

FX losses offset underlying improvement
(SELL: ₦15.91)

- PZ Cussons Nigeria Plc. (PZ) released its unaudited FQ1 2017 results wherein revenues rose 12% YoY to ₦16.8 billion. Nonetheless, PZ posted pre-tax and post-tax losses of ₦2.4 billion and ₦1.6 billion respectively. The sharp contraction in earnings stemmed from the recognition of unrealized foreign exchange losses of ₦4.7 billion in the review period.

FX losses on trade payables drives negative Q1 earnings

- FQ1 17 straddles the period when CBN adopted a flexible FX regime which resulted in a 43% USDNGN depreciation. Thus, in line with a pattern across FMCGs, PZ's FX loss of ₦4.7 billion reflects translation impact of a net short FCY position from trade payables associated with raw material imports. Excluding the FX loss reported, PZ would have recognized a profit of ₦2.3 billion.

Income Statement Data

	2017- 3M	2016-3M	%chg
Revenue	16,753	14,953	12%
PBT	(2,431)	547	N/A
Tax	(845)	119	N/A
PAT	(1,586)	428	N/A

Balance Sheet Data

	2017-Aug	2016-May	%chg
Inventory	20,602	19,278	6.9%
Receivables	14,964	15,587	-4%
Cash	17,485	12,868	-26.4%
Payables	33,606	25,716	30.7%
Net Assets	41,817	43,403	-3.7%

Stock Data

Price	₦18.69
52-week range	₦17.6- ₦33.05
Market Cap. (N'm)	73,255.00
1-month Avg. Vol	237,020.8
Curr. PE	N/A
Bloomberg Ticker	PZ:NL

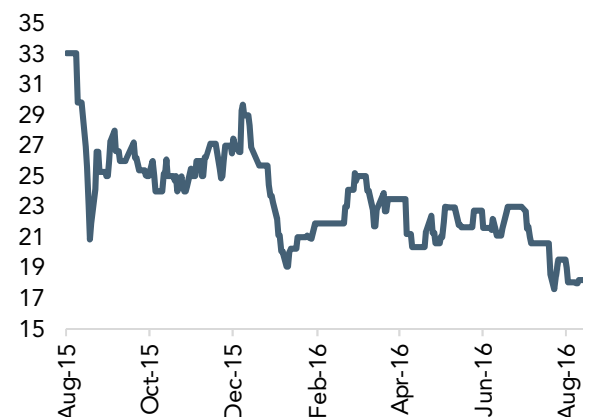
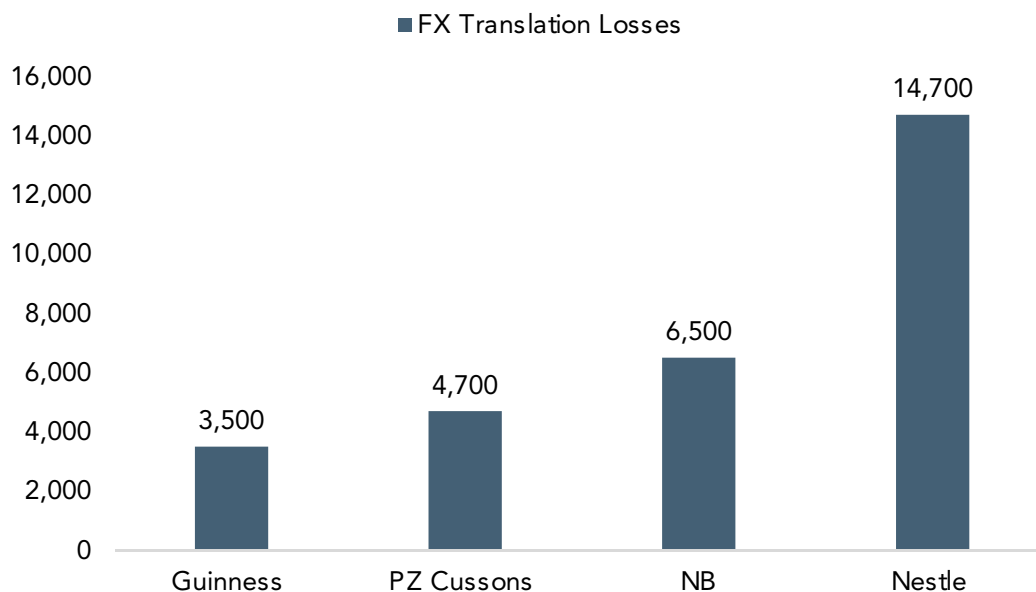
PZ Cussons Nigeria Plc- Share Price Trend

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Figure 1: FX translation losses across coverage FMCG companies in Q2 16 (₹ million)



