EQUITY NOTE: ZWACK UNICUM

Recommendation: HOLD (unchanged)

Target price (12M): HUF 17,000 (revised down)

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We revised slightly down our 12M target price to HUF 17,000 from the previous TP of 17,382 HUF/share for Zwack Unicum (Zwack HB; ZWCG.BU) and maintain the HOLD recommendation.

Zwack's revenues bounced back in April-June 2021 and achieved a skyrocketing growth in July-September as life returned to the normal after the latest, but not last wave of the pandemic. In the past quarter, consumers' demand remained very strong in Zwack's both distribution channels, on-premise consumption recovered very quickly as we could see last summer, while retail consumption is also yet to lose steam, though prices creep higher.

By now, however, pandemic situation has changed again, Hungary has lost its relative advance in mass immunisation and a new wave of infections is building up. Although the economy works with practically minimal restrictions, consumers may become more cautious.

Although Hungary's tourism & restaurant industry recovered quickly (unspent cafeteria plan benefits also support demand) and Zwack gained from this development, the near future seems more uncertain now. The rising number of covid patients in hospitals may necessitate re-imposing restrictive measures in Hungary.

Considering profitability issues, Zwack had to tackle growing raw material and packaging costs, and strengthening wage dynamics may also pose a risk to maintaining the usual profitability level. Supply and freight capacity shortages may also hinder regular operation, as it happens in other manufacturing industries. Regulatory risk and rising inflation are also factors that must be closely monitored. Our forecast assumes moderate profitability rates.

The change in the MNB's monetary stance stopped the depreciation trend of the HUF. As a consequence, the strengthening HUF may temper the price increase of imported raw materials and packaging, but at the same time, it stops supporting Zwack's HUF-denominated export performance. Considerable changes in our yield forecast had a downside effect on the discounted cash flows.

We expect EBIT to increase to HUF 2.3bn in the current business year (1 April 2020 –31 March 2022) from 1.8bn in 2020/2021. EPS is expected to increase to 884 HUF/share in 2021/2022 and to HUF 926 in 2022/2023 from the previous year's HUF 706.

Our current target price is 1.2% higher than the HUF 16,800 closing price on 9 November 2021, the day Zwack's earnings report was released. Expected total return is 5.4% on a 12-month horizon. We assume 90% payout ratio as Zwack returns to 'business as usual' as economies normalise.

Summary/Earnings Highlights

- Zwack reported outstanding HUF 4.4bn net sales revenue in July-September 2021, getting closer and closer to years before the pandemic. Top-line quarterly growth was 29% YoY after registering 55% YoY growth in the previous quarter.
- The current FY's cumulative net sales revenues grew to HUF 8.0bn, a level not seen for more than a decade.
- Domestic sales revenues struck to new highs (+27% YoY) and gave evidence that the catering industry, hit by previous restrictions, and coupled with strong demand, is able to bounce back quickly as covid measures were withdrawn and Zwack Unicum became an obvious beneficiary.
- Export revenues in HUF terms surged 40% YoY, increasing slightly slower than in the previous quarter (46%) as exports to Italy heated up, airline travel is taking off and some HUF weakening also added to HUF-denominated growth.
- Profitability rates also remained at a high level registered in April-June 2021, and some rates even improved both in yearly and quarterly comparison, with EBIT rate jumping to 25% and EBITDA rate leaping to 28%.
- We maintain our optimistic assessment of future sales growth, even though we are aware of the downside risks that may negatively affect our forecast. We updated the domestic sales forecast and slightly revised up the forecast on export revenues, in line with recent expectations of consumption growth in the EU and earnings releases of Zwack's European peers. Our updated model also reflects the significant rise in yields in the past quarter. In the current business year, we expect net sales revenues to climb to HUF 15.5bn, representing 19% top-line growth. The EPS of the current FY is expected to rise to 884 HUF/share, from last year's HUF 706.
- The new HUF 17,000 target price reflects our expectations for the next 12 months including that risks related to new covid variants and its consequences still linger. We maintain the previous HOLD recommendation.

