

# EQUITY NOTE: ZWACK UNICUM

**Recommendation: HOLD**

**Target price (12M): HUF 17,781**

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## Highlights

We revise our rating on Zwack Unicum (Zwack HB; ZWCG.BU) to HOLD from previous BUY recommendation with a new 12M target price of 17,781 HUF/share, 1% higher than the HUF 17,550 closing price on February 6. Total return is estimated at 7% on a 12-month forecast period.

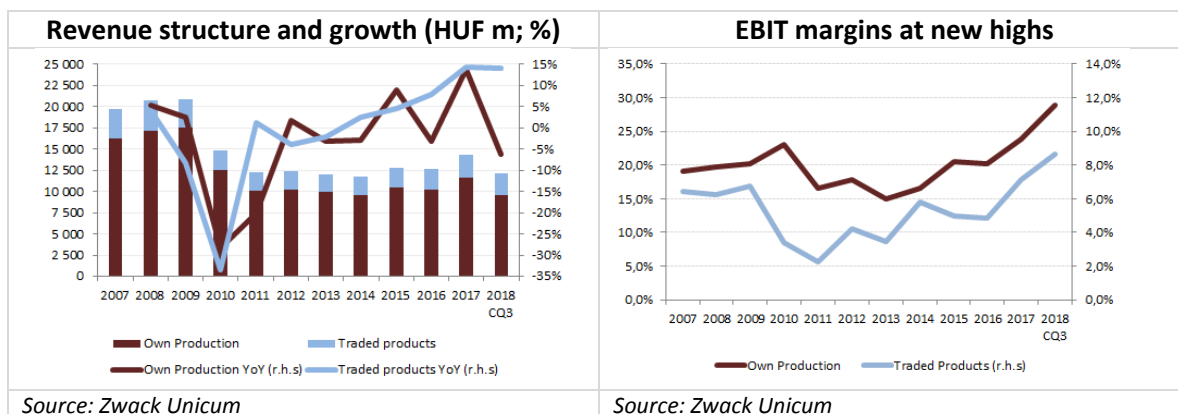
## Summary/Earnings Highlights

- As it was expected, net sales revenues declined due to previous stockpiling.
- Q3 EPS increased to HUF 800, a level not seen in the past three years. ROE and ROA also improved
- Recent earnings results are in line with our expectations, we maintain our whole-year net profit forecast of HUF 2.0bn. This is in sync with the Management's recently raised net profit forecast of over HUF 2.0bn, compared to HUF 1.7bn projected earlier.
- As our earnings forecast remained the same, our stock price trajectory also remained unchanged. Although the present interest rate environment is challenging, volatility is undoubtedly present, we are in a wait and see stance regarding the revision of our interest rate forecast. The present change in the stock's target price is due to the progress we have made in time.
- Consumption growth fuels improving sales prospects, however seasonal (calendar) effects add downside risks to the long-term sales forecasts.

## Financial highlights of Q3 earnings report

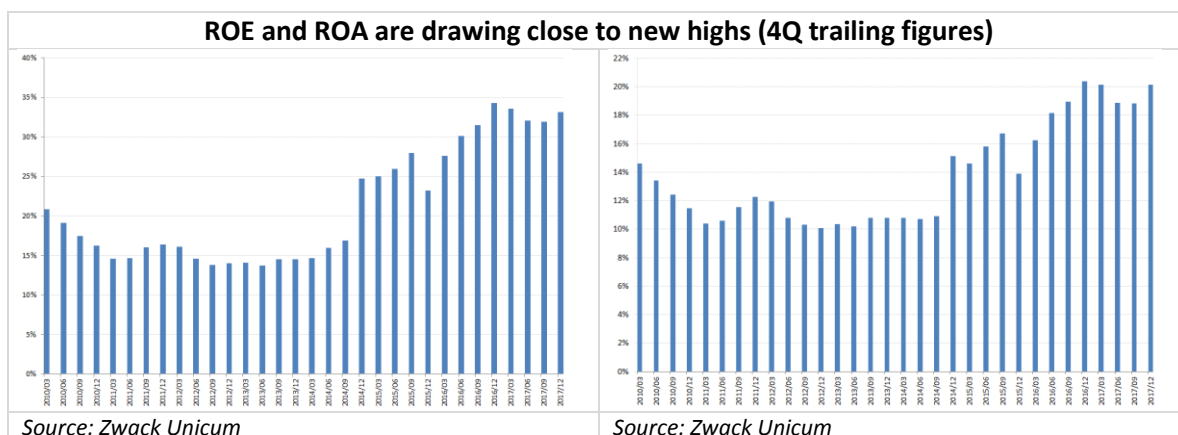
**Declining sales with sparkling details.** Zwack Unicum reported HUF 5.7bn net sales in Q3, 5% lower than in the same period of the last financial year. High base-period sales due to heavy stockpiling at the end of 2016 resulted in 7% decrease of domestic sales in October-December 2017, though the unexpected growth of Unicum digestive and the successful introduction of high-end digestive 'Unicum Riserva' partly offset the falling vodka sales. Exports increased by 12% YoY in Q3. Although detailed information is not available on this last individual quarter, favourable macro-environment in Germany (cumulative 20% YoY) and particularly in Romania (cumulative 17% YoY) must have had a significant role in growing export sales.

