otp Research

EQUITY RESEARCH: ZWACK BUY

15 December 2017

Company name		
Recommendation		**BUY**
12m Target price	HUF	17 668
Estimated total return	%	12%
Key market data		
Market cap	(HUF bn)	34
Free float	%	24%
Shares outstanding		2 035 000
Average daily trading volume	(HUFm)	170
Shareholder structure		
Domestic institutions		2,15%
Foreign institutions		78,09%
Domestic private investors		12,02%
Foreign private investors		5,99%
Management and employees		0,03%
Convertible prefered stocks		0,90%
Free float		24%
Key financial data		
Book value / share	HUF	2 708
EPS (4Q-rolling)	HUF	1035
Dividend / share	HUF	1050
Dividend yield	%	6,3
Debt to Equity	%	8,1
Net debt / Equity	%	-11,4
Net debt / EBITDA	%	-9,3
ROE (4Q-rolling)	%	31,4
ROA (4Q-rolling)	%	18,3
P/E	%	16
P/BV	%	6,2
Price Performance		
52-w range	HUF	16445-17795
52-w performance	%	4,47
Relative performance vs Bux	%	-17,7
Relative performance vs Bumix	%	-119,1
Beta		0,36
Valuation		
DCF		17 668
DDM		17 597
Multiple Analysis		16 518
Analyst		
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Highlights

We initiate the coverage of Zwack (Zwack HB; ZWCG.BU) with a BUY recommendation with a fair value of 17668 HUF/share, 11% higher than the HUF 16,720 closing price on December 15.

Zwack is a traditional Hungarian distiller with 227 years of history and strong domestic market position. The company also distributes the product-range of Diageo as a wholesaler. Zwack entered the Hungarian stock market in 1993 as one of the early birds, so it has a well-known track record.
Zwack should be considered as a dividend-stock, with a low-risk-low growth profile and a dividend-yield of 6%. The company follows conservative policies: liquidity is kept high, while indebtedness is at low levels. On the other hand growth opportunities are moderate, even if income-elasticity of demand for Zwack's premium products could be higher than for spirit-consumption as a whole. The majority of free cash-flow is usually paid out to shareholders as dividends.

The current macro-environment is expected to be favourable for Zwack, as the ongoing fast wage growth with low unemployment will result in fast consumption growth and is likely to positively affect demand for its products. Monetary policy is also supportive, as not only euro, but also HUF interest rates could remain low for an extended period, while the National Bank is expected to keep the HUF at current levels, while an appreciation would result in stronger price competition through imported spirits.

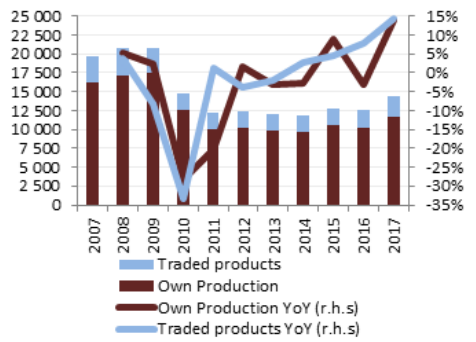
Main price drivers

- Revenue growth
- Solid fundamentals and market position
- High dividend yield
- Low yield environment, weak HUF

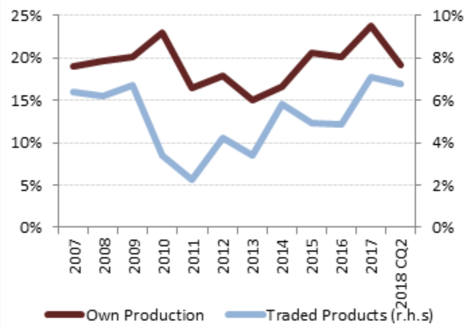
Main risks to our target price

- Yield normalisation

Revenue structure and growth (HUF bn.; %)



EBIT Margins (%)



Source: Zwack

Company profile

Zwack operates in two main fields:

1) Distilling, rectifying and blending of spirits (NACE 11.01) and

2) Wholesale of beverages (NACE 46.34) of its own brands and as the exclusive distributor of Diageo brands in Hungary.

The company started its operation as a family business with one secret recipe of digestive under the name Unicum, which grew to a very strong brand in the local market, providing very strong market presence. Zwack also produces a wide range of other spirits.

Zwack's main products consist of high-quality spirits with which it is positioning itself to the premium category. The flagship product is Unicum, which was produced more than 200 years ago and it is an 80% proof herbal liquor from a secret blend of many herbs and spices. Before 2015 Zwack also produced medium-quality distilled spirits, but after the government liberalised spirit distillation at home in small quantities in 2010, competition intensified this segment and the possibility to create value has disappeared, so Zwack abandoned this market.

Since then Unicum can be purchased in various varieties. In 1937, the palette was broadened with the introduction of the Fütyülős pálinka, which consists of many different varieties as well. The other main products of Zwack are the Vilmos, St. Hubertus and Kalinka liquors. Moreover there are some type of liquors which can be count to the absolute top of the premium segment, like the Zwack Sándor Nemes Pálinka and the Zwack Maximillian.

In 1993, the predecessor of Diageo bought 26% of the company, and since then Zwack has been the sole distributor of Diageo's products, which provide a reliable source of income and it helps the company to position itself to the premium segment. The distributed products include Johnnie Walker, Henessey, Evian, Smirnoff and many other liquor products.

The company can be considered active in the export markets as well, its export sales revenues come from 30 different countries. The main destinations of the company's products are Italy and Germany, but also Romania and Slovakia. Since 2008, the share of export sales has increased from 6% to 11%. If that trend continues in the future, then it will lead to a more stable and predictable revenue as the company is able to diversify its revenue sources.

