

# EQUITY NOTE: ZWACK UNICUM

**Recommendation: HOLD (unchanged)**

**Target price (12M): HUF 15,882 (revised down)**

**07 Aug 2019**

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We maintain our **HOLD** recommendation on Zwack Unicum (Zwack HB; ZWCG.BU) with a **new 12M target price of 15,882 HUF/share**, revised down from 16,056 HUF/share. Higher taxes, slowing consumption and increasing operational costs also play a role in the somewhat subdued profit outlook in the challenging business environment in the short and middle run. The new target price stands 4% below the HUF 16,600 closing price on 7 Aug, 2019. Due to subdued performance in the current business year, investors can expect more modest dividend payment compared to the past years. Estimated total return is expected to improve to 0.9% in a 12M-horizon. Shares of Zwack Unicum dropped 0.9% on 07 Aug, 2019.

## Summary/Earnings Highlights

- As it was expected, Zwack Unicum sales revenues remained subdued in April-June 2019, after heavy stockpiling in the second half of 2018 ahead of the significant tax increase from the beginning of 2019.
- Quarterly domestic sales revenues declined by 18% YoY, while export sales jumped. Zwack's relatively weak sales performance in the domestic market this year comes as no surprise after higher levies on food and beverages deemed unhealthy (tax called 'NETA') took effect on 1 January 2019. Zwack is not only affected by the fact that 'NETA' had been increased but also its flagship products Unicum and 'pálinka' became taxable.
- Self-manufactured production and sales revenues from the distributed portfolio also declined by 17% and 9% YoY, respectively. Falling revenues in the self-manufactured production with higher profit margin heavily hurt profitability. Quarterly EBIT almost halved in the past quarter, as EBIT and EBITDA margins considerably deteriorated in a yearly horizon.
- Quarterly EPS plunged to HUF 114 from HUF 243 one year before.
- Zwack Unicum maintains its earlier forecast of HUF 14.0bn sales revenue for the current business year. Zwack also expects EBIT to drop to 1.8bn in 2019/2020 and after-tax profit to amount to HUF 1.4, resulting in EPS of HUF 703. The company also expects nominal after-tax profit to return the HUF 2bn level by 2021/2022.
- In February, we revised down our earnings forecast and on the longer run we applied a more conservative scenario, considering profit estimates, than Zwack. We maintain this earlier forecast and expect this year's sales revenue to decrease to HUF 13.9bn, while EBIT may drop to HUF 1.6bn. EPS may decline to HUF 679 in the current business year. According to our forecast, the levelling off may take more time than earlier anticipated, after-tax profit is expected to return to the level of HUF 2bn in 2022/2023.

- Although we made no significant changes in our forecast, minor adjustment in some parameters of the valuation models had to be implemented. As a result, the new 12-month target price was revised down to HUF 15,882 from the earlier 16,056 HUF/share, and we still maintain the HOLD recommendation.

Financial Q1 (HUFm)	2019 Apr-June	2018 Apr-June	YoY Change
Domestic sales	2 658	3 251	-18%
Export sales	412	363	13%
<b>Net sales income</b>	<b>3 070</b>	<b>3 614</b>	<b>-15%</b>
Material-type costs	1 100	1 249	-12%
<b>Gross profit</b>	<b>1 970</b>	<b>2 365</b>	<b>-17%</b>
Personnel costs	738	721	2%
Depreciation	126	134	-6%
Other operating expenses	863	960	-10%
Total operating expenditures	<b>1 727</b>	<b>1 815</b>	<b>-5%</b>
Other incomes	69	63	10%
<b>EBIT</b>	<b>312</b>	<b>613</b>	<b>-49%</b>
Pre-tax profit	<b>312</b>	<b>613</b>	<b>-49%</b>
Tax	81	119	-32%
<b>After-tax profit</b>	<b>231</b>	<b>494</b>	<b>-53%</b>