In terms of segmentation, sales of own production fell 9% YoY in Q3 after 7% decline in Q2 as flagship Kalinka sales lost momentum. Sales of Diageo products (with about 40% weight in the sales of the traded portfolio) increased by 18% YoY, while the sale of other distributed products (exclusive of own production) increased by 6%, resulting in a total 11% growth in the sales of off-production segment



**Slightly declining margins with counterbalancing effect of corporate tax rate cut.** Considering individual quarters, profit margins are close to the level Zwack usually performs in this period of the year. However, in year/year comparison, margin data lag behind the last financial year’s figures. The reason behind the slight deterioration is the decline of own sales with higher profit margin (40% in FYQ3, doubling margins in the previous two financial quarters), while the sales of the traded portfolio bearing tighter margin (11% in FYQ3) rose. Corporate tax cut – effective from January 1, 2017 – benefited the company, and resulted in 29% after-tax profit ratio, the highest in the past ten years. Quarterly net income rose to HUF 1,629 million (6% gain YoY). EPS amounts to HUF 800, while 4Q trailing EPS is nearing previous highs.

Profitability is drawing close to new highs. 4Q rolling ROE and ROA improved compared to the first two quarters of the present financial year. 4Q trailing ROE and ROA improved to 33% and 20% respectively, well above the industry average. In historical comparison, the figures of this latest quarter are the third best in the last seven years beginning from the legalization of home distilleries in 2010.



**Economic environment – Supporting macro environment, strong competition in the spirits market.** The current macro-environment is still 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, but an appreciation would result in stronger price competition through imported spirits.

**Positive outlook with possible calendar effect.** The management of Zwack also announced in its earnings release that after-tax profit in Q1-Q3 exceeded the company’s

expectation. In light of the latest results, the management is going to raise its profit target for the FY 2018/2017 to HUF 2.0bn. This matches our earlier expectation. We forecast HUF 2,056m net profit and HUF 1,010 EPS. On a longer run it must be considered that due to calendar effect, the next financial year may result in only modest growth. This year Easter (a very high season of spirit sales) falls to end of March – this means that Zwack's current financial year benefits from two Easter holidays, while its next financial year, which starts in April, will lack this holiday.

**Valuation.** We raise our 12-month target price to HUF 17,781/share from previous HUF 17,668/share. As this recent earnings release is in line with our expectations, our stock price trajectory also remained unchanged. Although the present interest rate environment is challenging, volatility is undoubtedly present, we are in a wait and see stance regarding the revision of our interest rate forecast. The present change in the stock's target price is due to the progress we have made in time. As a result, and due to price movements in the past weeks, Zwack shares offer lower estimated total return than before. We changed our rating to HOLD from previous BUY recommendation.

#### **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 in 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.

Company name		
Recommendation		<b>HOLD</b>
12M Target price	HUF	17 781
Estimated Total Return	%	7%
Key market data		
Market cap	(HUF bn)	35,7
Free float		24%
Shares outstanding		2 035 000
Average daily trading volume	(HUFm)	8,3
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 preferred stocks		1,72%
Free float		24%
Key financial data		
Book value / share	HUF	2 755
EPS (4Q-rolling)	HUF	1083
Dividend / share	HUF	1050
Dividend yield	%	6,0
Debt to Equity	%	6,0
Net debt / Equity	%	-28,0
Net debt / EBITDA	%	-29,6
ROE (4Q-rolling)	%	18,6
ROA (4Q-rolling)	%	12,8
P/E	%	16,2
P/BV	%	6,4
Price Performance		
52-w range	HUF	16 660-17 910
52-w performance	%	2,33
Relative performance vs BUX	%	-17,5
Relative performance vs BUMIX	%	-106,8
Beta		0,36
Valuation		
DCF		17 781
DDM		17 710
Multiples Analysis		16 518
Analyst		
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Sources: Bloomberg, OTP Research

**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.

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Any information relating to the date and time for the price mentioned in this recommendation is revealed in the part of the recommendation where the given price is indicated.

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

Date	Recommendations	Target Price	Publication
15/12/2017	BUY	HUF 17,668	Initiation of coverage

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

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