BUSINESS UNITS:

Zwack's primary activity is producing and selling alcoholic drinks. According to IFRS 8 all activities of Zwack belong to one segment. However, the Company still publishes product range information that make it possible to follow changes in own production and traded products. Own production covers Zwack's traditional and own-developed products, while traded products covers the Diageo portfolio.

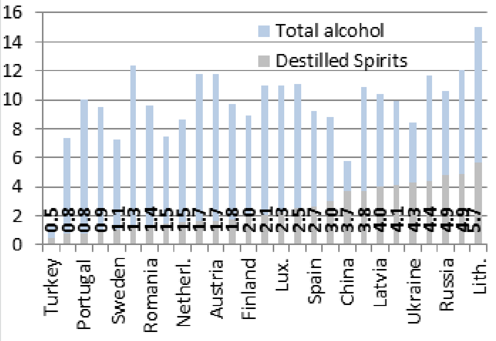
Own production: Around 80% of Zwack's domestic sales revenue comes from the own production of premium and quality brands. Further information on segmentation by product categories is not available due to strategic reasons, but Zwack must be the biggest market player in the market of bitters (digestives) through its traditional and historic Unicum line, and has strong position in the segment of "pálinka" and vodka. Due to inventory effect (strong stockpiling at the end of 2016 due to change of Public Health Product Tax – "NETA") the sales income of own production decreased in the first half of current financial year and is expected to fall behind last years' data. The long-term average of the own production's EBIT margin nears 20% considering the 4Q-rolling figures.

Traded products: The revenue from the sales of traded products (covering Diageo's portfolio) amounts to about 20% of domestic net sales. The sales income of this portfolio had a double-digit growth rate in the past few quarters, well above the usual growth dynamics. The EBIT margin of the traded products is well below the profit rate of the own production, the long-term average is around 5% while the 4Q-rolling margin increased to over 7% in the past few quarters.

Ownership structure:

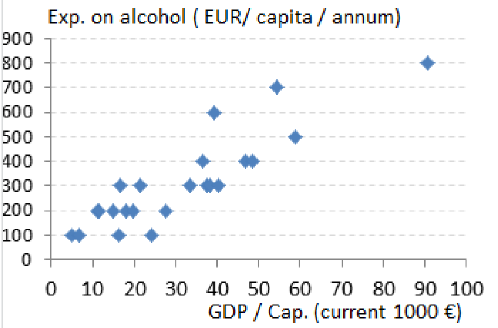
49% of the shares are owned by the Zwack family. In 1993, 26% of the company's shares were acquired by the multinational IDV, which later merged with UDG to become Diageo.

Alcohol consumption / capita (15y+, pure alcohol)



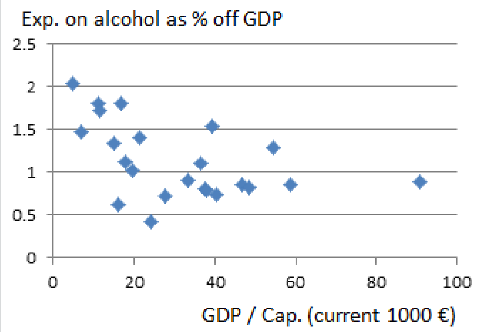
Volume of alcohol consumption is not influeneced by income

Alcohol consumption (current prices) vs GDP / Capita



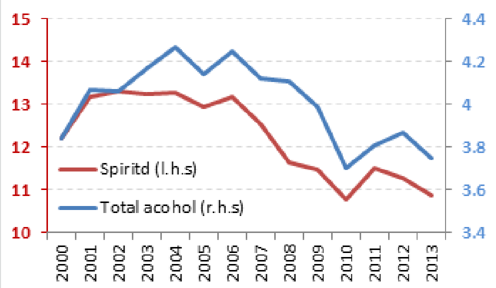
However in Europe spending on alcohol is increasing with income as consumers buy more expensive drinks

Alcohol consumption as % of GDP vs GDP / Capita



..but income elasticity is below one

Alcohol consumption in Hung. / cap. (15y+, pure alcohol)



Registered alcohol consuption in Hungary decreased as a conseqeunce of the crisis and the the liberalisation of destillation at home

Sources: WHO, Eurostat

Industry Overview

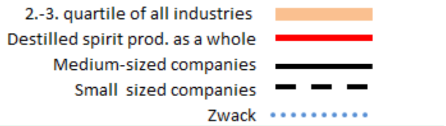
Demand: Alcohol and spirit consumption is usually a matter of tradition, influenced also by health and tax policies.

The volume of demand expressed in pure alcohol is hardly influenced by income. In Europe, the correlation between alcohol (spirit) consumption and income is negligible (in terms of both cross section and over time). But while people do not drink more if they earn more, they do spend more via buying more expensive drinks, at least in Europe. According to Eurostat's data, Bulgarians, Hungarians and Poles spend EUR 100-200 on alcohol annually, roughly 1.5-2% of their income. On the other hand Germans, Austrians and the British – with roughly three-to-four times higher GDP/capita – spend EUR 300-400 a year, about 0.8-1% of their income. Our estimation suggests that on the long run income elasticity is 70%, so 1% growth in income results in roughly 0.7% increase in expenditures on alcohol. This is also true in crisis times, when consumers may also substitute more expensive products with cheaper alternatives.