Financial Q1 (HUFm)	2019 Apr-June	2018 Apr-June	YoY Change
<b>EPS (HUF)</b>	<b>114</b>	<b>243</b>	<b>-53%</b>
<b>4Q-rolling EPS (HUF)</b>	<b>1160</b>	<b>1118</b>	<b>4%</b>
<b>EBITDA (HUFm)</b>	<b>438</b>	<b>747</b>	<b>-41%</b>
<b>Gross profit rate</b>	<b>64.2%</b>	<b>65.4%</b>	<b>-1.3 pp</b>
<b>EBIT rate</b>	<b>10.2%</b>	<b>17.0%</b>	<b>-6.8 pp</b>
<b>EBITDA rate</b>	<b>14.3%</b>	<b>20.7%</b>	<b>-6.4 pp</b>
<b>ROE</b>	<b>4.4%</b>	<b>9.8%</b>	<b>-5.4 pp</b>
<b>4Q-rolling ROE</b>	<b>48.9%</b>	<b>29.6%</b>	<b>19.2 pp</b>
<b>ROA</b>	<b>2.0%</b>	<b>4.3%</b>	<b>-2.4 pp</b>
<b>4Q-rolling ROA</b>	<b>20.1%</b>	<b>13.0%</b>	<b>7.1 pp</b>

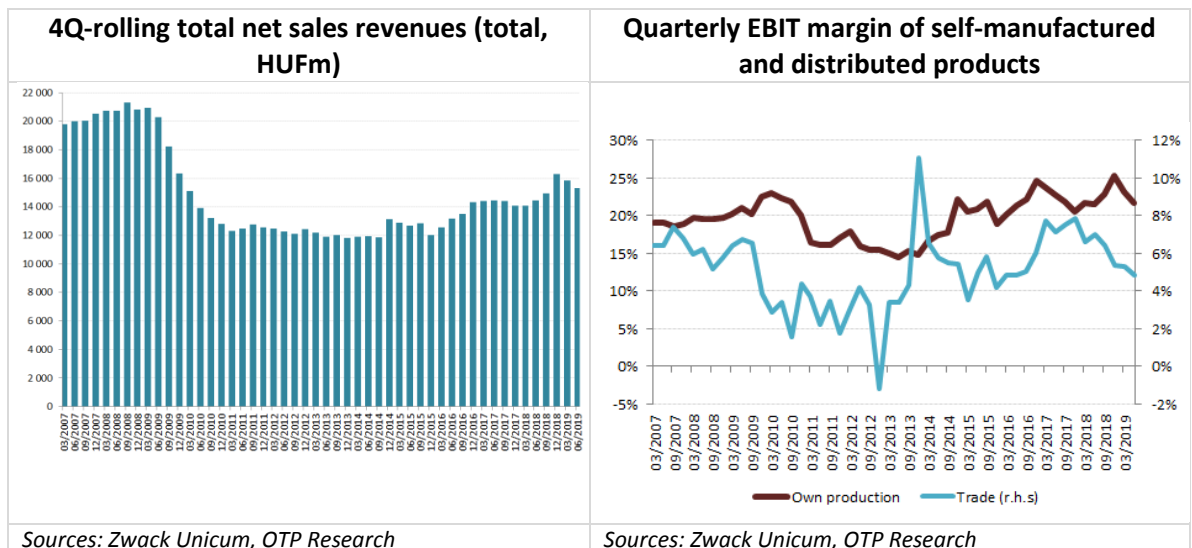
Sources: Zwack Unicum, OTP Research

**Subdued domestic sales after major tax increase.** After strong inventory building at the end of 2018, domestic sales remained subdued in the April-June period. Quarterly domestic sales revenue declined 18% YoY after plunging 24% YoY in January-March. The HUF 2.7bn domestic net sales revenue was somewhat lower than our expectation. Revenues from own production dropped 22% YoY in the quarter, with the revenues of the prime segment falling 21%, while the sales of the quality segment declined 26%, Zwack announced.

The net sales revenue of the traded products decreased by 9% YoY in the April-June period. Revenues from the Diageo portfolio representing a major part in the total distributed products increased by 7% compared to the same period a year before. The revenues from other traded products almost halved (-45%) as Zwack stopped trading the products of Moët-Hennessy as of March 01, 2019.

Zwack's sluggish sales performance in the domestic market this year comes as no surprise after higher levies on food and beverages deemed unhealthy (tax called 'NETA') took effect on January 1, 2019. Zwack is not only affected by the fact that 'NETA' had been increased but also its flagship products Unicum and 'pálinka' became taxable. Heavy stockpiling due to the scheduled tax increase in the second half of 2018, especially in the calendar Q4, dragged down sales in the past quarters and sets back this year's sales performance in an otherwise healthy economic environment. Market research data for the period of April – June 2019 reflected stable consumer demand on Hungary's retail market of spirits (12% nominal YoY growth, and 2.5% gain in volume).

