

5 October 2017

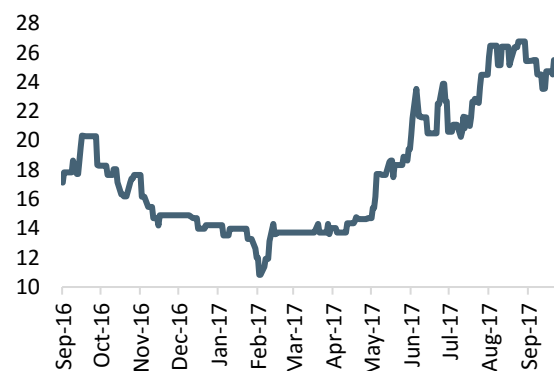
**PZ Cussons Nigeria Plc. | Earnings Report**

3 months ended 31 August, 2017

**Cost pressures inform downward earnings review**
**(SELL: ₦22.16)**

- PZ Cussons Nigeria Plc (PZ) reported its first quarter 2018 result (FQ1 2018), posting pre-tax and post-tax losses of ₦181 million and ₦123 million respectively. Despite an increase in revenue (13% YoY) mainly due to higher prices, input cost pressure and foreign exchange loss (net short FCY position from trade payables) clouded the strong top-line story to batter earnings.
- For the rest of the year, we have revised our input cost higher to ₦57.6 billion (previously ₦55 billion) to reflect higher petrochemical prices. Consequently, we expect a contraction in gross margin to 32% (-3pps YoY). Similarly, we have revised PZ's operating costs higher to ₦17 billion (+16% YoY) in line with FQ 18 performance to leave EBIT 24% lower YoY at ₦10.2 billion. In addition, we forecast finance expense at ₦1.1 billion (+3.8x YoY) to reflect the company's elevated level of borrowing relative to prior year. Thus, our revised EPS of ₦1.04 (previously ₦1.83) is 24% higher YoY. In view of the foregoing, we lower our rating from **BUY** to **SELL** with our fair value estimate (FVE) at ₦22.16 (vs ₦28.81 previously).

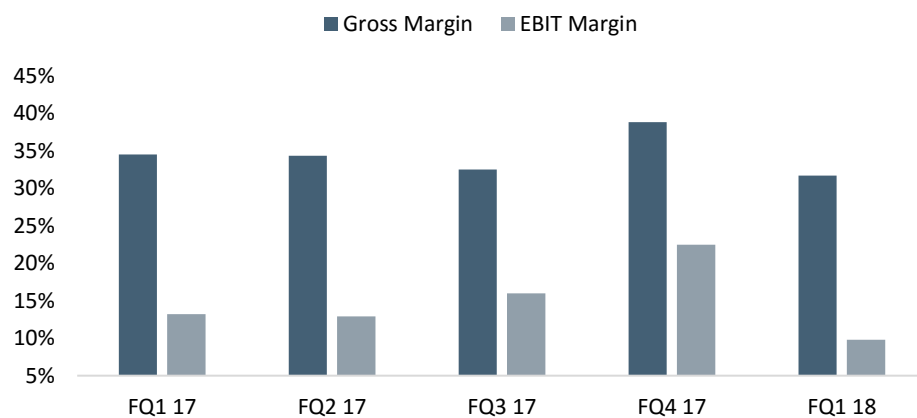
Income Statement Data			
	2018-3M	2017-3M	%chg
Revenue	18,899	16,753	13%
PBT	181	2,431	-93%
Tax	58	845	-93%
PAT	123	1,586	-92%
Balance Sheet Data			
	2018-Aug	2017-May	%chg
Inventory	28,152	26,710	7%
Receivables	19,255	17,222	12%
Cash	2,175	8,022	-73%
Payables	29,845	39,723	-25%
Net Assets	45,014	45,138	-3%
Stock Data			
Price	₦24.23		
52-week range	₦10.83- ₦27.3		
Market Cap. (N'm)	96,205		
1-month Avg. Vol	605,713		
Curr. PE	18.68x		
Bloomberg Ticker	PZ:NL		
PZ Cussons Nigeria Plc- Share Price Trend			


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### Margins head south on subsisting cost woes...

- As in FY 17 when revenue rose 15% YoY, PZ continued to record strong double-digit revenue growth (FQ1 18: +13% YoY) in the quarter on the back of higher prices across product portfolio (*Olympic milk*: +55% YoY, *Imperial Leather*: +52% YoY, *Premier soap*: +33% YoY). However, for the first time in four quarters, input acceleration (+18% YoY) outpaced that of revenue, owing to sharp increases in mean Brent crude price (+4% YoY) and CPO prices (+5% YoY) over the review period. Thus, despite the top-line gain, gross margin slid 2pps YoY to 31.7% - lowest level in four quarters. Elsewhere, admin expense (+43% YoY to ₦1.9 billion) compounded overall cost pressures to drag operating profit 16.2% lower YoY at ₦1.9 billion while related margins slid 3.4pps YoY to 9.8%.

**Figure 1: Historical Gross and EBIT Margins**



Source: Company financials, ARM Research

### ...as FX loss immerses operating profits

- As earlier noted, the bigger drag on the company's performance came in form of another FX loss of ₦1.8 billion. Although, FX loss was 62% lower YoY, it also amounted to ~97% of the company's operating profit in the review quarter. In a word, whilst recent FX liquidity gains have been supportive—as evidenced by the decline in FX gains from FQ4 17 levels, the company's weak operating performance made the impact of naira down-leg more telling. Furthermore, after five quarters of debt-free operations, PZ accessed overdraft facility in the period, which according to our estimate sits at ₦1.7 billion. The foregoing underpinned the recognition of

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₹273 million in net finance expenses in the review period (FQ4 17: ₹44million net finance income). Consequently, PZ declared another pre- and post-tax losses in the quarter under review.