Financial highlights of Zwack's FQ2 2021/2022 earnings report

Financial Q1 (HUFm)	July-Sep 2021	July-Sep 2020	YoY Change
Domestic sales	3 802	2 992	27%
Export sales	578	414	40%
Net sales income	**4 380**	**3 406**	**29%**
Material-type costs	1 594	1 288	24%
Gross profit	**2 786**	**2 118**	**32%**
Employee benefits	734	636	15%
Depreciation	139	117	19%
Other operating expenses	1 017	680	50%
Total operating expenditures	**1 890**	**1 433**	**32%**
Other incomes	193	124	56%
EBIT	**1 088**	**806**	**35%**
EBITDA	**1 228**	**925**	**33%**
Pre-tax profit	1 088	806	**35%**
Tax	**176**	**21**	736%
After-tax profit	**913**	**785**	**16%**

Financial Q1 (HUFm)	Apr-June 2020	Apr-June 2019	YoY Change
EPS (HUF)	**281**	**-16**	**-1856%**
4Q-rolling EPS (HUF)	**1 002**	**704**	**42%**
Gross profit rate	**66.9%**	**62.1%**	**4.7 pp**
Operating profit rate	**18.2%**	**0.9%**	**17.3 pp**
EBITDA rate	**21.9%**	**5.9%**	**16.0 pp**
ROE	**8.7%**	**-0.6%**	**9.2 pp**
4Q-rolling ROE	**34.8%**	**26.3%**	**8.5 pp**
ROA	**4.2%**	**-0.3%**	**4.5 pp**
4Q-rolling ROA	**15.0%**	**11.7%**	**3.3 pp**

Sources: Zwack Unicum, OTP Research

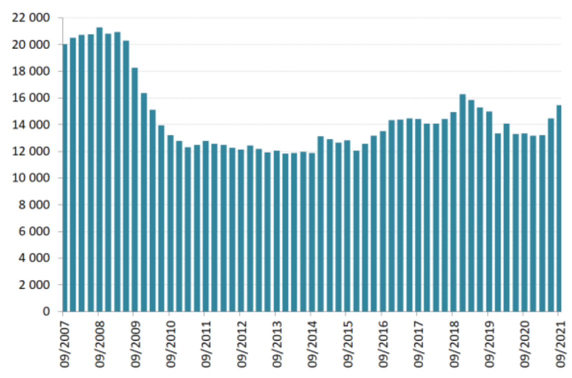
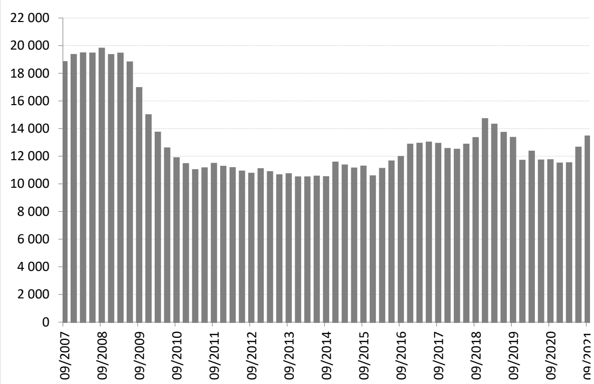
Outstanding sales performance again, even compared to a strong base period

Zwack reported sky-rocketing HUF 4.4bn net sales revenue in July-September 2021. Quarterly top-line growth was 29% YoY as restrictions were fully withdrawn by the summer and domestic tourism geared up in the holiday season.

Thanks to these positive developments, the on-premise channel could work as in 'usual' times, supporting the growth of domestic revenues. Inland sales rose to HUF 3.8bn, 27% higher than in the strong base period one year ago. Sales in the retail channel increased beyond expectations, as Zwack reported, although market research data for April-September show some slowing in the cumulative growth compared to April-June figures. Beyond doubt, Hungary's retail market of spirits expanded by 11.7% YoY in real terms and 17.8% in value.

In terms of product groups, revenues of Zwack's own manufactured products grew 24% YoY, and revenues from the traded product portfolio increased 35% YoY. In the previous quarter, both product groups showed over-50% revenue growth.

