

We initiate coverage on Unity Foods Limited (UNITY) with a Dec'21 target price of PKR 54.4/share, representing an upside of 41.7% from last day's closing. Our investment case is hinged upon:

- Transformation from an edible oil company to a complete staple food company
- Aggressive expansion plans in the company's edible oil refinery, chemical refinery, fractionation plant and flour mill
- Continued focus to augment market share in the high margin consumer packs segment, and
- Investment in a fractionation plant, chemical refinery, shortening and margarine plant as well as diversification in the production of soap products.

With that said, Unity is now the 2nd largest listed consumer company in Pakistan in terms of sales. At current levels, Unity is trading at the cheapest price to sales ratio in the listed food sector while its forward PE ratio (FY22F / FY23F of 8.1x / 6.6x) also appears enticing. Therefore, we recommend 'BUY'.

Edible Oil (Vanaspati) to complete staple food company

With the aggressive mind set of management and robust expansion plans, the company has taken little time to achieve major milestones and managed to set strong footprints in the edible oil and flour market of Pakistan (by acquiring 69% of shares in Sunridge foods). Furthermore, company has obtained approval from its shareholders to make further equity investment of up to PKR 461mn to acquire remaining 31% of shareholding in the Sunridge, which will make Sunridge a wholly owned subsidiary of the company. After witnessing significant success in edible oil and flour business, the management is considering entry into the rice business through acquisition or by setting up new rice mill in Pakistan. This transaction will take Unity a step closer to becoming a complete staples food company. The company intends to diversify its business further by setting up a new soap factory and start business of pulses or other food related products. We believe the diversification strategy will increase earnings outlook of the company and also act as a trigger for the stock price of the company.

Triple Digit Growth in Profitability

That said, we expect Unity to continue posting massive growth in profitability going forward due to the fact that the company enjoys a strong customer base, experienced management, concrete liquidity position, state of the art machinery, alongside its upcoming expansion in refinery, fractionation plant, soap, wheat and rice. We expect profitability of the company to grow at 3-yr CAGR of 201%.

Exhibit: 01

Valuation Snapshot

		FY20A	FY21E	FY22F	FY23F
EPS	PKR	0.2	3.8	4.7	5.9
DPS	PKR	-	0.5	1.0	1.0
Dividend Yield	%	-	1.4	2.6	2.6
P/E	x	51.7	10.1	8.1	6.6
P/B	x	1.0	2.8	2.2	1.7

Source (s): Company Financials, AHL Research

	UNITY PA
Recommendation	BUY
Target Price (Dec'21)	54.4
Current Price	38.4
Upside (%)	41.7
Shares (mn)	994
Market Cap. (PKR mn)	38,152
Market Cap. (USD mn)	250

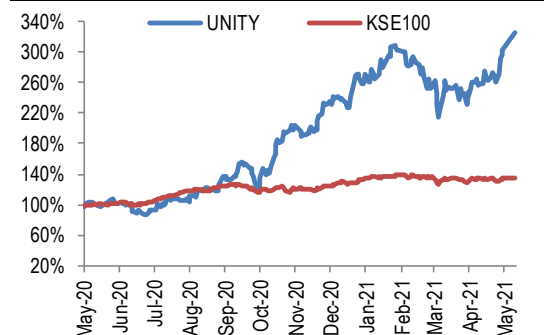
Major Shareholders

- Directors, Chief Executive Officer and their Spouse

Price Performance

	3M	6M	12M
Return (%)	12.5	67.9	219.3
Avg. Volume (mn)	21.0	21.8	22.9
High Price - PKR	38.4	38.4	38.4
Low Price - PKR	25.3	22.4	10.3

Relative Performance



Source: Bloomberg

Analyst:

Arsalan Hanif

D: +92 21 3246 2589

UAN: +92 21 111 245 111, Ext: 255

F: +92 21 3242 0742

E: arsalan.hanif@arifhabiltld.com

www.arifhabiltld.com

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Valuation

Our Dec'21 target price (including DCF, P/S and P/E) for the company works out to PKR 54.4/share, which translates into an upside potential of 41.7% from last closing of PKR 38.4/share. Our valuation parameters include beta of 1.4, risk free rate of 9% and a risk premium of 6.0%, which brings cost of equity to 17.4%. Hence, we have a 'BUY' call on the scrip. Currently the stock is trading at FY22F and FY23F P/E of 8.1x and 6.6x, respectively. While dividend yield of the company is expected to settle at 2.6% for FY22F.