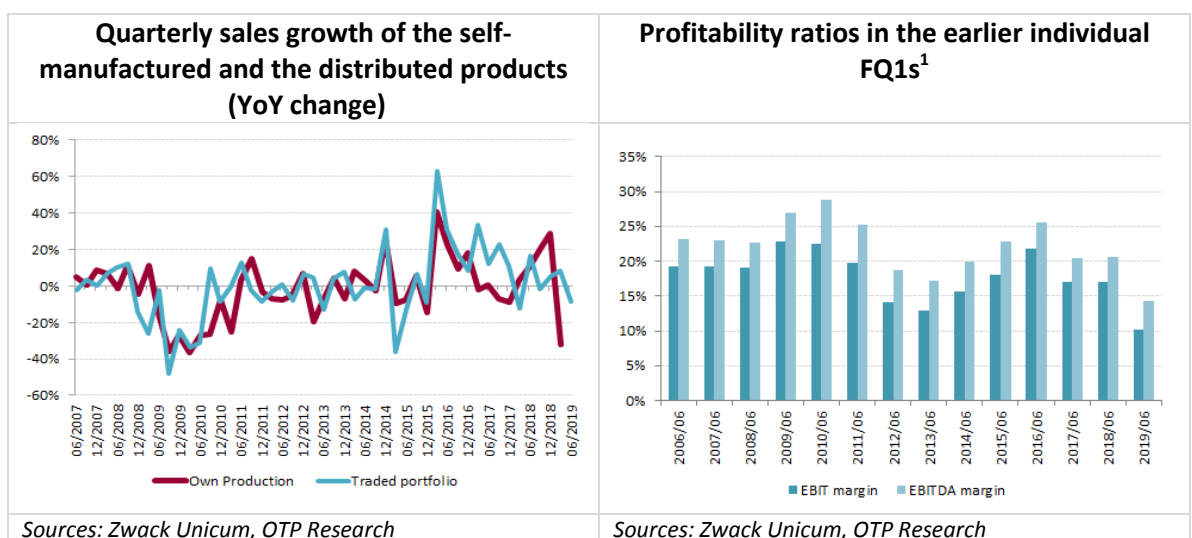
**Strong export growth is cold comfort.** Export revenues added 13% YoY in the April-June period as sales to Italy picked up from the last business year's low base and jumped 23% YoY. That also means that other relevant markets may have increased at a slower pace in the past quarter.



**Profitability considerably deteriorated.** Profit margins significantly dropped as sales of self-manufactured products with higher profit content took a dip this year. Gross profit margin decreased to 64% in the past quarter from 65% one year before. EBIT margin declined to 10%, from 17% in the corresponding quarter of 2018. Personnel costs slightly increased due to the general wage increase program implemented at the beginning of 2019. EBIT declined to HUF 312m in April-June, half of the sum Zwack reported a year ago. EBITDA plunged 41% YoY to HUF 438m, EBITDA margin fell to 14% from 21% in the corresponding period of 2018.

Zwack announced some changes to the accounting policy, effective from the start of 2019. The modifications affect mainly the accounting of material-type costs, other incomes and other costs, while some changes in the accounting of certain allowances (bonuses for long service and retirement bonuses) have direct effect on retained earnings. Zwack publishes the financial report in accordance with the new accounting rules, but only enables YoY comparison for the base periods (financial Q4 2017/2018 and the consecutive quarters). As a consequence, long-term comparisons cannot be made.

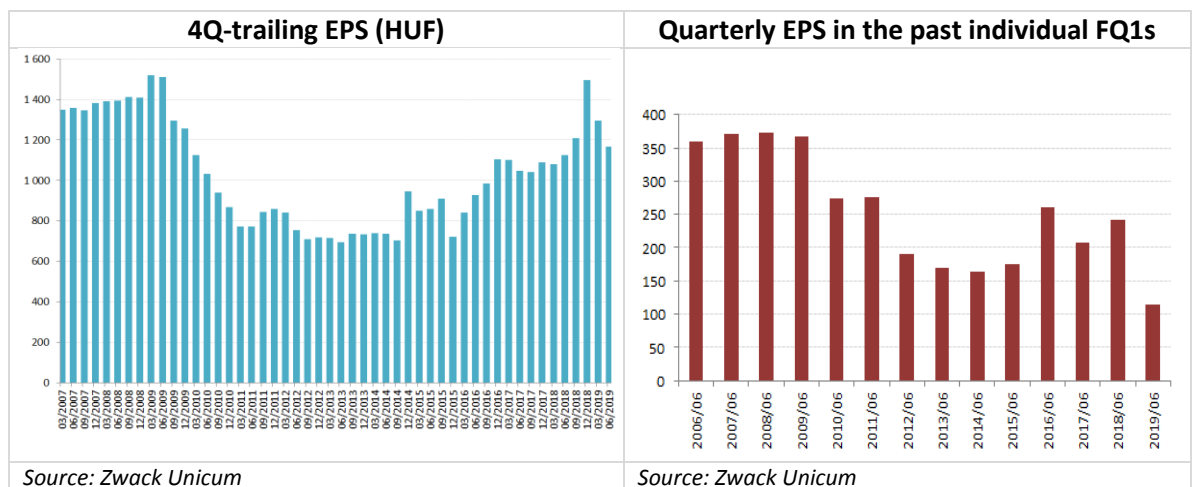
After-tax profit declined 53% YoY to HUF 231m, while quarterly EPS plunged to HUF 114 from HUF 243, the lowest in the past nine years (without counting the usually loss-making financial last quarters).