Export revenues jumped 40% YoY in the past quarter as exports to Italy doubled and sales of Unicum to Romania remained outstanding. At the same time, duty-free sales steadily recovered as airline traffic picked up.

12M total net sales revenues (HUFm)	12M domestic net sales revenues (HUFm)
	
Sources: Zwack Unicum, OTP Research	*Sources: Zwack Unicum, OTP Research*

Profitability remained at high level not seen in a long time

Zwack seems to manage to a certain extent the increase of material-type costs, however these items rose 24% YoY after a 36% hike in April-June. The 2% HUF weakening, when comparing quarterly averages, also added somewhat to the rise of material-type costs.

As costs' hike was not as steep as that of revenues, gross profit increased to HUF 2.8bn (+32% YoY after 67% yearly profit growth in the preceding quarter) and gross profit margin neared 64%. It definitely reflects an improvement in a yearly comparison, although the gross profit rate slightly decreased from the 67% registered in April-June 2021. The dominance of the own-produced high-margin goods in the revenues helped keep profit margins high again.

The double-digit increase in payroll expenses, and growing depreciation due to the installation of new machinery in the Dunaharaszti plant contributed to the considerable increase in operating costs (+32% YoY). As business activities returned to the normal, marketing expenditure rose steeply (+50% YoY) compared to last year, when marketing activities had been postponed. After the third wave of the pandemic, Zwack managed to launch its previously postponed marketing campaign, including the one in Italy, the company announced. Higher freight costs also added to the considerable growth of other operating expenses.

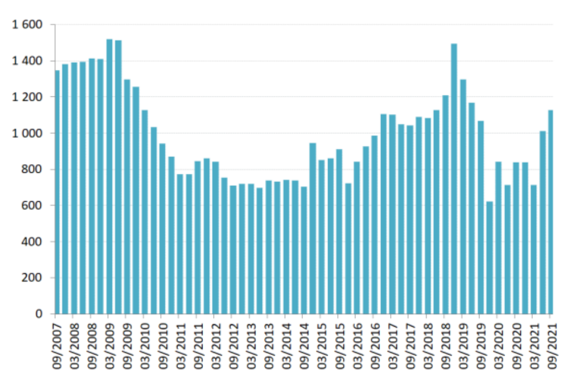
All in all, EBIT jumped to near HUF 1.1bn, from HUF 808m one year ago. EBIT margin climbed to 25%, and EBITDA rose to 28% from 24% and 27%, respectively in July-September 2020.

Considering profitability in the two main segments, the quarterly EBIT rate of manufactured products remained high (well over 20%) and moved even higher compared to the April-June period. However, on a yearly basis it slightly deteriorated (27.5% vs. 28.3%). The EBIT margin of traded products leaped to near 16%, a multi-year high.

Zwack also announced that after the full repayment of HUF 2.5bn loan facility, the company got a HUF 1.5bn stand-by loan for the current business year to ensure the company's financial stability in the current unpredictable environment. As the company reported, interest expenses of the loan and the interest incomes of time deposits are closely at par.

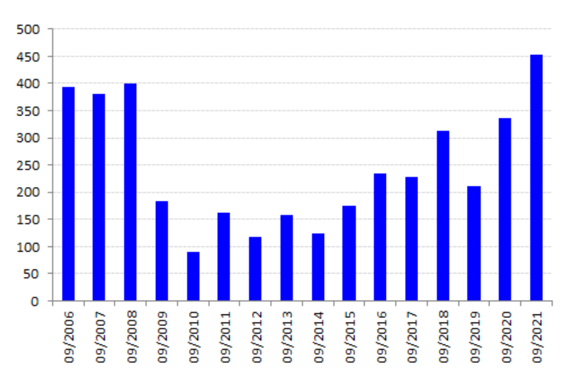
After taxation, net profit climbed to HUF 923m in July-September, from HUF 571m in April-June 2021. YoY quarterly net income grew by a third. EPS rose to HUF 454, the highest value in more than 10 years, when comparing these periods of the year.

