payable.

Animal Feed & Edible Oils: Strong Prospects Ahead

The animal feed business is targeted at the domestic poultry and aquaculture market. The poultry business accounts for the bulk of the division's revenue- an average of 62.22% in the past five years. The fish feed business, which contributes c.11% to the animal feed revenue, has benefited significantly from the land border closure and customers' switch from imported to locally produced brands. Nonetheless, the firm still contends with other vibrant players for market share- *OLAM, Animal Care, and Premier Feed Mills.*

Overall, revenue generated from the business grew by 5.22%YoY in 2020 and 13.62%YoY in 9M:2021. As we mentioned in an earlier section, the performance of this division is significantly influenced by commodity prices (corn, etc.); hence pandemic-induced disruptions, among other challenges, drove costs northwards. In response, the firm adjusted prices upwards across major product categories to offset the increase in production cost. The upward review in prices, in turn, supported the double-digit revenue growth recorded during the period.

We, however, note that there is little room for upward review of prices considering the high level of competition in the market. Other measures such as the capacity expansion of higher-margin products like Edible Oils are more sustainable. Nonetheless, given the paltry contribution of the Edible Oils business (c.6%) to overall revenue from the animal feed division, a drastic improvement in revenue performance is not likely in the medium term.

Packaged Foods and Beverages: Focus on Domestic Market Buoys Earnings

Some of the firm's iconic brands marketed under the UAC Foods Subsidiary include Gala, SWAN, Supreme, and Fun time. Revenue from this business expanded by 38.72%% to NGN17.73bn in 9M:2021. The performance was supported by the capacity expansion in the water division, the introduction of new snack variants (Gala spicy and Gala Classic), and improved routes to market networks. More specifically, the solid growth was primarily influenced by the low base from last year.

The business also thrives on its decade-long presence and brand acceptance in this market. All in, we see more room for capacity expansion to cater to the growing demand, especially in the diary and water businesses.

Paints: Better Volume Potential with Recent Consolidation

Following the merger between CAP and Portland Paints, the combined entity now controls significant market share amongst the listed players in the domestic paints market. The firm produces under the Dulux, Caplux, Hempel and Sandtex brands.

The paints business was the most impacted by the pandemic due to its discretionary nature. The halt in production, coupled with the decline in sales volume impacted top-line performance. Hence, the business revenue declined by 6.14% in 2020FY to NGN10.33bn (vs. NGN11.00bn in 2019FY). **However, considering the rebound in economic activities, the division recovered in 2021, recording revenue growth of 42.82% in 9M:2021 to NGN10.20bn, driven significantly by volume growth. For the rest of the year, we remain upbeat about the firm's revenue performance. Our outlook is hinged on the firm's ability to enjoy an improved supply of its premium brand (Dulux Trade) as global trade and supply chain condition improves.**

Quick Service Restaurant: Gaining Strides in a Competitive Landscape

UAC Restaurants (UACR) operates two Quick Service Restaurants (QSR) business divisions targeting the mass market with Mr. Biggs and high-quality pizza lovers with Debonairs Pizza. The QSR market is an intensely saturated space consisting of other major and widely known brands such as *Sweet Sensations, Dominos Pizza, and Chicken Republic*. Historically, UACR employed a franchise-only strategy but has recently launched some corporate stores and is looking towards maintaining the hybrid strategy going forward.

Although the firm operates in the food market, its performance was impacted by lockdown restrictions in 2020. During the heat of the pandemic, outdoor dining declined, and the firm had to intensify home deliveries to keep its business going.

In 2020FY, the segment revenue grew marginally by 1.77% to NGN1.52bn but rebounded strongly by 51.16%YoY in 9M:2021. As we mentioned earlier, the restaurant market's fight for market share is intense, and players have to invest heavily in technology and delivery capabilities to catch up with consumers' changing preferences and needs.

For the near term, the firm's management is focused on rolling out more corporate stores to expand its reach and, in turn, capture more sales. **On this note, we expect an improvement in revenue from the QSR business owing to increased investment in the company-owned restaurants, royalties from franchises, and the planned expansion of corporate stores.**

Outlook and Recommendation

In 2021FY, we expect an expansion in the group's revenue driven by the rebound in macroeconomic conditions and improvement in supply chain activities. Specifically, the consolidation of the paint's businesses, the improved roll-out of more QSR stores, and improved demand for animal feed and edible oil should fuel the growth in revenue in the mid to long term. Premised on these factors, we project revenue growth of 21.17% to NGN98.58bn in 2021FY (vs. NGN81.36bn in 2020FY). In addition, we expect an average revenue growth rate of c.10.65% within the next five years.