<sup>1</sup> Financial data for April-June 2017 or earlier are not revised in line with the changes in the accountancy policy implemented as of January 1, 2019

**Sales and profit outlook under pressure in the medium term.** Zwack Unicum maintains its earlier forecast of much less prosperous quarters of the current business year as the developments of the past quarters fulfilled this expectation. Due to falling sales volumes – a consequence of tax-related price increase – Zwack Unicum expects sales revenues in the present business year to decline by more than 10%. Higher expected packaging costs put profitability under pressure; the company plans to offset it by cutting marketing and other operational costs. Total net profit may decline by more than 40% in the 2019/2020 business year, Zwack Unicum announced.

According to the business plan for the business year 2019/2020 the management of Zwack Unicum presented and the AGM approved, the company expects net sales revenues to decline to HUF 14.0bn (-11% YoY), EBIT to fall to HUF 1.8bn (-42%) and after-tax profit drop to HUF 1.4bn (-46%). Zwack Unicum does not expect to achieve HUF 2.0bn after-tax profit before the business year 2021/2022, the company added.



## Comments

- Zwack's sales and profit figures in the April-June period of 2019 (financial 1<sup>st</sup> quarter of the 2019/2020 business year) slightly fell below our quarterly forecast. As it had been announced, the public health product tax (NETA in Hungarian) rose by 20% from 1 January 2019, and from that day Unicum and 'pálinka' have been taxed, marking the end of the tax exemption the company benefited from in recent years. As expected, wholesalers and retailers started building inventories in 2018 and it took its toll on the sales performance of the current year. In this recent quarterly report, as in the one before sales and profit figures became much less appealing than in 2018.
- The inclusion of 'Unicum' and 'pálinka' under the effect of 'NETA-rules' affects Zwack Unicum where it hurts the most. The sales decline – though it is expected to be provisional – of self-manufactured products with much higher profit margin is a drag on Zwack's overall profit-generating ability. With quarterly sales still slightly lower than our forecast, it is possible that levelling off may take more time than originally anticipated, and sales revenues (and profits) can be under pressure for a longer period of time. Zwack's distribution contracts with MHCS and Hennessy were terminated at the end of February 2019, and as it happened, the sales performance of the distributed portfolio also decreased.
- In our forecast, we apply a more conservative scenario than the one of Zwack Unicum. We expect after-tax profit to return the HUF 2bn target in 2022/2023.

## Conclusion

- Although the recently reported sales and profit figures of the last quarter (April-June 2019) are somewhat lower than our quarterly forecasts, we maintain our forecasts for the current whole business year and the coming ones.
- Although our forecast remained unchanged, some minor adjustments to our valuation models needed to be implemented. As a result, our new 12-month target price declines to 15,882 HUF/share from the previous 16,056 HUF/share, and we still maintain the HOLD recommendation.
- The new target price is 4.3% down from the HUF 16,600 closing price on 7 August 2019 while 0.9% total return is forecast on a 12M-horizon. The expected dividend yield may decrease to 4% from the 6–7% yield paid in the past years.