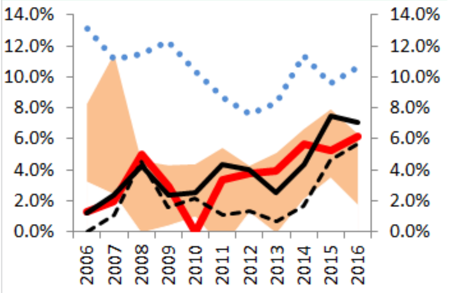
Hungary – and the Central Eastern European region – belongs to the top decile of the world's countries in alcohol and spirit consumption (expressed in pure alcohol) per capita. The registered volume of consumption – we have data until 2014 – decreased between 2005 and 2014, but the reasons are not clear. It could be the consequence of the crisis, but the liberalisation of spirit distillation at home in 2010 may also have contributed. The consumption of spirits in Hungary is estimated at 60 million litres per year.

Supply side: Roughly half of the 60 million litres per year spirit market is covered by the lease distilleries and home-made distilling, legalized in 2010 – a segment hardly controlled concerning the payment of excise duties. The market size of distilled spirits with excise duties properly paid is estimated at 30 million litres per year. The market size of the premium and mainstream (or value for money, VFM) segment is approximately 17.5 million litres, of which 10 million litres per year could be premium. As the grey market is sizeable in both the retail trade of alcohol and sales in bars and restaurants, the structure of the market is not really known. But the market share of imported spirits is definitely strong. According to Eurostat's data, Hungary's imports of spirits are roughly seven times higher than exports.

Destilled spirit industry vs. Zwack

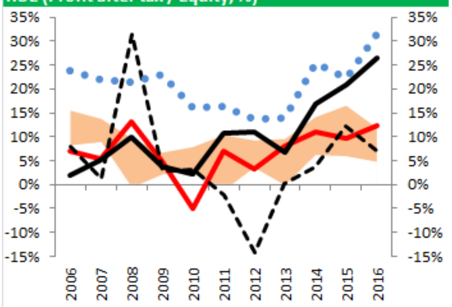


Margins (EBIT / Net revenues, %)



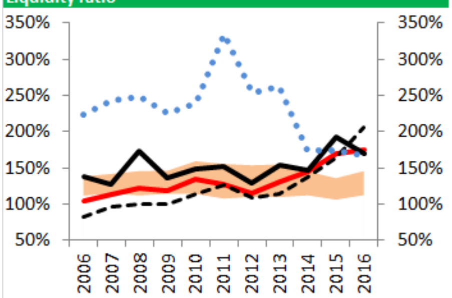
Margins of spirit destillations are high compared to other industries

ROE (Profit after tax / Equity; %)



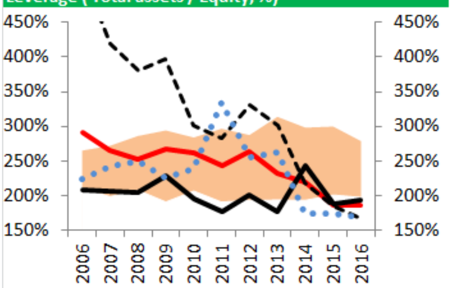
ROE is in line with the economy as a whole

Liquidity ratio



Liquidity is high

Leverage (Total assets / Equity; %)



While leverage is definitely low compared to other Hungarian industries.

Sources: GKI, National Tax and Customs Administration of Hungary, Zwack

Spirit distillation is a matured industry. It is a low-concentration industry in Hungary, the majority of market participants are micro, or small companies, and only a few can be considered medium-sized or large enterprises. The share of exports in total revenues is around 13%. Margins are high compared to other sectors, liquidity is high, while leverage is modest. Return on equity is usually around the average of the whole economy.

Compared to the spirits industry as a whole, Zwack posts higher margin and profitability. Nevertheless, its indebtedness is low, not only compared to the economy as a whole, but even compared to other Hungarian distillers, while liquidity is in line with the average.

Competitive Positioning: Challenging pricing environment

The company's primary activity is producing and selling alcoholic beverages. The principal aim of Zwack is to maintain its market leading role in Hungary's market of spirits, and further strengthen its dominant presence in the premium and quality products segment.[1] The company's market share (including own production and the Diageo portfolio) is estimated at over 30% while it has a 29% stake in the local production of distilled beverages[2].

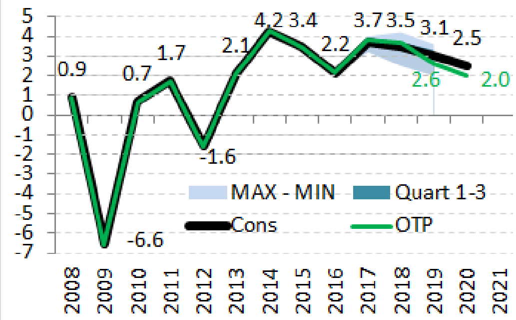
The main competitors of Zwack are the imported brands in the premium and the quality segments. Even in the premium segment, Hungarian consumers are very price sensitive and not particularly loyal to one brand. Maybe the only exception from this is Unicum, which is considered as "Hungaricum"[3], and has faithful customers. However pricing is a crucial element of the market strategy to maintain or increase share. A HUF appreciation would definitely deteriorate Zwack's market position, risks sales performance or dent profitability through the increased marketing costs to maintain its market position. With such consumer characteristics, the legalization of home distillery in 2010 weighs on the whole tax-paying spirits market and also its premium segment, biting out a share that is not expected to be regained soon.