Exhibit. 02	Valuation Criteria
Risk Free Rate	9.0%
Beta	1.4
Risk Premium	6.0%
Cost of Equity	17.4%

Source (s): AHL Research

Exhibit. 03	Valuation Snapshot				
PKR mn	Jun-22	Jun-23	Jun-24	Jun-25	Jun-26
Profit after tax	4,710	5,820	6,337	7,053	7,702
Add: Depreciation	309	536	612	675	688
Interest expense (net of taxes)	789	678	578	475	411
Capital Expenditure	(3,545)	(2,126)	(1,881)	(888)	(856)
Changes in Working Capital	(518)	(933)	(956)	(746)	(733)
Free Cash Flow to Firm	1,746	3,974	4,691	6,569	7,213
Discounted Values	1,640	3,246	3,286	3,919	3,649
Sum of PV	15,741				
Cash	5,610				
Debt	13,953				
Terminal Value	35,888				
Equity Value	43,286				
Outstanding Shares (mn)	994				
Value Per Share	43.5				

Source (s): AHL Research

We have used three different methodologies to arrive at a target price of PKR 54.4 which includes P/E valuation, Price to sales valuation and Discounted Cash Flow valuation.

Exhibit: 04	Valuation Methodology			
	LTM PE	LTM PS	DCF	Average
UNITY Multiples	13.1	0.6		
Average Sector Multiples	26.0	2.1		
Discount	40%	40%		
Multiple (after discount)	15.6	1.2		
Target Price	46.0	73.7	43.5	54.4

Source (s): Company Financials, AHL Research

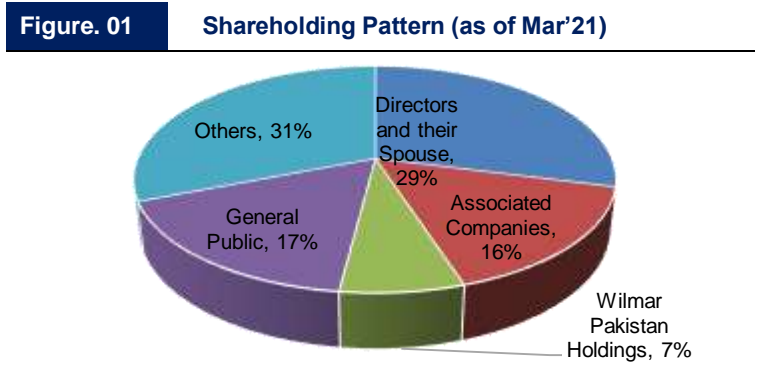
About the company: “Achieving Great Result in Such a Short Span”

Unity foods took over Taha Spinning Mills in May 2017 and the name was officially changed to Unity Foods Limited in October 2017. Taha Spinning Mills suspended its yarn manufacturing business in 2008 due to volatility in the prices of raw cotton. As a result, they reduced their quantum of operations to offset the heavy losses and liquidity crunch it faced. The company was unable to recover its losses and decided to completely close down its mill in 2012. After four years, the company decided to change its business nature. This resulted in a takeover process in 2016. After the successful takeover process, the company was established with the key purpose of edible oil extraction and its sale, along with the introduction of a new cooking oil brand in local market. Moreover, the company also deals in animal feed meal and specialty fats. Both these segments contribute more than ~20% of sales revenue of the company.

