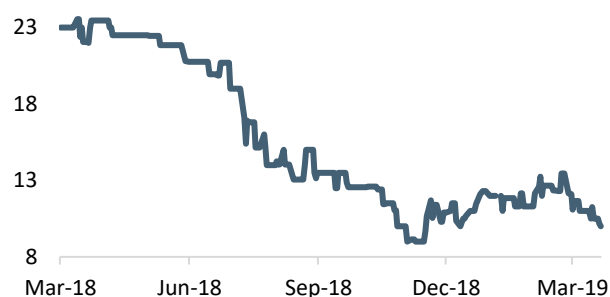




Rating	SELL
Price	₦10.00
52-week range	₦9.00– ₦23.45
Market Cap. (₦'bn)	39,705
1-month Avg. Vol	334,573
Current PE	12.55x

PZ Cussons: NL - Share Price Trend



Analyst(s)

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PZ Cussons Nigeria Plc (PZ Cussons .NL)

Initial View

Lower sales, sticky cost, poor earnings

- The intense cross product competition in the home and personal care (HPC) segment further exerted pressure on PZ Cussons' operation over its FQ3 19¹ financial year (to recall, the company's financial year runs from June to May) results released after the close of market yesterday. The company reported loss after tax of ₦414.2 million following higher than expected decline in sales (-9.6% YoY to ₦20 billion), sticky production cost (-0.1% YoY to ₦16.2 billion) and higher operating expenses (+3.7% YoY to ₦4.2 billion). The decline in sales was steeper, relative to our expectation of a mild decline (-0.6% YoY) as the second half happens to be its peak season. That said, reflecting the loss in FQ3 19, PZ's 9M 19 earnings printed at ₦807.1 million with EPS for the period declining 39.6% YoY to ₦0.20.
- The parent company in its half year trading update, guided that the Nigeria business will increase focus on optimizing its price points and pack sizes across the key brands and product portfolio, in a bid to leverage the retail end of the market to drive volumes. For us, we believe the persistent competition in the market supported by a favorable FX environment continued to place pressure on the company's selling price and volumes. To add, while we do not rule out the impact of depressed consumer wallet on sales, we believe the change in consumer taste and preferences in the HPC segment, has also played a major role in worsening the company's sales. For context, while its flagship product "imperial leather" and few new products recorded a decent performance in the European and Asian countries, trading in Africa has remained unimpressive for

¹ Financial Quarter 2019.

the company. Consequently, over the review period, revenue dropped by 9.6% YoY to ₦20.0 billion.

- ***Sticky production cost and higher operating costs amplified the loss.***
Despite the decline in sales, input cost remained sticky, with cost to sales ratio expanding 770bps YoY to 81%. For us, we believe the flat input cost despite the decline in sales emanated largely from significant disruption being faced in clearing goods at the port. For context, during the review period, prices of the key production inputs, CPO and petrochemical, have decline 8.5% YoY and 7.4% YoY respectively. Overall, gross profit fell 36% YoY to ₦7.8 billion, with related margin contracting to 19% (FQ3 18: 26.7%).
 - Further down, the unsettled supply chain optimization and higher marketing expenses in a bid to increase awareness of its retail focused pack sizes across the key brands, further pressured earnings. Over FQ3 19, the company's cost to income ratio widened to 21% (FQ3 18: 18.3%), which led to an operating loss of ₦399.5 million – relative an operating profit of ₦1.8 billion recorded over FQ3 18.
 - Contrary to the prior quarters wherein gains on invested cash provided some support for PBT, the lower cash position of ₦3.5 billion (H1 19: ₦6.6 billion, 9M 18: ₦11.5 billion) over the period coupled with moderation across treasury assets further constrained finance income during the period. For context, finance income during the period came in lower at ₦34 million from ₦473 million.
 - Our last communicated FVE on PZ is ₦10.93 which translates to a **NEUTRAL** rating based on last trade price.
 - **More analysis to follow.**
-

Summary of Results and Forecast

Income statement – (R'million)	Q3 19	YoY growth	QoQ growth	Deviation	9M 19	9M 18	YoY growth
YE – May							
Revenue	20,019	-9.6%	4.5%	9.9%	55,070	63,260	-12.9%
Cost of sales	16,209	-0.1%	9.1%	0.0%	42,433	45,024	-5.8%
Gross profit	3,810	-35.5%	-11.3%	52.0%	12,637	18,236	-30.7%
Operating expenses	4,209	3.7%	42.3%	0.8%	11,315	12,506	-9.5%
Operating profit	-399	-121.6%	-129.9%	-487.4%	1,322	5,730	-76.9%
Net interest expense	-79	20.3%	-278.3%	-129.7%	16	-567	N/A
PBT	-414	-137.7%	-126.6%	-417.0%	936	1,967	-52.4%
PAT	-414	-155.4%	-129.0%	-335.4%	807	1,337	-39.6%

*N/M means not meaningful

Key Ratios	Q3 19	Q2 19	Change(pps)	9M 19	9M 18	Change(pps)
Gross margins	19.0%	22.4%	-3.4%	22.9%	28.8%	-5.9%
EBIT margins	-2.0%	7.0%	-9.0%	2.4%	9.1%	-6.7%
PBT margins	-2.1%	8.1%	-10.2%	1.7%	3.1%	-1.4%
PAT margins	-2.1%	7.4%	-9.5%	1.7%	3.1%	-1.4%
Effective tax rates	0.0%	8.3%	-8.3%	13.8%	32.0%	-18.2%

Source: ARM Research

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
RESTRICTED	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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