[1] Zwack Unicum Plc's Annual Report 2016/2017

[2] Source: National Tax and Customs Administration, 2016

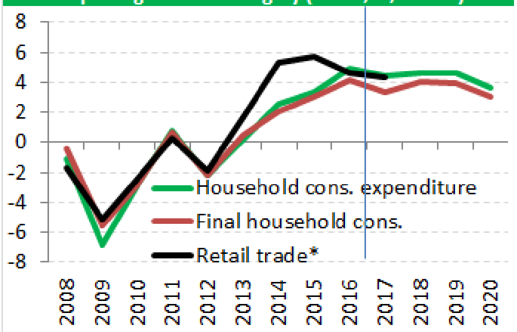
[3] According to www.hungarikum.hu, the official website of Hungarikums: "Hungarikum is a collective term indicating a value worthy of distinction and highlighting within a unified system of qualification, classification, and registry and which represents the high performance of Hungarian people thanks to its typically Hungarian attribute, uniqueness, specialty and quality.

GDP forecasts, Hungary (Y-o-Y; %; Bloomberg)



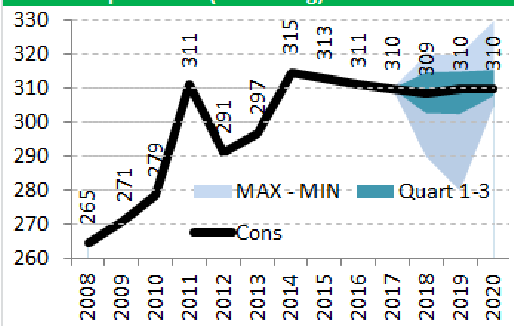
Growth could remain strong till 2019, which is expected to be followed by a slowdown around 2020.

Consumption growth in Hungary (Y-o-Y; %, OTP fc)



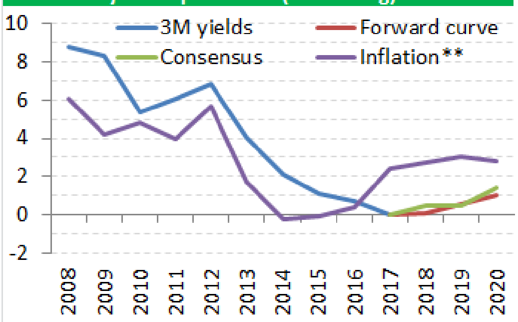
Growth in retail trade and consumption is likely to exceeed headline GDP growth.

EURHUF expectations (Bloomberg)



Analysts expect the EURHUF to remain flat as the NBH could neutralise appreciation pressure.

Short term yield expectations (Bloomberg)



As inflation is expected to remain below the target, monetary policy could remain loose

Sources: Bloomberg, OTP Bank, CSO

* Jan.-Sept.

** Annual average change, fact & forecast

Macroeconomic & interest rate environment

After a temporary slowdown to 2% in 2016, caused by the short-lived fall in EU-funds-related public investments, the Hungarian economy gained traction again in 2017. GDP growth accelerated back to the 3-4% range (GDP grew by 3.9% YoY in Q3). The business cycle has reached maturity stage and growth is broad-based, therefore exports, consumption, public and private investments posted decent growth rates. GDP growth could reach 3.8% in 2017 as a whole, while the consensus expects growth to moderate to 3.4% in 2018, 2.8% in 2019, and to 2% until 2022 (OTP Research forecasts 3.7% for 2018, 2.6% for 2019, and then a slowdown to 2% as the growth contribution of real estate and EU--related investments is expected to moderate, with upward risks. Consumption expenditure of households – which is more important for Zwack – could grow faster than GDP in the coming years, by 4-5% in the 2017-2020 period in our estimation, as the consumption-to-disposable-income ratio is still low in historical comparison, due to the long-lasting effects of the crisis, while catching up with historical averages in the coming years is supported by record low unemployment, high wage growth, and rising loan demand.

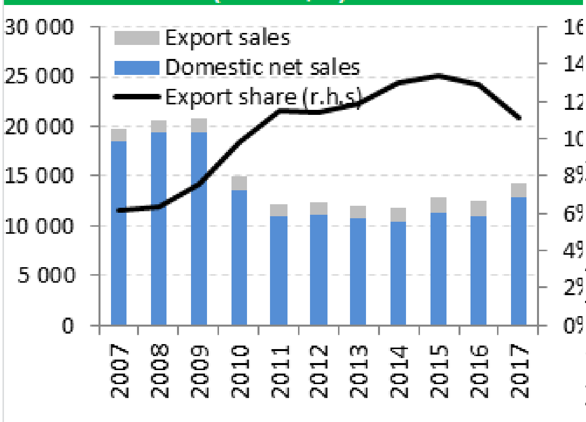
Monetary conditions are expected to remain supportive. HUF yields fell to historic lows as a consequence of loose monetary policy in developed countries and also in Hungary, where low inflation and decreasing vulnerability let the MNB cut rates and implement unconventional monetary policy measures to weaken the exchange rate and push down yields. As the MNB, the market consensus, and OTP all expect inflation to remain below the target for an extended period, short-term yields could remain around zero for at least two more years – in line with the forward guidance of the central bank. This could be followed by a cautious monetary tightening from 2019. Taking into account the central bank's firm commitment to keep the EUR/HUF above 300, we believe that a sizeable appreciation, which could affect Zwack's profitability, is unlikely. However, interest rate risks are clearly on the upside. Right now the effects of domestic factors, like strong demand and fast wage growth are counterbalanced by low global energy and food prices and modest imported inflation. Should global inflation pick up faster than expected, these factors would not be able to mitigate domestic factors any more, which could trigger faster normalization of yields.

Financial Analysis

Sales: Focus on the local market; growth affected by NETA changes, introduction of Unicum Riserva adds further momentum to the premium segment

As an FMCG producer, Zwack's sales income is driven mostly by the consumption demand. A dominant part (approx. 90%) of Zwack's sales revenue comes from the domestic market. Sales income of the own production bears significantly higher EBIT margin compared to the operating margin of traded product portfolio. That is the case, even though own products have a higher excise tax obligation than the Diageo portfolio sold by Zwack due to the characteristics of the product mix.