Unity aims to fulfill basic food needs of human life and as part of consumer food staple strategy, the company acquired a stake in Sunridge foods that produces fortified flour in Pakistan. The company also plans to start pulse business and to acquire a rice mill in Pakistan. Along with this, the company is also setting up a soap plant and margarine facility in Pakistan.

Exhibit. 05 Shareholding Pattern (as of Mar'21)		
	No of Shares*	% of Shares
Directors and their Spouse	288	29%
Associated Companies	159	16%
Wilmar Pakistan Holdings	70	7%
General Public	169	17%
Others	308	31%

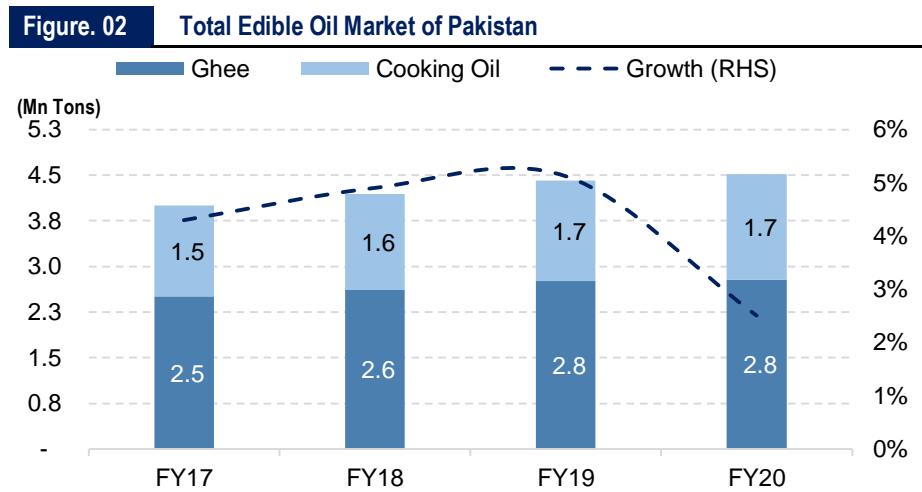
Source (s): Company Financials, AHL Research



Source (s): Company Financials, AHL Research

Industry Overview:

Pakistan is one of the top edible oil importing countries in the world with per capita consumption of about 21kg. Total consumption of oil and fats is about 4.5mn tons. Import of palm oil contributes around ~90% of total edible import while rest of the share goes in the bag of soybean oil imports. There has been a significant increase in import of soybean oil due to growing awareness and is also consumed by poultry sector of Pakistan as vegetable proteins for feed. During last 4 years, we have witnessed average growth in demand by 4% in the overall market (including ghee and cooking oil). We expect demand of edible oil to increase by 4% to 4.7mn tons in 2021. However, drastic increase in international palm oil prices from current levels will dampen demand going forward.



Source (s): AHL Research

Palm Oil Prices Trading at 11 Year High

International palm oil prices reached 11-year high levels amid Covid-19 outbreak which affected production levels of the world’s major producers as workforce was reduced to contain spread of the pandemic. Global demand of palm oil is increasing while decline in production level is putting pressure on palm oil prices. However, we may have witnessed slowdown in international palm oil prices as India is the world’s largest edible oil importer and Indian edible oil industry is decreasing import of palm oil due to Indian government imposing restrictions which reduced consumption of edible oil in the country. Despite production levels showing signs of improvement, we believe prices of palm oil to hover around USD 900-1000/ M.Tons due to demand growth being higher than production growth which will keep palm oil prices stable at current levels.