The downside risks to our outlook on the firm's performance include foreign exchange volatility, increase in leverage and debt financing, and the impact of inflationary pressures on production costs. In 9M:2021, earnings slumped by 70.39% to NGN563.12mn from NGN1.90bn in 9M:2020, on the back of increased production cost pressures and finance costs.

We have modelled a cost-to-sales ratio of 81.23% in 2021FY from 80.35% in 2020FY based on our expectation of continued cost pressures in the last quarter of the year. Nonetheless, we expect a 4.55% growth in bottom-line to NGN3.62bn from NGN3.46bn in 2020FY, supported by our revenue growth projection.

Overall, we project a 2021FY EPS of NGN1.25 and a target P/E ratio of 8.79x. This yields a target price of NGN11.03, implying an upside potential of 8.14% based on the closing price of NGN10.20 on November 2nd, 2021. Hence, we rate the ticker **HOLD.**

Sensitivity Analysis of Dec-2021 Target Price to key model inputs						
		EPS				
	11.03	**8.69**	**8.74**	**8.79**	**8.84**	**8.89**
Target PE	**1.05x**	9.12	9.18	9.23	9.28	9.33
	1.15x	9.99	10.05	10.11	10.17	10.22
	1.25x	10.90	10.97	**11.03**	11.09	11.16
	1.35x	11.73	11.80	11.87	11.93	12.00
	1.45x	12.60	12.67	12.75	12.82	12.89

Min	**9.12**
Max	**12.89**

Financial Highlights and Forecasts (NGN billion)

Profit & Loss Account	**9M:2021**	**2020A**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**
Revenue	71.37	81.36	98.58	108.83	120.21	132.78	147.75
Cost of sales	59.01	65.37	80.04	86.26	95.39	105.26	117.09
Gross Profit	12.36	15.99	20.70	25.03	27.65	30.54	33.98
OPEX	10.59	-13.49	15.61	16.73	18.66	20.71	22.87
Other Income	0.37	1.24	2.38	2.28	2.90	3.14	3.43
Operating Profit	2.14	3.60	2.93	5.85	6.17	6.80	7.78
Finance Cost	1.07	-0.50	1.07	1.20	0.97	1.19	1.41
PBT	1.38	5.12	5.32	8.03	9.24	9.92	11.00
PAT	0.56	3.93	3.62	5.46	6.28	6.74	7.48

Balance Sheet	**9M:2021**	**2020A**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**
Property, Plant and Equipment	21.25	21.01	23.12	25.41	28.20	31.09	34.41
Total Debt	10.26	4.49	7.41	8.65	9.41	10.53	11.27
Total Assets	**87.19**	**92.17**	**125.49**	**129.88**	**136.10**	**136.93**	**142.94**
Total Equity	**49.72**	**61.37**	**68.23**	**70.85**	**76.00**	**78.96**	**82.73**
Total Current Liabilities	**30.82**	**24.09**	**34.26**	**34.47**	**37.98**	**34.49**	**35.70**
Non-Current Liabilities	**6.62**	**6.66**	**5.43**	**5.73**	**5.79**	**5.68**	**5.93**
Total Liabilities	**37.47**	**30.79**	**57.26**	**59.03**	**60.10**	**57.97**	**60.21**

Financial Ratios	**9M:2021**	**2020A**	**2021F**	**2022F**	**2023F**	**2024F**	**2025F**
Gross Margin	17.32%	22.14%	21.00%	23.00%	23.00%	23.00%	23.00%
Operating Margin	3.00%	5.62%	5.20%	7.73%	7.56%	7.46%	7.57%
Net Margin	0.79%	4.25%	3.67%	5.02%	5.22%	5.08%	5.06%
Return on Asset	0.65%	3.75%	3.30%	3.91%	3.97%	4.14%	4.24%
Return on Equity	1.13%	5.63%	6.07%	7.16%	7.10%	7.18%	7.32%
Return on Invested Capital	3.97%	7.38%	7.05%	9.08%	8.81%	7.43%	8.22%
Asset Turnover	0.82x	0.88x	0.54x	0.54x	0.54x	0.54x	0.54x
Financial Leverage	1.75x	1.50x	1.84x	1.83x	1.79x	1.73x	1.73x
Debt to Asset Ratio	0.12x	0.05x	0.06x	0.07x	0.07x	0.08x	0.08x
Current Ratio	1.49x	2.11x	1.81x	1.79x	1.68x	1.82x	1.81x
Quick Ratio	0.67x	1.28x	1.08x	1.04x	1.04x	1.06x	1.05x