Revenue srtucture (HUF mn; %)

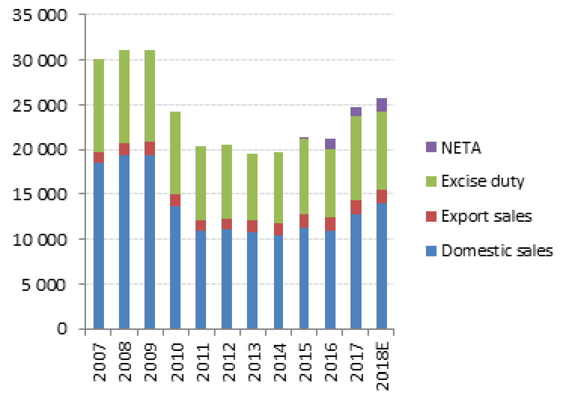


As distilled beverages are subject to excise and additional duties, the domestic demand also depends on the changing tax environment and the product-based strategic decision made by Zwack. In recent years the manufacturing of distilled beverages was hit by a series of government measures. In 2010 the government permitted the small-scale home-distillery of spirits, in 2015 the government introduced the NETA on the digestive spirits as well, which increased the prices by HUF 900/liter. However, as Zwack positioned itself in the premium segment it was able to weather these negative effects better than its pears. In 2010, then the small-scale home distillery was permitted, its ROE decreased from 22% to 16%, but it was still far better than the industry average. Moreover due to the NETA, the company was able to increase its market share as its customers are less price-sensitive than costumers in the lower price segment. In our baseline scenario we do not expect significant tax changes in the short run in terms of the afore-mentioned duties.

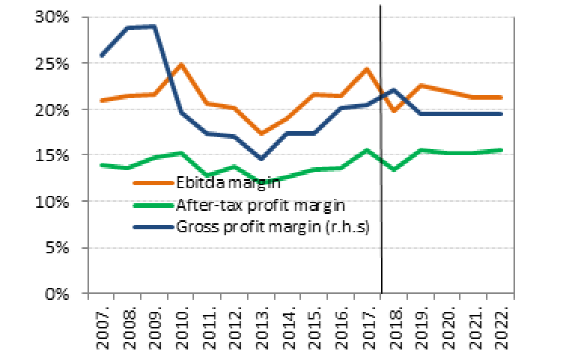
As economic conditions improved after the crisis, Zwack's revenue growth improved as well. Since 2014, the revenue's annual average growth rate was 5%.

Currently growing wages and accelerating household consumption provide a favourable environment for the market. However, due to the modification of "NETA" regulation, an early stockpiling at the end of 2016 resulted in a high base year hardly to be exceeded in volumes in the current business year (stockpiling heavily weighs on the sales performance of VFM range (including Zwack's "Kalinka" product line). According to market information, the Hungarian market of distilled beverages

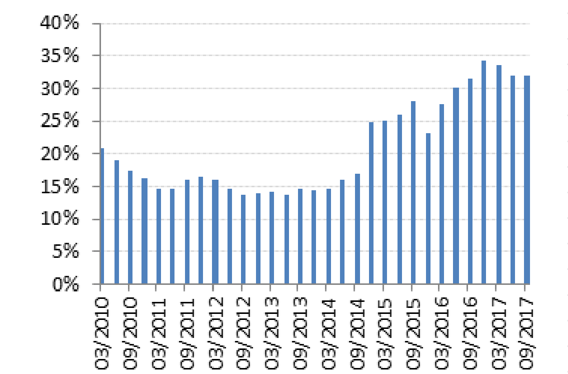
Revenue structure of Zwack in light of duties



Profit margins are expected to turn down due to increased indirect costs (Forecast period 2018-2022)



Roe (4Q AVG; %)



Source: Zwack, OTP Bank

Financial year of Zwack lasts from April to next March.

increased by more than 4% in the period of April – July of 2017. Market research data provided by Zwack in its regular earnings report show almost 6% increase in the premium and the non-branded segment, while the VFM segment slightly fell YoY. Nielsen's market research, conducted between September 2016 and August 2017 in Hungary, shows 7% increase in the retail sales of distilled beverages and it rose to HUF 80bn or 44,000hls. As far as the market of digestives is concerned, the retail sales of this product group increased by 12% YoY to over HUF 21bn in current prices, resulting in a market share of 26%. Vodka and pálinka, respectively had a 25 and 12% market share in the investigated period.

Looking ahead, 6% annual growth rate in revenues is projected, which is in line with the overall nominal growth rate of the economy in the forecast horizon. The introduction of Unicum-specialty "Unicum Riserva" in the gastronomy added 1pps to 9% half year's sales growth in the premium segment. Riserva's introduction in the retail segments scheduled for March 2018 is expected to give further momentum to the premium segment in the coming quarters. As the earlier stockpiling effect fades away, slow sales growth also may return in the VFM segment.

Zwack's export performance is balanced. The company's aim to maintain an around 10% export share has been fulfilled in broad lines. Zwack's priority export market is the EU, where the steady sales to Italy give the biggest stake. Sales of Unicum steadily increased, but pálinka sales lately fell in Germany. Sales to Italy and in the duty free areas shows slight increase this year, while sales to Romania witnessed double-digit growth rate.

Zwack's domestic net IFRS sales income is expected to slightly decline in the current business year, while 2017-2022 CAGR is expected to increase to 2.4%, from the historical 1.9% in the period of 2010-2017.

