UNITY

A script with exceptional growth potential, offering a return of 41%

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We initiate our coverage on UNITY Foods Limited (UNITY) with a DCF based Dec-20 TP of Rs.18 which provides an upside potential of 39%. A dividend yield of 2%, if incorporated gives a total return of 41%

The revenue of the company has grown by 68% YoY in 6MFY20, following a growth of 407% YoY during FY19

Going forward, we expect its revenues and earnings to grow at a 5-year CAGR of 30% and 50% respectively on account of entering into flour business, rapid acceptance of company's products by consumers and improved gross margin due to efficient inventory management

Company Overview

The company was involved in the textile business under the name of Taha Spinning Mills 3 years ago. However, due to the prevailing crisis in the textile industry, the management decided to change its industry and enter the edible oil business with the edible oil refining capacity of 54,000 MT per annum. Now the company has extended its refining capacity to 234,000 MT per annum. Furthermore, the company is also setting up a hydrogenation ghee plant, a chemical refinery, a fractionation plant and a storage facility at Port Qasim with an investment of Rs.3.75bn. All the funds have been raised through a right issue in Feb-19. The main products of the company are Edible Oil, Specialty Fats, and Animal Feed Meal.

Entering into Flour Business

In line with its growth strategy and keeping the wheat flour demand in view, the company has announced to build its stakes in Sunridge Foods by acquiring 69% shares against the value of Rs367mn which it will finance through internally generated funds.

Sunridge Foods has a capacity to produce 36,000 metric tons of wheat flour per year. Its plant is located at Port Qasim and has an established nationwide distribution network.

Substantial Growth in Revenues

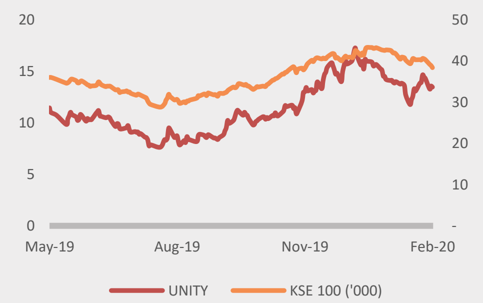
The revenues of the company had grown by 407% YoY to Rs14bn in FY19 as compared to Rs2.8bn in FY18. It is worth mentioning here that the oil refining operations commenced in Feb-18 and the operations related to solvent extraction commenced in Mar-18 which means that the financial performance in FY18 only reflects the performance of one quarter. Recently, the company has announced its 2QFY20 result where its revenues have grown by 68% YoY to Rs11.3bn in 6MFY20 as compared to Rs6.7bn during SPLY.

Post commencement, the company introduced two new brands namely "Zauqeen" and "Ehtemaam", targeting the discount segment of the edible oils consumer market. The continuous and robust growth in revenues depicts the acceptance of the company's brands by consumers. Furthermore, the introduction of stricter regulatory requirements pertaining to sales of edible oil would increase demand in the discount segment for good quality, hygienic processed edible oil. Going forward, we expect the company's revenues to grow at a 5-year CAGR of 30% to Rs53bn by FY24 as the hydrogenation plant, chemical refinery, fractionation plant, and flour business would increase the top line of the company significantly.

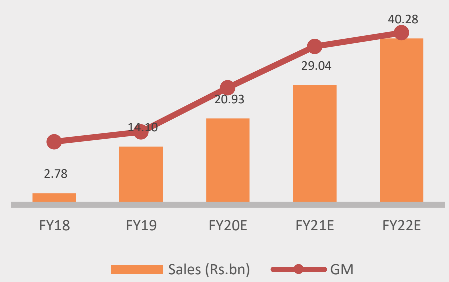
Key Statistics

Symbol	UNITY
TP - Dec 20	18.00
LDCP	12.98
Upside (%)	38.67
Free Float ('mn)	218
Market Cap. (Rs.'mn)	7,062

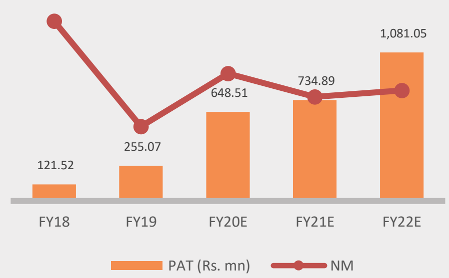
UNITY vs KSE 100



Sales (Rs'bn) vs Gross Margin



PAT (Rs'mn) vs Net Margin



Sources: ACPL Research, Company Financials, PSX,

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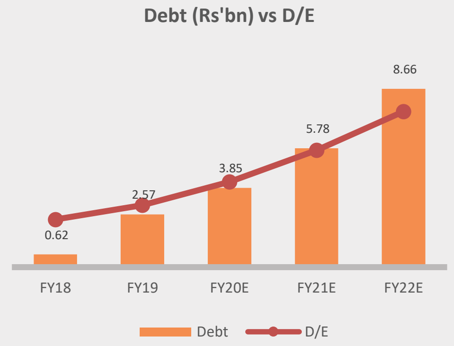