Figure. 03 Trend of International Palm Oil Prices

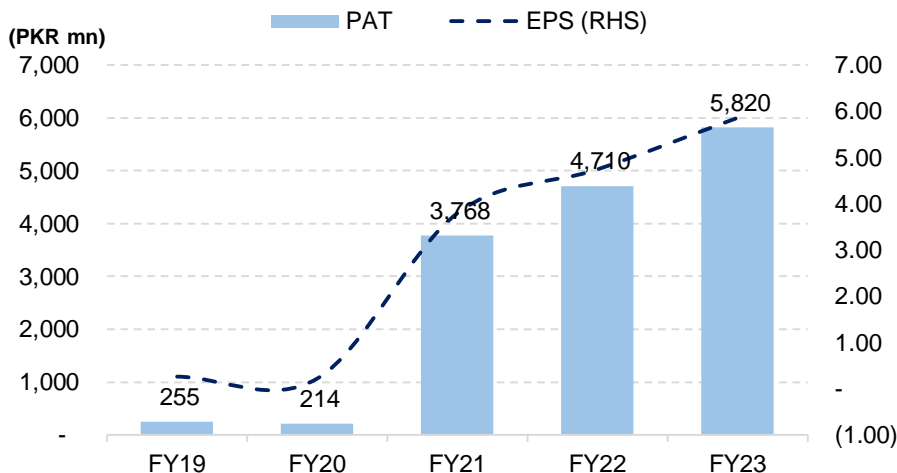


Source (s): Bloomberg, AHL Research

Exceptional Earnings growth

The company has displayed exceptional earnings growth led by its business strategy, collaboration with Asia’s largest edible oil player (Wilmar) and its diversified operations. The bottom-line of the company increased from PKR 210mn in FY20 to an expected PKR 3,768mn in FY21. Surge in international palm oil prices has helped the company to earn healthy margins along with increase in demand of consumer packs which is a high margin product. We expect company to maintain its growth momentum given strong liquidity position, diversification plans, rising footprint, growing customer base, growth in local edible oil market (3% per annum) and increasing reach of company’s branded oil sales. We view that edible oil (including ghee sales) is likely to remain the major contributor to the topline by maintaining contribution of more than 80%. Bottom line of the company is projected to grow at a 5-yr CAGR of 101%.

Figure. 04 Earnings to Witness Double Digits Growth



Source (s): Company Financials, AHL Research

Expansion: A Signal of Future Growth

Unity has aggressive plans to increase its edible oil refining capacity, flour production capacity (recently added 170MT/day plant), production of soap and related products (plant is currently under testing phase), acquisition of rice mill, Chemical refinery, Fractionation plant, margarine and shortening plant, and oil storage terminal which will reduce reliance on rental storage facility. Currently, the company has two oil refineries one is at SITE area (this refinery produces soft oil using oil seeds having a capacity of 150MT/day), the other is at Port Qasim (company produces Palm Oil and Palm Olien by using imported crude palm oil with a capacity of 500MT/day). This takes overall capacity to 650MT per day (which is yet to be completely utilized as it is currently operating at capacity utilization of 65-70%).

The company also has a solvent extraction plant at Kotri with crushing capacity of 450MT/day. This plant crushes oil seeds and the by-product of crush seeds becomes animal feed which is sold in local markets.

Unity is the largest importer of Palm Kernel Expeller (PKE), importing from Malaysia and Indonesia. The company is selling animal feed under a brand name of "PURE" and caters to a huge portfolio that includes Palm Kernel Expeller, Palm Kernel Pellets, Soybean Meal Hi-Pro, Soybean Meal Low-Pro, Soya Pellets and Canola Meal. Animal Feed segment contributes around 15% of overall sales due to high demand from livestock, and growing awareness of farmers to boost milk production capacity of dairy cows.

Unity also has a ghee manufacturing facility at Port Qasim which is also known as hydrogenation plant. The company is planning to double its hydrogenation capacity.

Sunridge foods is a subsidiary of the company having a stake of 69% which produces a wide range of fortified flour in Pakistan having a total capacity of 300MT/day, earlier it was 130MT/day. We expect Sunridge sales to stand at PKR 3.5bn in FY21 and will increase to PKR 10bn by FY23. The growth in sales of purified Chakki Atta will also improve the bottom-line of the company as gross margin of Sudridge food is around ~15%.