Margins:

The company's profit margins are very good, which is due to its market positions as well. Zwack does not explicitly announce margin requirements. According to historical data, 4Q-rolling profit margin was in the range 55-57% in the past three years, with a long-term average of 58%.

EBIT margin is more volatile, ranging between 15% and 22%, the long term average is 17%. We expect in the short run margins to move to the downside as labour shortage results in increasing labour cost, while on the longer run HUF depreciation may result in higher costs due to base material import or domestic purchases fixed in EUR. The management expects double-digit growth rate in marketing costs as the introduction of a new product (Unicum Riserva in 2018), the renewal of the existing products and the maintenance of the market position suppose bigger efforts in terms of marketing expenses.

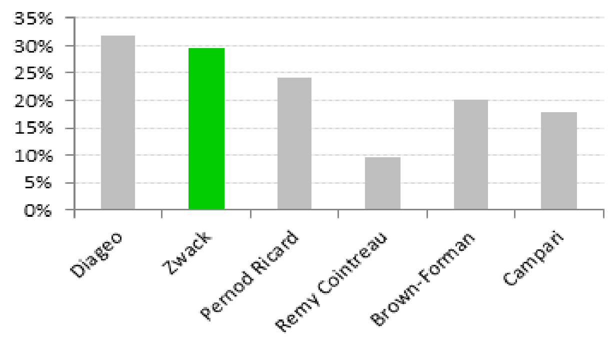
The company's ROE exceeded 30% and ROA was above 15% in 2016, which was well above its local peers and the national average. On the other hand, increasing wages could slowly decrease profit margins. We calculated with 8% annual growth in personal costs, which could force the management to rationalize operations in the medium term and increase operating efficiency in order to preserve profit margins. It is worth mentioning that this is not a Zwack-specific problem; it will affect the whole manufacturing of distilled beverages industry as well. Moreover as labour shortage heavily effects the overall retail sector as well, there may be unforeseen risks concerning the distribution channels in the company.

Compared to its peers, the company has very low leverage, the debt ratios are low, which can be translated to a higher shock-absorbing capacity than its peers. It can be part of the management strategy to keep the leverage low. The only potential vulnerability of the company is the relatively high trade receivables, which is elevated compared to both revenues and its peers.

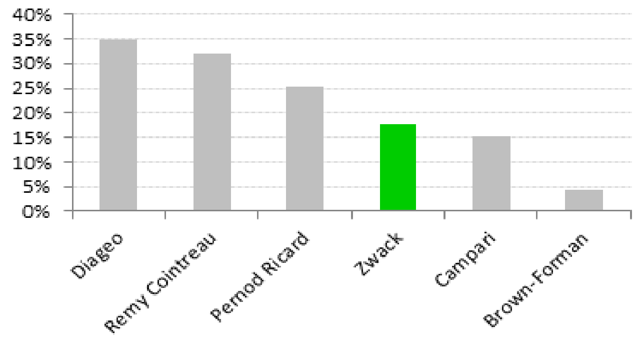
Cash Flow

Steady and modest sales growth, slightly deteriorating margins in the forecasting period and the significant decrease of the corporate tax rate from 2017 contribute to the slightly increasing operating cash flow. In our estimates operating cash flow increases by HUF 170 million per year on average in the next five years. OCF/Sales is expected to decrease in the next business years, but is likely to increase to 19% by the financial year 2020/2019, slightly down from the average historical ratio.

High share of trade receivables compared to the peer companies (trade receivables/sales revenues)



Relatively low share of trade payables compared to the peer companies (trade payables/sales revenues)



This operating cash flow is partly used to finance additional capital expenditures, increasing net working capital and a slight reduction of financial position. Relatively high trade receivables share (as the percentage of sales) and low share of trade payables leave room to further cash flow improvement.

Zwack is yet to announce official dividend policy. We assume that in the coming years Zwack will pay out its yearly profit to shareholders as it happened in the past years. At the same time we do not expect dividend payment against profit reserve, like in 2013, 2014 and 2015. Dividend payment ratio is expected to decrease to an average 87% in the forecast period compared to the average 130% between 2007 and 2017.

DCF

Main assumptions:

- We expect 6% revenue growth in the next five years, based on strong GDP and consumption growth.
- In the long run, our baseline assumes 3% revenue and profit growth in the case of Zwack, in line with our long term nominal growth forecast.
- Costs could grow by 6% in the forecast period.
- Our interest rate forecast shows that Hungarian yields could remain low for a few years, and then a normalisation process should start. The current yield curve suggests that the 5x10 year forward yield could be 3.7%. As we consider the normalisation of the yield environment as a main risk, we also run a sensitivity analysis to explore the potential effects of faster pick-up in yields.
- Our DCF values Zwack at 17,668 HUF/share, or HUF 34.0bn, in respect of total corporate value by end-Q1 2019. Cash flow statement shows well balanced FCFE volumes during the forecast period resulting in safe cover for dividend payments.