Analyst's Certification and Disclaimer

This research report has been prepared by the research analyst(s), whose name(s) appear(s) on the cover of this report. Each research analyst hereby certifies, with respect to each security or issuer covers in this research that:
(1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers (the Issuer); and
(2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. Research analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Meristem Securities Limited (the Firm). Like all of the Firm's employees, research analysts receive compensation that is impacted by overall Firm profitability, which includes revenues from other business units within the Firm.
(3) each research analyst and/or persons connected with any research analyst may have interacted with sales and trading personnel, or similar, for the purpose of gathering, synthesizing and interpreting non-material non-public or material public market information.

As at the date of this report, any ratings, forecasts, estimates, opinions or views herein constitute a judgment, and are not connected to research analysts' compensations. In the case of non-currency of the date of this report, the views and contents may not reflect the research analysts' current thinking. This document has been produced independently of the Issuer. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the ratings, forecasts, estimates, opinions and views contained herein are fair and reasonable, neither the research analysts, the Issuer, nor any of its directors, officers or employees, shall be in any way responsible for the contents hereof, and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

Analysts' Compensation: The equity research analysts responsible for the preparation of this report receive compensation based upon various factors, including the quality and accuracy of research, client feedback, competitive factors, and overall firm revenues, which include revenues from, among other business units, Investment Banking.

Conflict of Interest

It is the policy of Meristem Securities Limited and its subsidiaries and affiliates (Individually and collectively referred to as "Meristem") that research analysts may not be involved in activities that suggest that they are representing the interests of Meristem in a way likely to appear to be inconsistent with providing independent investment research. In addition, research analysts' reporting lines are structured so as to avoid any conflict of interests.

For example, research analysts are not subject to the supervision or control of anyone in Meristem's Investment Banking or Sales and trading departments. However, such sales and trading departments may trade, as principal, on the basis of the research analysts' published research. Therefore, the proprietary interests of those Sales and Trading departments may conflict with your interests.

Important Disclosure

For U.S. persons only: This research report is a product of Meristem Securities, which is the employer of the research analysts who has prepared the research report. The research analysts preparing the research report are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analysts are not subject to supervision by a U.S. broker-dealer, and are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This report is intended for distribution by Meristem Securities only to "Major Institutional Investors" as defined by Rule 15a-6(b)(4) of the U.S. Securities and Exchange Act, 1934 (the Exchange Act) and interpretations thereof by U.S. Securities and Exchange Commission (SEC) in reliance on Rule 15a 6(a)(2). If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor.

Legal entity disclosures

Meristem Securities Limited is a member of The Nigerian Stock Exchange and is authorized and regulated by the Securities and Exchange Commission to conduct investment banking and financial advisory business in Nigeria**.** However, **the** company through its subsidiaries carries out stock broking, wealth management, trustees and registrars' businesses which are regulated by the SEC and ICMR.

IMPORTANT INFORMATION: DISCLAIMER

Meristem Securities Limited (''Meristem'') equity reports and its attendant recommendations are prepared based on publicly available information and are meant for general information purposes only and it may not be reproduced or distributed to any other person. All reasonable care has been taken to ensure that the information contained herein is not misleading or untrue at the time of publication; **Meristem** can neither guarantee its accuracy nor completeness as they are an expression of our analysts' views and opinions.
Meristem and any of its associated or subsidiary companies or the employees thereof cannot be held responsible for any loss suffered by relying on the said information as this information as earlier stated, is based on publicly available information, analysts' estimates and opinions and is meant for general information purposes and should not be construed as an offer to buy or sell or a solicitation of an offer to buy or sell securities or any financial instruments. The value of any investment is subject to fluctuations, i.e. may fall and rise. Past performance is no guide to the future. The rate of exchange between currencies may cause the value of investment to increase or diminish. Hence investors may not get back the full value of their original investment.
Meristem Securities is registered with the Securities and Exchange (SEC) and is also a member of The Nigerian Stock Exchange (The NSE). Meristem Securities' registered office is at 124 Norman Williams Street, Southwest, Ikoyi, Lagos, Nigeria. Website: www.meristemng.com; Email: research@meristemng.com.