Furthermore, other plans include setting up Fractionation plant (which is expected to commence operation from 3QFY22), new chemical refinery with a capacity of 200MT/day for production of Canola and Soybean oil (expected to commence operations from 3QFY22), oil terminal facility with a capacity of 45,000 MT to maintain inventory at optimal levels (expected in 3QFY22), and Soap Production plant which has already started its test run.

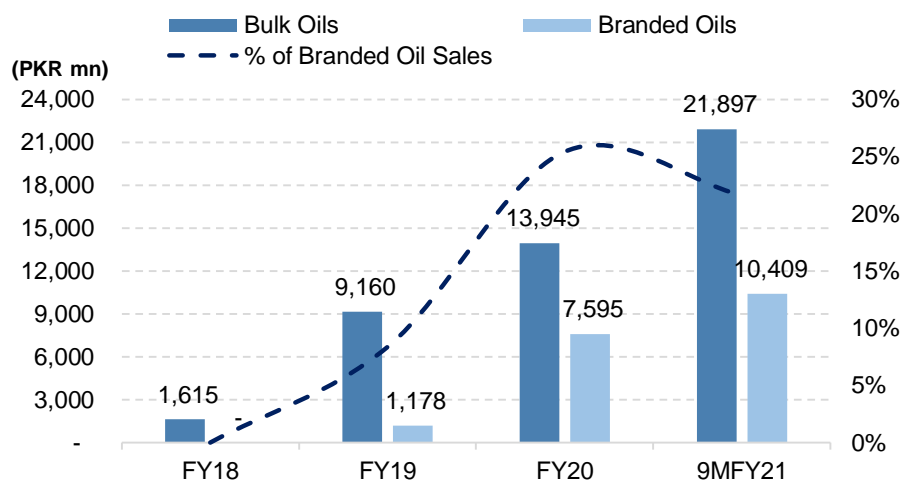
Company is also planning to add margarine and shortening plant with a capacity of 12,000 tons per annum which is expected to start from 4QFY22. After commencement, this plant will contribute PKR 2.2bn in sales during FY23 while gross margin is expected between 10-15%.

Moreover, management is also aggressively following its diversification strategy by planning to acquire rice mill in Pakistan and further plans to expand its portfolio by looking for new joint ventures.

Focusing to Capture Consumer Packs Market share

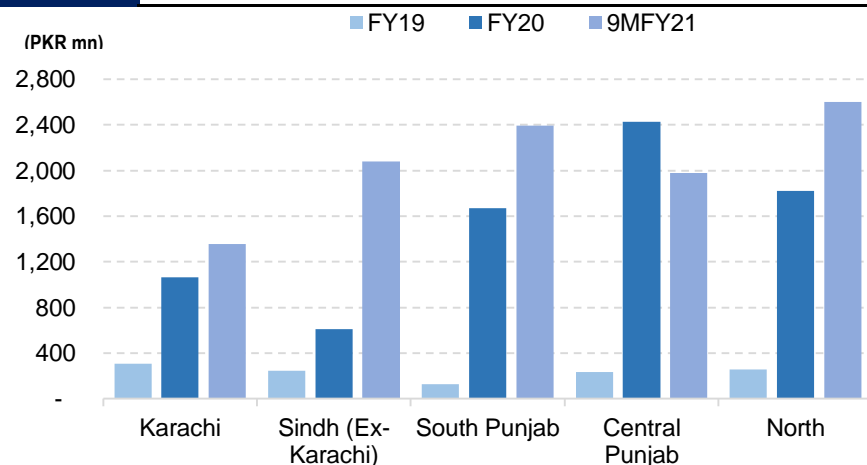
Management intends to increase penetration of its branded oil products in the market by aggressive marketing strategies (through PSL and TV commercials) of its premium product quality brand (DASTAK). The company is also increasing its geographic footprints and distribution network all over Pakistan. This approach will provide an opportunity for the company to take away market share from other players and will also give tough competition to existing players located in Punjab. Current market share of consumers packs in Sindh stands around 30-33% of total sales, around 40-43% in South and Central Punjab, and 26% share of Northern areas (KPK). Improvement in branded oil sales will increase gross margins of the company as consumer pack products are much higher margin products compared to bulk oil sales. The gross margin on bulk oil sales is approximately 6-7% while gross margin on consumer pack products is around 11-12%.