### Risks surrounding our forecast

As Zwack does not publish either product level data or data on sold quantities, the uncertainty regarding our sales forecast is moderate to high. When analysing different scenarios we suppose the demand's price elasticity is near -1 but, due to lack of information we did not calculate with the probably existing substitution effect among different products or different brands. The substitution effects can play a role as the relative price of Unicum products will be higher after tax changes compared to competitors' products. And in this environment Zwack Unicum even may have to face the possibility of decreasing market share. No information is available even though there is also a risk: whether the management can assess the danger caused by the persistent decline in the market share, induced by higher prices. In the long run, domestic consumption growth is expected to slow, wage dynamics may falter while the external economic environment is also challenging (global trade war, no-deal Brexit, sluggish economic growth in the eurozone).

We emphasize, for lack of available data the forecast bears a considerable uncertainty both to the downside and the upside.

Profit & Loss Statement (HUF m)	2016/2017	2017/2018	2018/2019F	2019/2020 F	2020/2021F	2020/2021F
Domestic net sales	12 854	12 418	14 209	12 319	13 658	14 068
Export sales	1 427	1 540	1 602	1 561	1 592	1 624
<b>Net sales income</b>	<b>14 281</b>	<b>13 958</b>	<b>15 810</b>	<b>13 880</b>	<b>15 250</b>	<b>15 692</b>
Material-type costs	6 044	6 032	6 663	5 552	6 253	6 748
<b>Gross profit</b>	<b>8 237</b>	<b>7 926</b>	<b>9 147</b>	<b>8 328</b>	<b>8 998</b>	<b>8 944</b>
Total operating expenditures	6 021	6 051	6 563	7 170	7 918	7 603
<b>EBIT</b>	<b>2 959</b>	<b>2 580</b>	<b>3 270</b>	<b>1 624</b>	<b>1 628</b>	<b>1 878</b>
<b>Pre-tax profit</b>	<b>2 940</b>	<b>2 582</b>	<b>3 271</b>	<b>1 626</b>	<b>1 630</b>	<b>1 880</b>
Tax	714	378	455	244	244	282
<b>Profit after tax</b>	<b>2 226</b>	<b>2 204</b>	<b>2 816</b>	<b>1 382</b>	<b>1 385</b>	<b>1 598</b>
Dividend	2 137	2 137	2 544	1 221	1 323	1 628
<b>EPS (HUF)</b>	<b>1 094</b>	<b>1 083</b>	<b>1 384</b>	<b>679</b>	<b>681</b>	<b>785</b>
<b>DPS (HUF)</b>	<b>1 050</b>	<b>1 050</b>	<b>1 250</b>	<b>600</b>	<b>650</b>	<b>800</b>

Balance sheet (HUFm)	2016/2017	2017/2018	2018/2019	2019/2020F	2020/2021F	2021/2022F
Property, plant, equipment	2 891	3 205	3 330	3 710	3 803	3 613
Intangible assets	106	89	84	103	103	93
<b>Non-current assets</b>	<b>3 157</b>	<b>3 447</b>	<b>3 582</b>	<b>4 051</b>	<b>4 163</b>	<b>3 970</b>
Inventories	1 862	2 185	2 386	2 584	2 588	2 818
Receivables and other current assets	2 208	2 275	2 115	2 282	2 340	2 789
Cash and cash equivalents	2 809	2 770	3 064	3 162	2 972	2 681
<b>Current assets</b>	<b>6 879</b>	<b>7 230</b>	<b>7 565</b>	<b>8 028</b>	<b>7 900</b>	<b>8 288</b>
<b>TOTAL ASSETS</b>	<b>10 036</b>	<b>10 677</b>	<b>11 147</b>	<b>12 078</b>	<b>12 063</b>	<b>12 258</b>
Share capital	2 000	2 000	2 000	2 000	2 000	2 000
Capital reserve	165	165	165	165	165	165
Retained earnings	4 558	4 662	4 915	5 542	5 834	5 636
<b>Total Equity</b>	<b>6 723</b>	<b>6 827</b>	<b>7 080</b>	<b>7 707</b>	<b>7 999</b>	<b>7 801</b>
Long-term loans and other liabilities	427	410	472	389	389	389
<b>Non-current liabilities</b>	<b>427</b>	<b>410</b>	<b>472</b>	<b>389</b>	<b>389</b>	<b>389</b>
Loans and credits	0	0	0	23	11	19
Payables and other short-term liabilities	2 889	3 384	3 567	3 935	3 641	3 993
<b>Current Liabilities</b>	<b>2 886</b>	<b>3 440</b>	<b>3 595</b>	<b>3 984</b>	<b>3 676</b>	<b>4 068</b>
<b>TOTAL EQUITY AND LIABILITIES</b>	<b>10 036</b>	<b>10 677</b>	<b>11 147</b>	<b>12 079</b>	<b>12 063</b>	<b>12 258</b>