Profit & Loss Statement (HUF m)	2013 / 2014	2014 / 2015	2015 / 2016	2016 / 2017	2017 / 2018F	2018 / 2019F	2019 / 2020 F
Domestic net sales	10 420	11 283	11 033	12 854	13 981	14 820	15 709
Export sales	1 355	1 513	1 425	1 427	1 449	1 478	1 508
Net sales income	11 775	12 795	12 458	14 281	15 430	16 298	17 217
Material-type costs	5 225	5 678	5 306	6 044	6 368	7 008	7 403
Gross profit	6 550	7 117	7 152	8 237	9 062	9 290	9 814
Total operating expenditures	5 302	5 498	5 781	6 021	6 522	6 967	7 458
EBIT	1 735	2 236	2 160	2 959	3 147	2 946	2 998
Profit of financial transactions	115	24	14	2	-5	-5	-10
Pre-tax profit	1 852	2 248	2 177	2 940	3 142	2 941	2 988
Tax	359	534	483	714	353	412	359
Profit after tax	1 493	1 714	1 694	2 226	2 789	2 530	2 629
Dividend	1 515	1 768	1 725	2 137	2 035	2 035	2 035
Dividend from profit reserve	3 573	674	4	0	0	0	
EPS	734	842	832	1 094	1 370	1 243	1 292
DPS	2 500	1 200	850	1 050	1 000	1 000	1 000

Balance sheet (million HUF)	2014 / 2015	2015 / 2016	2016 / 2017	2017 / 2018 F	2018 / 2019F	2019 / 2020 F
Property, plant, equipment	2 845	2 891	2 863	3 000	2 950	2 950
Intangible assets	119	106	103	94	103	103
Non-current assets	3 283	3 170	3 088	3 372	3 323	3 337
Inventories	1 876	1 862	2 256	2 902	3 066	3 239
Recievables and other current assets	2 162	2 208	2 518	3 126	3 302	3 488
Cash and cash equivalents	2 257	2 809	2 820	3 315	3 414	3 835
Current assets	6 295	6 879	7 595	8 767	9 219	9 997
TOTAL ASSETS	9 578	10 049	10 682	12 138	12 542	13 334
Share capital	2 000	2 000	2 000	2 000	2 000	2 000
Capital reserve	165	165	165	165	165	165
Retained earnings	4 045	4 571	4 531	5 025	5 125	5 546
Total Equity	6 210	6 736	6 696	7 190	7 290	7 711
Long-term loans and other liabilities	360	427	427	389	389	389
Non-current liabilities	360	427	427	389	389	389
Loans and credits	0	0	18	20	20	20
Payables and other short-term liabilities	2 889	2 792	3 423	4 019	4 245	4 485
Current Liabilities	3 008	2 886	3 567	4 133	4 364	4 610
TOTAL EQUITY AND LIABILITIES	9 578	10 049	10 690	11 711	12 043	12 709

CASH FLOW statement (HUF million)	2014 / 2015	2015 / 2016	2016 / 2017	2017 / 2018 F	2018 / 2019F	2019 / 2020 F
EBIT	2 236	2 160	2 959	2 072	2 946	2 998
Tax (-)	-531	-479	-719	-353	-413	-360
NOPLAT	1 705	1 681	2 240	1 771	2 534	2 638
Depreciation (+)	533	514	515	636	743	785
Gross CF	2 238	2 195	2 755	2 407	3 277	3 423
Change in provisions (+/-)	50	51	-25	32	-32	5
Change in current liabilities (-/+)	492	-692	-32	-712	-689	-206
Change in short-term liabilities (+/-)	-253	579	-97	631	596	227
CFO	2 527	2 132	2 601	2 358	3 151	3 449
Change net non-current assets (+/-)	242	-184	131	67	-264	69
Depreciation (-)	-533	-514	-515	-636	-743	-785
Investment CF	-291	-698	-384	-569	-1 007	-716
Extraordinary income (+)	0	0	0	0	0	0
Extraordinary income (-)	0	0	0	0	0	0
Extraordinary CF	0	0	0	0	0	0
FCFF	2 236	1 434	2 217	1 789	2 144	2 733
Change in loans (+/-)	0	0	0	18	2	0
Financial profit (+)	24	14	2	-5	-5	-10
Tax shield for financial profit	-6	-3	0	1	1	1
FCFE	2 255	1 445	2 219	1 803	2 142	2 725
Dividend	2 442	1 730	2 137	2 035	2 035	2 035
Change in equity (+/-)	-641	6	119	61	495	100
Change in cash	-187	-285	82	791	107	690

Zwack's valuation (HUFm)	Base Year	2019	2020	2021	2022	2023	FCFF in the explicit period
FCFE	-77	2 142	2 725	2 653	2 794	2 515	
Discount factor	0,94	0,96	0,96	0,95	0,94	0,94	0,89
DCF		-1 569	-972	2 636	1 849		1 945
Terminal value (HUFm)							32 725
Net present value (HUFm)							34 790
Net debt							735
Equity value - Dec 31 2017							33 800
Number of shares							2 035 000
Expected return on equity							6,4%
12M Target price							**17 688**
Current price							16 720
Upside/Downside							6%
TR Upside/Downside							12%

Dividend Discount Model

Our one-year model values Zwack at HUF 17,597 per share with a 5.2% total return. Calculating with 5-year holding period and based upon our forecast we may get an average 2.6% total return per year.

	2 018	2 019	2 020	2 021	2 022	2 022
Expected DPS	1 000	1 000	1 100	1 100	1 100	2 239
Expected sales price	16 705	17 764	18 941	20 273	21 771	23 379
Required return of equity	6,3%	6,6%	7,0%	7,4%	7,4%	11,8%
Fundamental value		17 597				18 985
1Y TR		5,2%				
5Y TR						2,6%

Multiple Comparison

Our multiple comparison research brought mixed results. The companies that produce the well-known European digestive brands like Jägermeister and Underberg may be closer to Zwack in size and product portfolio characteristics, but are not listed companies. Thus we made a price comparison with the big multinational beverages producers. According to the comparison Zwack seems well undervalued on the basis of the indicators below, except the P/BV ratio. Applying the peer groups' P/BV indicator, Zwack is overvalued compared to the group's median value to companies like Campari, Pernod Ricard and Remy-Cointreau (HUF 14 894/per share).