- A look through the company's balance sheet also revealed that a substantial portion of the company's outstanding trade payables (-25% QoQ to ₹29.8 billion) was paid down in the review quarter. In view of this, PZ reported a steep decline in cash balance in the period (-73% QoQ to ₹2.2 billion).

#### **Elevated cost pressures underpin soft earnings outlook**

- We have left our estimate for FY 18 revenue at ₹84.7 billion (+6% YoY) given the narrow disparity between our estimate and actual number. However, we have revised our input cost higher to reflect increasing cost of petrochemical inputs. This, together with a milder top-line growth expectation, should see gross margin shed 3pps YoY to 32% despite related profit of ₹27 billion. Similarly, we have revised PZ's operating costs higher to ₹17 billion (+16% YoY) in line with FQ 18 performance to leave EBIT 24% lower YoY at ₹10.2 billion.
  - Going by recent stability in FX markets, PZ is unlikely to experience significant troubles on the FX front in coming quarters with our projection for FX losses still firmly at ₹2.5 billion (vs. ₹1.8 billion as at FQ18). In addition, we forecast finance expense at ₹1.1 billion (+3.8x YoY) to reflect the company's elevated level of borrowing relative to prior year.
  - Given PZ's aggressive move to pay down its outstanding trade payables (-25% QoQ), we have revised our FY 18 payables' projections lower to ₹20 billion (-49% YoY). Similarly, we have revised finance income lower to ₹313 million to reflect its lower cash balances (-73% QoQ to ₹2.2 billion). Net impact of our model revisions translates to PBT and PAT of ₹7 billion (+45% YoY) and ₹4.7 billion (+29% YoY) respectively.
  - PZ trades at a forward P/E of 29.37x vs. 26x for Bloomberg Middle East and Africa. We downgrade our rating on the stock to a SELL (vs. BUY previously) with a FVE of ₹22.16 (previously ₹28.81).
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## Summary of Results and Forecasts

### QUARTERLY

Income Statement (₹mln)*	FQ1 2018A	FQ2 2018E	FQ3 2018E	FQ4 2018E
Sales	18,899	19,764	23,635	22,413
COGS	12,907	13,044	16,071	15,581
Gross profit	5,992	6,720	7,563	6,833
Operating cost	4,139	3,895	4,847	4,146
Operating profit	1,853	2,825	2,716	2,856
Net finance cost	273	178	222	107
<b>Profit before taxation</b>	181	2,085	1,973	3,094
Tax	58	510	635	1,143
<b>Profit after taxation</b>	123	1,575	1,337	1,951
<b>Earnings per share</b>	0.03	0.40	0.34	0.49

### ANNUAL

Income Statement (₹mln)	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
Sales	73,126	69,528	79,630	84,711	86,693
COGS	52,672	49,326	51,682	57,603	56,351
Gross profit	20,454	20,201	27,948	27,107	30,343
Operating cost	13,803	14,068	14,733	17,027	16,645
Operating profit	6,773	6,419	13,414	10,250	13,871
Foreign Exchange Loss	-	2,884	8,798	2,500	-
Interest Expense	445	598	290	1,093	377
Interest Income	229	210	486	313	60
<b>PBT</b>	6,557	3,148	4,811	6,971	13,554
Tax	1,986	1,019	1,125	2,231	4,337
<b>PAT</b>	4,571	2,130	3,687	4,740	9,217
Earnings per share	1.02	0.47	0.84	1.04	2.02
Dividend per share	0.81	0.50	0.50	0.60	1.16

Balance Sheet (₹mln)	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
<b>Assets</b>					
Fixed assets	25,218	26,505	28,514	30,045	31,109
Inventories	21,013	19,278	26,710	21,889	21,413
Trade debtors	17,912	15,587	17,222	17,789	19,073
Cash and other bank balances	2,328	12,868	8,022	(4,035)	2,901
<b>Total Assets</b>	67,388	74,430	90,088	73,312	78,830
<b>Liabilities</b>					
Trade Creditors	17,835	25,716	39,723	20,161	20,850
Long Term Liabilities	4,152	3,932	2,584	2,633	2,729
<b>Total liabilities</b>	23,715	31,027	44,950	25,475	26,385
<b>Shareholders' fund</b>	43,672	43,403	45,138	47,837	52,446

Key Ratios	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
<b>Profitability margins</b>					
Gross margin	28.0%	29.1%	35.1%	32.0%	35.0%
Operating margin	9.3%	9.2%	16.8%	12.1%	16.0%
PBT	9.0%	4.5%	6.0%	8.2%	15.6%
Net margin	6.3%	3.1%	4.6%	5.6%	10.6%
<b>Valuation multiples</b>					
EPS	1.02	0.47	0.84	1.04	2.02
P/E	23.74	51.64	28.94	23.33	12.00
P/B	2.20	2.22	2.13	2.01	1.83
EV/EBITDA	10.91	10.02	5.79	8.24	5.92
ROA	6.6%	3.0%	4.5%	5.8%	12.1%
ROE	10.6%	4.9%	8.3%	10.2%	18.4%

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
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% — 20 %	<b>NEUTRAL</b>	5% — 20 %
<b>NEUTRAL</b>	0% — 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% — 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	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
<b>UNDERWEIGHT</b>	Minimise exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio

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