#### CONSOLIDATED CASH FLOW (HUFm)

	2016/2017	2017/2018	2018/2019F	2019/2020F	2020/2021F	2021/2022F
EBITDA	3 474	3 049	3 643	2 207	2 258	2 504
Cash flow from operation	2 601	2 854	3 754	1 965	1 655	1 928
Cash flow from investment	-371	-765	-927	-1 032	-722	-412
FCFF	2 230	2 089	2 827	2 827	933	932
FCFE	2 232	2 091	2 848	2 848	958	922

Sources: Zwack Unicum, OTP Research

#### Deduction of 12M Target Price

Zwack's valuation (HUFm)	2018/2019	2019/2020	2020/2021	2021/2022	2022/2023	2023/2024	FCFE in the explicit period
FCFE	2 900	1 757	1 191	2 183	1 289	1 887	
Discount factor	0,92	0,92	0,92	0,92	0,91	0,91	
DCF	2 619	879	846	1 397	1 781	1 438	6 340
Terminal value (HUFm)							31 967
Net present value (HUFm)							26 546
Net debt							-2 750
Equity value (HUFm) - June 30, 2019							29 296
Number of shares (pcs)							2 035 000
Expected return on equity							9,1%
12M Target price (DCF)							15 699
12M Target price (DDM)							16 066
12M Weighted Target price (HUF)							<b>15 882</b>
Current price							16 600
Upside/Downside							-4,3%
TR Upside/Downside							0,9%

Source: OTP Research

#### Risks surrounding Zwack's economic activity

**Regulatory risk:** In recent years regulatory changes in the industry caused headwinds to the company's profitability. The most notable was the liberalization of spirit distillation at home in small quantities in 2010. The EU lately expressed criticism on discriminative

taxing policy of spirits in Hungary and threatened to start infringement process against Hungary. The new regulatory changes (increase of NETA) which took effect on January 1, 2019, are aimed to resolve this conflict with the EU and increase budget revenues at the same time.

**Exchange-rate risk:** As the company operates in foreign markets as well and the share of export is increasing among the revenues, in case of an appreciating HUF the exchange-rate risk can be an issue, if not managed properly. Weakening HUF poses more risks on the cost side, as most of Zwack's raw materials' price is denominated in EUR, so a significant depreciation of the HUF against the EUR could weigh on the company's profitability. That can be counterbalanced to a certain extent by the higher export revenue in HUF.

**Cost-inflation risk:** Due to the improving economic conditions and labour shortages in various industries, real wages started to increase significantly in 2016 and kept on rising since then. This landscape is hardly expected to change in the near future. As Zwack's business is somewhat labour-intensive (the share of personnel cost in total costs is around 20%), it will be heavily affected by sustaining high wages denting in profitability.

#### Notes:

[The initiation report, which contains the assumptions of the models used, is available here.](#)

[The valuation methodology used in this present equity research note to determine our price targets and recommendations is available here. \(Also available in Hungarian\)](#)

This investment recommendation has not used proprietary models.

The risk warning, which includes the adequate explanations of the length of time of the investment to which the recommendation relates as well as a sensitivity analysis of the assumptions, is indicated in the part of this recommendation where the length of time and the risks of the investment are presented.

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OTP Bank Plc's recommendations and price targets history for Zwack Unicum in the past twelve months:

Date	Recommendation	Target Price	Publication
03/08/2018	HOLD	HUF 17,046	Earnings Update
13/09/2018	HOLD	HUF 17,046	News Comment
07/11/2018	HOLD	HUF 16,806	Quarterly Earnings Update
06/02/2019	HOLD	HUF 16,271	Quarterly Earnings Update
23/05/2019	HOLD	HUF 16,056	Quarterly Earnings Update
30/05/2019	HOLD	HUF 16,056	Comment
07/08/2019	HOLD	HUF 15,882	Quarterly Earnings Update

Period	Recommendation	% of recommendations
Q3 2018	BUY	0
	HOLD	100
	SELL	0
Q4 2018	BUY	0
	HOLD	100
	SELL	0
Q1 2019	BUY	0
	HOLD	100
	SELL	0
Q2 2019	BUY	0
	HOLD	100
	SELL	0

[The list of all recommendations made in the past 12 months is available here.](#)

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This document was finalized at 6:46:04 PM on 07 August 2019