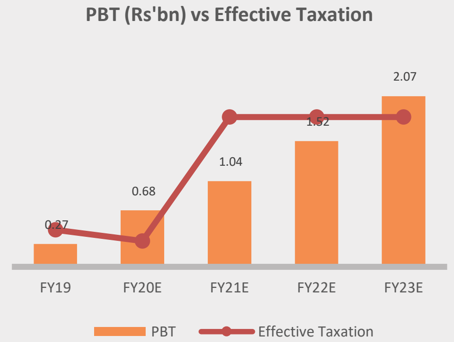

Sources: ACPL Research, Company Financials,

Improving Gross Margin Despite Unstable Exchange Rate

The company imports four types of raw materials on a month to month basis 1) Soybean seeds from USA 2) Canola Seeds from USA 3) Palm oil from Malaysia & Indonesia 4) Specialized Fats from Malaysia & Indonesia. Therefore, the depreciating exchange rate could significantly affect the gross margin of the company. However, the financials of the company are telling us the whole different story. Despite around 55% devaluation of Pak rupee against USD in the last two years, the gross margin of the company is continuously on the rising trajectory since the commencement of its operations. The company posted the gross margin at 9.1% in FY19 as compared to 8.9% in SPLY. Moreover, the margin has further expanded to 9.7% in 6MFY20 which depicts the prudent decision making by the senior management with respect to inventory management. Going forward, we expect the company's gross margin to remain intact between 10-11% as the establishment of the oil terminal with the capacity of 45,000 metric tons at Port Qasim would allow the company to hold inventory and thereby control costs.

Cut in Interest Rate to Ease the Burden from Bottom line

Growth in revenues always comes up with higher working capital requirements. Therefore, the finance cost of the company has significantly been increased by 178% YoY to Rs244mn in 6MFY20 as compared to Rs89mn during SPLY on account of the higher interest rate. Now, as we know that the interest rate has been peaked out and the SBP is expected to adopt a dovish stance later in this calendar year. The company is all set to relieve the burden from its bottom line as the rate cut would provide a breather to the earnings of the company. According to our sensitivity analysis, a cut of 100bps in KIBOR would increase the earning by Rs0.1.

Valuation

UNITY is currently trading at FY20E PE of 10.89x. Furthermore, the script is trading at a FY20E P/B of 1.14x which offers a significant discount of 56% relative to its historical 2-year average of 2.61x. We have a **BUY** stance on the script with a DCF based Dec-20 TP of Rs.18 which provides an upside potential of 39%. Furthermore, it also offers a dividend yield of 2% which makes the total return of 41%.

Key Risks to Valuation

- More than expected depreciation of PKR
- Hike in prices of raw material
- Less than expected growth in demand

Key Ratios

Profitability Ratios		FY18A	FY19A	FY20E	FY21E	FY22E	FY23E	FY24E
GP Margin	%	8.92	9.06	9.70	10.30	10.50	10.70	11.00
NP Margin	%	4.37	1.81	3.10	2.53	2.68	3.18	3.68
OP Margin	%	4.15	3.99	5.50	5.80	6.00	6.20	6.50
ROE	%	6.85	4.48	10.45	10.84	14.15	16.65	18.81
ROCE	%	6.51	9.87	19.77	29.39	42.41	51.35	55.61
ROA	%	2.66	2.44	4.46	4.05	4.61	5.96	7.30
Liquidity Ratios		**FY18A**	**FY19A**	**FY20E**	**FY21E**	**FY22E**	**FY23E**	**FY24E**
Current	x	1.08	1.54	1.18	1.06	0.99	0.98	1.01
Quick	x	0.43	0.65	0.57	0.48	0.45	0.41	0.41
Activity Ratios		**FY18A**	**FY19A**	**FY20E**	**FY21E**	**FY22E**	**FY23E**	**FY24E**
Inventory Turnover	x	1.71	5.48	5.15	5.29	5.30	4.87	4.87
Inventory Days		213.07	66.63	70.91	69.01	68.91	74.99	75.02
Receivables Days		4.07	0.03	0.03	0.03	0.03	0.03	0.03
Payables Days		251.31	56.48	90.00	90.00	90.00	90.00	90.00
Operating Cycle		-34.18	10.18	-19.06	-20.96	-21.07	-14.98	-14.95
Investment Ratios		**FY18A**	**FY19A**	**FY20E**	**FY21E**	**FY22E**	**FY23E**	**FY24E**
DPS		0.50	0.10	0.25	0.30	0.40	0.55	0.75
Div. Yield	%	3.85	0.77	1.93	2.31	3.08	4.24	5.78
Dividend Cover	x	0.45	4.69	4.77	4.50	4.97	4.90	4.77
Retention	%		78.67	79.03	77.79	79.87	79.59	79.04
Payout	%		21.33	20.97	22.21	20.13	20.41	20.96
No. of Shares	('m)	0.54	0.54	0.54	0.54	0.54	0.54	0.54
EPS		0.22	0.47	1.19	1.35	1.99	2.70	3.58
BVPS		3.26	10.47	11.41	12.46	14.05	16.19	19.02
P/E	x	58.11	27.69	10.89	9.61	6.53	4.82	3.63
Sales per share		5.11	25.91	38.47	53.39	74.04	84.82	97.21
P/BV	x	3.98	1.24	1.14	1.04	0.92	0.80	0.68
P/S	x	2.54	0.50	0.34	0.24	0.18	0.15	0.13
Solvency Ratios		**FY18A**	**FY19A**	**FY20E**	**FY21E**	**FY22E**	**FY23E**	**FY24E**
Total Debt to Equity	x	0.35	0.45	0.62	0.85	1.13	0.98	0.84
L.T Debt to Equity	x	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Interest Cover	x	2.23	1.95	2.26	2.38	2.48	3.22	4.29