Figure. 05 Contribution of Branded Oil Sales



Source (s): Company Financials, AHL Research

Figure. 06 Regional Sales of Consumer Packs



Source (s): Company Financials, AHL Research

Efficient Distribution Network Allows Faster Growth

The management of the company is targeting to improve its distribution network which allows for wider customer reach because it will improve products reach to end consumers and also allow the company to expand its geographic footprints. The company achieved enormous growth in expansion of distribution network which will increase product visibility and increase customer base of the company. The company is currently supplying its products all over Pakistan including 254 regions, 489 distributors and supply to over 47,000+ retail shops. This approach will not only improve branded oil sales (which is a high margin product) of the company but will also add new industrial customers in company's customer books.

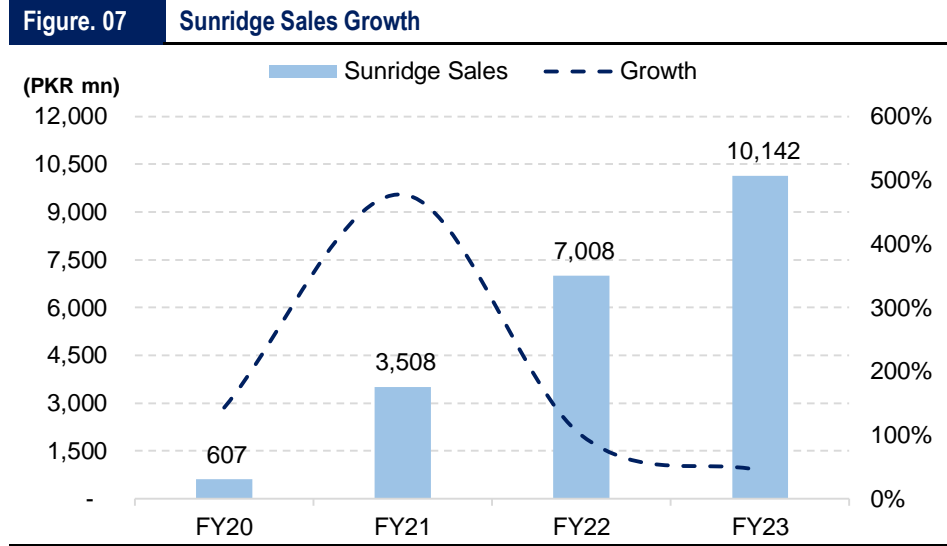
Exhibit. 06 Distribution Network

	Region	Distributors	Retail Outlets
Karachi	6	106	5,093
Sindh	84	119	5,047
South Punjab	32	48	7,165
Central Punjab	60	110	12,519
North	70	104	12,145
Others	2	2	5,209
Total	254	489	47,178

Source (s): AHL Research

Sunridge to contribute more than 10% of sales by FY23

Sunridge food is the only company which is producing a wide range of flour (Whole Wheat Atta, Fortified Atta, High Fiber Atta, Safaid Chakki Atta, Super Fine Atta, and Maida) in Pakistan. The unique selling point of Sunridge is Fortified flour which is not only free from all kinds of impurities such as dust, chemicals and bacteria but also equipped with all the essential vitamins and minerals. It is prepared in state-of-the-art PESA Mill (a Swiss technology introduced for the first time ever by Unity Foods in Pakistan). The current PESA mill flour production capacity is 130/MT a day and it is roughly operating at 80% of capacity utilization while newly added capacity of 170/MT a day is in the range of 50% capacity utilization. We expect Sunridge sales to increase to PKR 10bn in FY23 while gross margins of Sunridge food will be around 15%.