Price multiple comparison

Company name	Market cap (HUF bn)	P/E	P/S	P/B
Zwack	33	17,0	2,3	6,1
Campari	2 320	28,1	4,1	4,0
Pernod	10 076	21,5	3,8	2,5
Diageo	23 520	22,0	5,5	7,1
Remy	1 820	34,9	5,2	4,3
Brown	6 840	32,1	8,2	15,6
Average	8 915	27,7	5,3	6,7
Median	-	27,9	5,2	5,5

	EV/EBITDA	P/E	P/B
Campari	0,6x	0,58x	1,53x
Pernod	0,79x	0,62x	2,44x
Diageo	0,77x	0,43x	0,86x
Remy	0,49x	0,45x	1,42x
Brown-Forman	0,53x	0,29x	0,39x
Average	0,6x	0,5x	1,3x
Median	0,6x	0,5x	1,4x

Sensitivity analysis

We think that the main risk for the share price of Zwack is the interest rate environment. We found that a 200-basis-point increase in interest rates by 2022 could decrease the share price by around HUF 2,000.

A faster revenue growth – which could be on the cards – could also significantly affect the share price. Should the revenue growth be one percentage point faster, the share price could rise by HUF 1,700.

Profit growth after the explicit period	Net change of interest rates compared to the baseline (percentage points)								
	-0,5%	-0,25%	0,0%	0,25%	0,5%	0,75%	1,0%	1,50%	2,0%
0%	14750	14552	14361	14179	14003	13835	13673	13367	13083
1%	15729	15489	15259	15040	14830	14630	14438	14076	13743
2%	16919	16622	16341	16073	15818	15575	15344	14911	14514
3%	18396	18021	17668	17334	17019	16719	16435	15907	15428
4%	20277	19791	19336	18909	18508	18131	17774	17118	16529
5%	22756	22102	21495	20932	20407	19916	19457	18621	17880
6%	26172	25246	24399	23623	22908	22247	21635	20536	19578

Profit growth after the explicit period	Beta						
	0,49	0,59	0,69	0,79	0,89	0,99	1,09
0,0%	16412	15651	14972	14361	13810	13311	12856
1,0%	17711	16793	15981	15259	14613	14032	13507
2,0%	19332	18198	17210	16341	15571	14886	14271
3,0%	21411	19971	18737	17668	16734	15911	15181
4,0%	24174	22278	20688	19336	18174	17166	16282
5,0%	28027	25401	23265	21495	20006	18736	17641
6,0%	33770	29868	26830	24399	22413	20759	19363

Risks surrounding Zwack's economic activity

Regulatory risk: In recent years regulatory changes in the industry made headwinds to the company's profitability. The most notable was the liberalization of spirit distillation at home in small quantities in 2010. However, the company's financial health is outstanding, so if a new regulatory change occurs in the future, Zwack most likely will be able to adjust to it.

Exchange-rate risk: As the company operates in foreign markets as well and the share of export is increasing among the revenues, exchange-rate risk could be an issue in the future, if not managed properly. Moreover the price of most of its new raw materials is denominated in EUR, so a significant depreciation of the HUF against the EUR could decrease the company's profitability. But on the short run, the fundamentals of the Hungarian economy are strong, so the risk of sharp HUF depreciation is low. Moreover the loss on exchange rates could be somewhat offset by the higher export revenue.

Cost-inflation risk: Due to the improving economic conditions and labour shortages in various industries, real wages started to increase significantly in 2016 and they are expected to do so in the near future. As Zwack's business is labour-intensive (the share of personnel cost is almost 45%), it will be heavily affected by future wage increases which could erode margins.

History

Zwack’s most famous and important product, the "Unicum", was created by Dr. József Zwack, the Royal Physician to the Habsburg Court, for Emperor Joseph II in 1790. Legend would have it that the royal comment was: "Dr. Zwack, das ist ein Unikum!" giving this herb liqueur its name. The fame and popularity of Unicum was gradually to spread far beyond the Court in Vienna. However, it was a long way to go to mass production. On May 22, 1883, the herb liqueur under the name Unicum, made according to the Zwack family’s secret recipe dating back to 1790, was officially registered.

Meanwhile, in 1840 the family founded J. Zwack & Co., the first Hungarian liqueur manufacturer. By the early 1900s, the Zwack company had become one of the largest distilleries in central Europe, producing and exporting over 200 liqueurs and spirits.

During World War II, Budapest and the Zwack factory were completely destroyed. After the war, with the Communist regime, the factory was nationalized in 1948. The Zwack family fled the country. János Zwack, with his son Péter Zwack and great grandson József, was able to escape with the original Zwack recipe. Béla Zwack remained behind to give the communist government a fake Zwack recipe and went on to become a regular factory worker. Meanwhile, János and Péter migrated to the United States, eventually settling in the Bronx in 1949 when Péter was 22 years old.

In 1988, just one year before the fall of Communism, Péter Zwack returned to Hungary and resumed production with the original Zwack formula. He repurchased his family business from the State in the summer of 1989, and by the spring of 1990, the original Zwack product was reintroduced to the Hungarian market. That same year, Péter was named Hungarian Ambassador to the United States.

In 1992 Zwack Unicum Plc was founded when the partners, Peter Zwack & Consorten AG, submitted a successful bid during the privatization process and were thus able to buy back the entire enterprise, including several distilleries, from the Hungarian state. In 1993, 26% of the company's shares were acquired by the multinational IDV, which later merged with UDG to become Diageo. Also in 1993 the Zwack Unicum Company went on the Budapest Stock Exchange.

In 2008, Péter Zwack handed over the company's leadership to the family's 6th generation, his own children, Sándor and Izabella Zwack. One of their first initiatives was to launch Zwack in the USA. In 2013, the Zwack Company also launched Unicum in the USA.

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