Source: ACPL Research, Company Financials

Financial Projections

Rupees' millions	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E	FY24E
Revenue	2,782	14,097	20,928	29,045	40,281	46,147	52,885
Cost of sales	-2,534	-12,820	-18,898	-26,053	-36,051	-41,209	-47,067
Gross profit	**248**	**1,277**	**2,030**	**2,992**	**4,229**	**4,938**	**5,817**
Distribution cost	-56	-357	-649	-900	-1,249	-1,431	-1,639
Administrative expenses	-55	-181	-188	-261	-363	-415	-476
Other operating expenses	-22	-178	-42	-145	-201	-231	-264
Profit from operations	**116**	**562**	**1,151**	**1,685**	**2,417**	**2,861**	**3,438**
Other income	34	1	42	58	81	92	106
Finance cost	-52	-288	-510	-708	-975	-888	-802
Profit before income tax	**98**	**275**	**683**	**1,035**	**1,523**	**2,065**	**2,742**
Income tax expense	24	-20	-34	-300	-442	-599	-795
Profit for the year	**122**	**255**	**649**	**735**	**1,081**	**1,466**	**1,947**
EPS	**0.22**	**0.47**	**1.19**	**1.35**	**1.99**	**2.70**	**3.58**
EBITDA	**138**	**624**	**1,251**	**1,854**	**2,670**	**3,151**	**3,738**

Source: ACPL Research, Company Financials

Horizontal Analysis

	FY18A	FY19A	FY20E	FY21E	FY22E	FY23E	FY24E
Revenue		406.7%	48.5%	38.8%	38.7%	14.6%	14.6%
Cost of sales		405.9%	47.4%	37.9%	38.4%	14.3%	14.2%
Gross profit		**414.8%**	**58.9%**	**47.4%**	**41.4%**	**16.7%**	**17.8%**
Distribution cost		541.3%	82.0%	38.8%	38.7%	14.6%	14.6%
Administrative expenses		228.5%	4.1%	38.8%	38.7%	14.6%	14.6%
Other operating expenses		715.0%	-76.5%	247.0%	38.7%	14.6%	14.6%
Profit from operations		**386.1%**	**104.9%**	**46.4%**	**43.5%**	**18.4%**	**20.1%**
Other income		-96.6%	3538.2%	38.8%	38.7%	14.6%	14.6%
Finance cost		456.0%	77.0%	38.7%	37.8%	-8.9%	-9.8%
Profit before income tax		**180.9%**	**148.5%**	**51.6%**	**47.1%**	**35.6%**	**32.8%**
Income tax expense		-17.2%	73.7%	779.4%	47.1%	35.6%	32.8%
Profit for the year		**109.9%**	**154.2%**	**13.3%**	**47.1%**	**35.6%**	**32.8%**
EPS		**109.9%**	**154.2%**	**13.3%**	**47.1%**	**35.6%**	**32.8%**
EBITDA		**350.9%**	**100.4%**	**48.1%**	**44.0%**	**18.0%**	**18.6%**

Source: ACPL Research, Company Financials

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TP	Target Price	CAGR	Compound Annual Growth Rate	FCF	Free Cash Flows
FCFE	Free Cash Flows to Equity	FCFF	Free Cash Flows to Firm	DCF	Discounted Cash Flows
PE	Price to Earnings Ratio	PB	Price to Book Ratio	BVPS	Book Value Per Share
EPS	Earnings Per Share	DPS	Dividend Per Share	ROE	Return of Equity
ROA	Return on Assets	SOTP	Sum of the Parts	LDCP	Last Day Closing Price

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III. Relative Valuation Model
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HOLD	Between -5% to 15%
SELL	Less than and equal to -5%

Sector Rating	Sector Outlook
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Market Weight	Neutral
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