Source (s): AHL Research

Unity is now 2nd largest listed consumer company

There has been growing awareness about the health benefits of edible oil compared to other cooking fats which makes Unity one of the top brands in Pakistan as the company has various certifications that assure customers about the quality of their products. During the last three years, Unity has made substantial progress in operations as their sales increased from PKR 2.8bn in FY18 to PKR 69bn expected in FY21, showing a CAGR of 191% while bottom-line is expected to grow at similar pace with a CAGR of 201%. The sales growth is phenomenal which come from higher volumes and massive surge in international palm oil prices. This mammoth growth in revenue makes the company 2nd largest listed consumer company in Pakistan in terms of sales after NESTLE which has a revenue stream of more than PKR 110bn.

Unity trading at cheapest price to sales ratio

We have analyzed data of listed sector companies and found out that Unity is trading at the lowest price to sales ratio of 0.65x compared to industry average of 2.1x. This low ratio implies the stock is undervalued as the market price is not growing at a similar pace compared to growth of the company.

On the basis of price to earnings ratio, Unity food Limited is also trading at lowest price to earnings ratio of 13.1x which is far cheaper than the listed food industry average price earnings ratio of 26.0x. This low ratio indicates that the company share price has massive growth potential.

Exhibit: 07		Comparison with Industry								
Mar-21	Unit	FCEPL	NESTLE	UPFL	SCL	NATF	ISIL	PREMA	UNITY	Sector
Shares	mn Shares	766.6	45.3	6.4	3.9	186.5	66.4	177.5	994.1	
Free Float	mn Shares	76.7	2.3	0.2	0.4	55.9	3.3	44.4	546.7	
Free Float	%	10.0	5.0	3.5	10.0	30.0	5.0	25.0	55.0	
Current Price*	PKR/share	81.2	5,600.0	14,772.0	354.5	200.7	400.0	16.4	38.4	
Market Cap	PKR mn	62,225	253,957	94,097	1,383	37,423	26,543	2,907	38,152	516,686
Gross Margins	%	19.9	30.9	45.7	32.1	30.8	20.2	22.8	8.8	
Net Margins	%	4.7	9.9	28.9	8.4	5.7	5.1	5.6	5.8	
12-M Trailing EPS	PKR	1.1	223.9	701.0	34.1	12.2	26.3	1.2	2.9	
12-M Trailing P/E	x	72.8	25.0	21.1	10.4	16.4	15.23	14.16	13.05	26.0
12-M Trailing P/S	x	1.4	2.1	5.6	0.7	1.6	0.72	0.70	0.65	2.1
BVPS	PKR	11.9	163.2	659.7	163.6	69.1	165.8	16.0	13.3	
P/B	x	6.8	34.3	22.4	2.2	2.9	2.4	1.0	2.9	10.7

Source (s): Company Financials, AHL Research, *17-May-2021

Key Customers of the company

Major customers of the company which contribute approximately 20% of the sales are Pepsi Co, KFC, Hilal, Candyland, Peek Freans, OPTP, and Friesland Campina. Having customer trust in the brand has always been an important factor for the company. The company is also making efforts to enhance its corporate customer base that will increase sales volumes of the company.

Key Supplier Wilmar to Ensure Availability of Palm Oil

The major suppliers of the company are Wilmar, Cargill, Sime Darby, Virgoz Oils and Fats, FGV and IOI Group. In 2017, Unity group entered into an agreement with Wilmar (Asia's largest supplier of Palm Oil), a key supplier of the company that also holds strategic shareholding in the company. Strategic partnership with Wilmar will help the company to develop a complete range of staple food items along with an uninterrupted supply of palm oil at lower price compared to other suppliers.

Key Risks

- Change in policies by regulatory authorities.
- Irrational taxation imposed by the government.
- Drastic slowdown in demand of Edible Oil.
- Any unfavorable movement in PKR/USD leading to imports becoming more expensive.
- The risk of new entrants to capture market share of the company.
- Any further increase in domestic COVID-19 infection ratio may slow down economic activity of the country which poses downside risk for the company.
- Massive slowdown in international palm oil prices.