12M-trailing EPS is at the pre-pandemic level (HUF)



Source: Zwack Unicum, OTP Research

Quarterly EPS in the past individual FQ2s (July-September periods)



Source: Zwack Unicum

Comments

- Zwack's quarterly sales figures surpassed our not-so-moderate forecast and the company's own expectations and plans as well. Although we expected double-digit sales growth compared to a strong base period one year earlier, Zwack was able to surpass it.
- Strong consumer demand both in the retail segment and the on-premise line supported the expansion, as the pandemic restrictions of the previous months practically vanished. The summer holiday season witnessed strong domestic tourism demand and was also boosted by international events like UEFA Euro 2020.
- The increase of domestic revenues must be also outstanding in real terms. Although Zwack raised prices from January 1 2021, it does not seem to have dented demand. According to market research data, off-premise market increased 11.7% YoY in real and 17.8% in nominal terms, reflecting some slowing in the July-September period.
- The fact that immunisation in Hungary reached an elevated level relatively early in European comparison was a main driver helping the battered hospitality and other service industries to recover, starting from the second half of calendar Q2 2021. Strong and pent-up demand is also supported by employees' yet unspent cafeteria plan benefits.
- Since the summer however, Hungary's advantage in immunization has melted, though the government is reluctant to introduce harsh restrictions in the fourth

wave of the pandemic. As a result, some uncertainty lingers around the economic developments in the short to medium term. The pandemic has not ended, and it may have a longer-term effect on consumer demand.

- Future local and/or periodic lockdowns are not out of the question. Stronger price pressure is coupled with wage increases, rising energy and freight costs. Companies have to deal with freight capacity issues as well, and growing raw and packaging material prices may also harm profitability. Raw material and/or packaging material shortages may even hinder production and sale. In this environment, the weakening HUF also adds to FX-denominated costs, although on the revenue side it may offset somewhat the negative effects. More cautious consumer behaviour also adds to downside risks.

Valuation

- We slightly revised up our revenue forecast to HUF 15.5bn in the current financial year (2021/2022) as the export performance is well beyond expectations. In the past two quarters, Zwack benefited from the gradual easing of restrictions, as well as from the quick recovery of domestic tourism and restaurant businesses, as expected.
- The return of international tourism and thus the revival of the duty-free segment, along with very dynamic export growth in Italy boosted Zwack's export sales.
- We do not forget the risks our forecast bears: future sales growth is subject to downside risk stemming from the emergence of new covid variants that may undermine the ongoing recovery. Higher inflation pressure may consume purchasing power in the worst case, while regulatory risk is also a factor that may dent profitability. Raw and packaging material issues may hurt profitability; in line with this expectation, we slightly decreased the expected profit margins in our forecast.
- With the Hungarian economy returning to the path of recovery, and inflation coming to the fore, the MNB had earlier flagged the possibility of base rate hikes. In the past months, the national bank raised steadily interest rates, arriving to 1.8% by the beginning of November, and further increases are expected in the short run.
- The tightening of monetary conditions aims to fend off rising inflation and at the same time stops the long depreciation trend of the HUF that has characterized the market. As a consequence, the strengthening HUF stops supporting Zwack's HUF-denominated export performance, while on the cost side it will have the opposite effect.
- Our estimate for the current and next business year's EBIT stands at HUF 2.3bn and HUF 2.6bn, while EPS is expected to increase to 884 HUF/share (FY 2022/2021) and 926 HUF/share (FY 2023/2022).
- We revised somewhat down our target price to 17,000 HUF/share from the previous 17,382 HUF/share. We modified the discount rate in our valuation

models as long-term yields considerably rose in the past months. Accordingly, our DCF (FCFE) model indicates 17,268 HUF/share 12M target price, while the valuation from DDM reflecting future dividend payments suggests 16,990 HUF/share 12-month target price. In our DDM we applied 90% theoretical payout ratio for the current business year, while the latest AGM approved 700 HUF/share dividend for the past business year (FY 2020/2021).

- Our target price of 17,000 HUF/share is 1.2% higher than the HUF 16,800 closing price on 9 August 2021, the day Zwack's quarterly earnings report was released. The 12-month estimated total return is expected to be over 5%. We maintain the previous HOLD recommendation.