Key Catalysts

- Diversification in other food related business by setting up new plant or by acquisition of existing facility could be an upside trigger for the company.
- Acquisition of existing or operating edible oil plant in Pakistan could increase market share of the company.
- Further increase in international palm oil prices.
- Favorable movement in PKR/USD.
- Earlier than expected commencement of expansion plans.

Financial Highlights

Unity Foods Ltd. (UNITY)

PKR mn	FY20A	FY21E	FY22F	FY23F	FY24F	Current Price Target Price	38.4 54.4	Upside Recommendation	41.7% BUY	FY23F	FY24F	
						Unit	FY20A	FY21E	FY22F	FY23F	FY24F	
Income Statement Items						Per Share						
Net Sales	30,480	68,610	82,545	89,426	96,475	Earnings	PKR	0.2	3.8	4.7	5.9	6.4
Cost of Sales	28,379	62,537	74,058	79,547	85,359	Earning Growth	%	(16.0)	1,658.7	25.0	23.6	8.9
Gross Profit	2,100	6,073	8,487	9,879	11,116	Dividend	PKR	-	0.5	1.0	1.0	1.5
EBITDA	869	5,135	6,929	8,279	9,348	Book Value	PKR	10.8	13.7	17.4	22.3	27.2
Operating Profit	747	4,901	6,619	7,744	8,735	Valuation						
Financial Charges	548	720	1,111	955	814	P/E	x	51.7	10.1	8.1	6.6	6.0
Profit Before Tax	199	4,181	5,508	6,789	7,921	P/B	x	1.0	2.8	2.2	1.7	1.4
Profit After Tax	214	3,768	4,710	5,820	6,337	Return on Equity	%	3.7	38.7	30.4	29.5	25.8
Balance Sheet Items						Return on Assets	%	1.5	12.2	10.3	11.5	11.4
Paid-up Capital	5,441	9,940	9,940	9,940	9,940	Turnover & Activity						
Total Equity	5,850	13,621	17,337	22,163	27,009	Asset Turnover	x	2.1	2.2	1.8	1.8	1.7
Current Liabilities	12,877	28,895	30,869	30,790	31,128	Current Ratio	x	1.2	1.2	1.2	1.3	1.4
Non-Current Liabilities	216.65	189.61	170.65	153.58	138.23	Margins						
Current Assets	15,127	34,450	36,885	40,024	43,925	Gross Margin	%	6.9	8.9	10.3	11.0	11.5
Non-Current Assets	3,816	8,256	11,492	13,082	14,350	EBITDA Margin	%	2.8	7.5	8.4	9.3	9.7
Total Assets	18,943	42,706	48,377	53,107	58,275	Net Profit Margin	%	0.7	5.5	5.7	6.5	6.6

Source (s): Company Financials, AHL Research

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Arif Habib Limited (AHL) uses three rating categories, depending upon return form current market price, with Target period as December 2021 for Target Price. In addition, return excludes all type of taxes. For more details, kindly refer the following table;

Rating	Description
BUY	Upside* of subject security(ies) is more than +10% from last closing of market price(s)
HOLD	Upside* of subject security(ies) is between -10% and +10% from last closing of market price(s)
SELL	Upside* of subject security(ies) is less than -10% from last closing of market price(s)

* Upside for Power Generation Companies (Ex. KEL) is upside plus dividend yield.

Equity Valuation Methodology

AHL Research uses the following valuation technique(s) to arrive at the period end target prices;

- **Discounted Cash Flow (DCF)**
- **Dividend Discounted Model (DDM)**
- **Sum of the Parts (SoTP)**
- **Justified Price to Book (JPTB)**
- **Reserved Base Valuation (RBV)**

Risks

The following risks may potentially impact our valuations of subject security (ies);

- **Market risk**
- **Interest Rate Risk**
- **Exchange Rate (Currency) Risk**

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