Deduction of 12M TP

Zwack's valuation (HUFm)	Base Year 2019/2020	2020/2021	2021/2022*	2022/2023*	2023/2024*	2024/2025*	2025/2026*	FCFE in the explicit period
FCFE	2 264	253	2 983	2 007	1 580	2 054	2 802	
Discount factor	0,92	0,91	0,92	0,90	0,90	0,89	0,89	
DCF	2 076	231	2 733	1 659	1 172	1 363	1 662	8 589
Terminal Value (HUFm)								36 535
Net Present Value - FCFE (HUFm)								29 986
Net debt								-2 208
Equity value (HUFm)								32 194
Number of shares								2 035 000
Expected return on equity								9,2%
12M Target price (DCF)								17 268
12M Target price (DDM)								16 990
12M Weighted Target price (HUF) - Dec 31, 2021								**17 000**
Closing price on 09.11.2021								16 800
Upside/Downside								1,2%
TR Upside/Downside								5,4%

Source: OTP Research

Profit & Loss Statement (HUF m)	2018/2019	2019/2020	2020/2021	2021/2022F	2022/2023F	2023/2024F
Domestic net sales	14 238	12 281	11 442	13 730	14 569	15 136
Export sales	1 501	1 679	1 641	1 805	1 877	1 915
Net sales income	15 739	13 960	13 083	15 536	16 446	17 051
Material-type costs	5 723	5 287	5 149	6 230	6 728	6 991
Gross profit	10 016	8 673	7 934	9 306	9 718	10 060
Total operating expenditures	7 355	6 965	6 509	7 393	7 588	7 649
EBIT	3 079	2 169	1 787	2 337	2 578	2 876
Pre-tax profit	3 210	2 184	1 780	2 337	2 447	2 616
Tax	460	488	344	537	563	602
Profit after tax	2 750	1 696	1 436	1 799	1 884	2 015
Dividend	2 442	611	1 425	1 619	1 696	1 813
EPS (HUF)	1 288	833	706	884	926	990
DPS (HUF)	1 200	300	700	796	833	891

Balance sheet (HUFm)	2018/2019	2019/2020F	2020/2021F	2021/2022F	2022/2023	2021/2022F
Property, plant, equipment	3 330	3 336	3 442	3 150	2 986	3 158
Intangible assets	84	102	85	83	75	100
Non-current assets	3 582	3 585	3 652	3 405	3 239	3 444
Inventories	2 386	2 661	2 800	3 231	3 649	3 819
Recievables and other current assets	2 115	3 007	2 617	3 696	4 102	4 193
Cash and cash equivalents	3 064	2 709	3 989	3 526	3 034	2 873
Current assets	7 565	8 377	9 406	10 634	10 862	10 566
TOTAL ASSETS	**11 147**	**11 962**	**13 058**	**14 039**	**14 101**	**14 009**
Share capital	2 000	2 000	2 000	2 000	2 000	2 000
Capital reserve	165	165	165	165	165	165
Retained earnings	4 915	4 011	4 847	5 222	5 487	5 805
Total Equity	**7 080**	**6 176**	**7 012**	**7 387**	**7 652**	**7 970**
Long-term loans and other liabilities	472	453	531	400	384	369
Non-current liabilities	472	453	531	400	384	369
Loans and credits	0	1 250	1 250	1 500	1 500	1 000
Payables and other short-term liabilities	3 567	4 071	4 255	4 678	4 462	4 566
Current Liabilities	3 595	5 333	5 515	6 252	6 065	5 670
TOTAL EQUITY AND LIABILITIES	**11 147**	**11 962**	**13 058**	**14 039**	**14 101**	**14 009**

CONSOLIDATED CASH FLOW (HUFm)	2018/2019F	2019/2020F	2020/2021F	2021/2022F	2022/2023F	2023/2024F
EBITDA	3 643	2 646	2 311	2 895	3 109	3 244
Cash flow from operation	3 215	1 482	850	3 024	2 485	2 893
Cash flow from investment	-655	-480	-591	-291	-478	-814
FCFF	2 560	1 002	259	2 733	2 007	2 080
FCFE	2 563	2 264	253	2 983	2 007	1 580

Sources: Zwack Unicum, OTP Research

Risks surrounding Zwack's economic activity

Covid effect: Although Zwack operates in the non-cyclical consumer sector, a considerable part of demand for Zwack products comes from the catering and event business, the sectors that took the biggest blow from covid-19. While the pandemic had a positive effect on Zwack's sales performance in the January-March 2020 period, April 2020 sales plunged. With restrictions lifted, Zwack's revenues showed quick recovery in Q3, but September 2020 was also somewhat depressed in the wake of the second wave of the pandemic. With on-site consumption prohibited and night curfew introduced, the new restrictions implemented in November added a further blow to the restaurant industry. Zwack lost a considerable part of its on-trade revenue in the past two quarters of FY 2021/2020 while in terms of export, duty-free sales also plunged due to very subdued air travels. With mass immunisation at elevated level by May 2021 and reopening already having started, the outlook for economic recovery has improved. Q2 figures showed impressive recovery and Q3 2021 was expected to witness considerable rebound as more and more industries contributed to the aggregate economic growth. The hospitality sector revived again and Zwack became one of the recovery's beneficiaries. However, as it was expected, new covid variants popped up; the increasing number of coronavirus cases reflects that Hungary entered the fourth wave of the covid pandemic, which may endanger the expected and persistent recovery, and pose considerable downside risks to our forecast.

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 criticised Hungary's discriminative taxing policy of spirits, and threatened to start infringement procedure against Hungary. The latest regulatory changes (increase of NETA), which took effect on 1 January 2019, were aimed to resolve this conflict with the EU and boost budget revenues at the same time.

In the summer of 2020, the EU's decision-making body modified the initiative on the taxation of home distillery of 'pálinka'. Under the new regulation, every citizen of full age in the EU is entitled to distil tax-free 86 litres of fruit spirits a year. The new regulation took effect in Hungary on 1 January 2021.

Exchange-rate risk: As the company operates in foreign markets as well, and the share of exports among revenues is increasing, in case of HUF appreciation, the exchange rate risk can be an issue, if not managed properly. The HUF's weakening poses more risk on the cost side, as most of Zwack's raw material prices are EUR-denominated, 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.

Currently, as the Hungarian economy returned to the path of recovery, and as inflation came to fore, the MNB started a rate-hiking cycle and raised the base rate from 0.6% to 1.8% in five steps. That is also aimed to reverse the HUF's weakening trend. The tightening of monetary conditions causes gradual HUF appreciation and as a consequence, the strengthening HUF stops supporting Zwack's HUF-denominated export performance.

Cost-inflation risk: Due to the improving economic conditions and labour shortages in various industries, real wages started to increase significantly several years ago and kept rising since then. With the imminent and fast post-covid recovery of the Hungarian economy, the unemployment accumulated due to the pandemic may get absorbed very quickly, and result in tight labour market. This will further strengthen wage dynamics, which did not really lose steam even in the period hit by the pandemic. Further increasing payroll expenses may dent profitability again.

Zwack's latest earnings report indicated that, as an economic consequence of the epidemic, the company experienced rising prices of raw and packaging materials. Zwack considers this development a commodity risk, and estimates it to be at 2% of raw material and packaging expenses this year, but in the longer run, costs may easily increase by 7–8%.

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:

Period	Recommendation	% of recommendations
Q4 2020	BUY HOLD SELL	0 100 0
Q1 2021	BUY HOLD SELL	0 100 0
Q2 2021	BUY HOLD SELL	0 100 0
Q3 2021	BUY HOLD SELL	0 100 0

Date	Recommendation	Target Price	Publication
15/12/2020	HOLD	HUF 17,083	Quarterly Earnings Update
05/02/2021	HOLD	HUF 17,083	Quarterly Earnings Update
27/05/2021	HOLD	HUF 17,054	Quarterly Earnings Update
06/08/2021	HOLD	HUF 17,382	Quarterly Earnings Update
10/11/2021	HOLD	HUF 17,000	Quarterly Earnings Update

The list of all recommendations made in the past 12 months is available here.

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