Source: Company financials, ARM Research

Benign petrochemical prices bolster gross margin

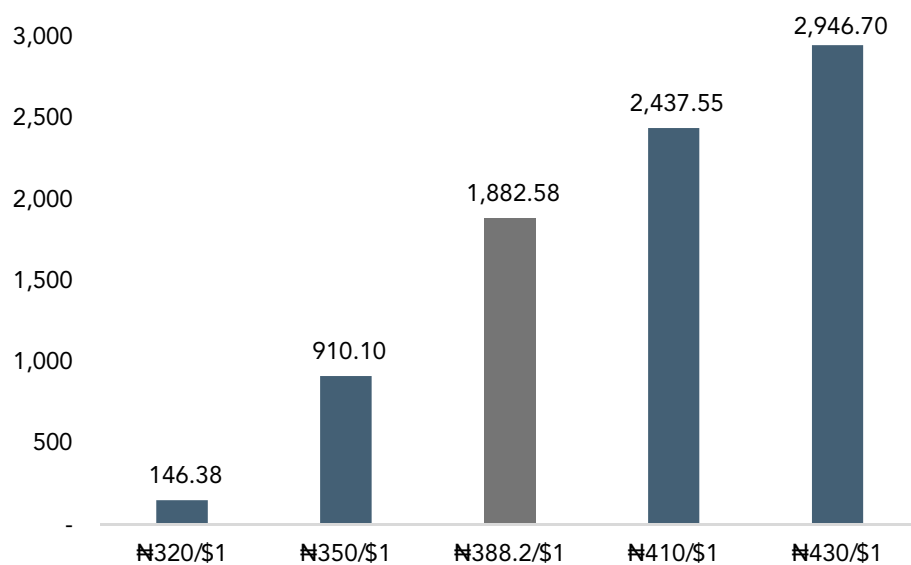
- Beyond the FX issues, the underlying numbers show marked improvement in PZ's performance with gross margin expanding 7pps YoY to 34.5%. Notably, PZ stripped out FX impact from COGS which allowed the effect of benign petrochemical input prices become more visible. In addition to the lower input costs, we believe PZ as with most FMCG companies hiked prices on HPC goods over the period. Consequently, revenues expanded 12% YoY to ₹16.8 billion – modestly ahead of our forecasts of ₹15.9 billion.
- Gains on benign input costs combined with tempered OPEX growth (+2.5% YoY), as PZ cutback on admin expenses (-3% YoY), drove a three-fold YoY growth in operating profit to ₹2.3 billion with related margin also expanding 8.9pps to 13.5% (FQ1 16: 4.7%).

FX loss to weigh on FY 17 earnings

- Over the rest of the year, persisting currency weakness which has resulted in price hikes across FMCGs, as firms seek to offset elevated import costs, leads to upward revisions in our sales forecasts. Given the strong FQ1 reading and sizable scope for price increases in the HPC space, we raise our FY17E sales projections 14% from previous to ₦75 billion (+ 8.3% YoY).
- On input costs, persisting supply glut of crude oil and weak demand from major markets underpins our bearish outlook on prices of petrochemical inputs. Thus we project a 7% YoY improvement in gross margin to 34% which translates to FY 17E gross profits of ₦23.7 billion (FY 2016: ₦17.3 billion).
- Given PZ's sizable import-COGS ratio (FY 2016: 81%), the company remains susceptible to sizable foreign currency losses in the near term which should impact negatively on earnings. Using the one year USD/NGN forward rate of ₦ 388.2¹/\$ as a guide to naira depreciation over FY 17, we estimate that the company could record additional FX translation losses of ₦1.9 billion. Overall, we expect the company to realize FX losses of ₦6.6 billion in FY2017. Net impact of our adjustments translate to modest recovery to profitability over FY 17E (PBT and PAT of ₦2 billion and ₦1.5 billion respectively).

¹ Source: FMDQ OTC; 1 year forward as at October 7, 2016

Figure 2: PZ's Sensitivity to varying FX scenarios (₦ million)



Source: FMDQ OTC, ARM Research

- In the light of these revisions, our blended FVE for PZ declined 5% to ₦15.91 (Last trading price: ₦18.64). PZ has lost 27.47% YTD and currently trades at an EV/EBITDA of 11.2x compared to its Bloomberg Middle and East Africa Peers at 8.58x. We maintain our **SELL** rating on the stock.

Summary of Results and Forecasts

QUARTERLY					
Income Statement (R' mln)*	Q1 2017F	Q2 2017F	Q3 2017F	Q4 2017F	
Sales	16,753	16,968	23,081	18,500	
COGS	10,971	11,623	15,764	13,224	
Gross profit	5,782	5,345	7,317	5,276	
Operating cost	3,572	3,394	4,616	3,479	
Operating profit	2,269	2,019	2,793	1,880	
Net finance cost	(1)	42	29	98	
Profit before taxation	(2,431)	1,350	1,886	1,344	
Tax	(845)	439	566	529	
Profit after taxation	(1,586)	911	1,320	816	
Earnings per share	(0.40)	0.23	0.33	0.21	
ANNUAL					
Income Statement (R' mln)	FY 2014A	FY 2015A	FY 2016A	FY 2017F	FY 2018F
Sales	72,906	73,126	69,528	75,302	80,088
COGS	53,711	52,672	52,210	51,582	54,700
Gross profit	19,195	20,454	17,318	23,720	25,388
Operating cost	12,893	13,803	14,068	15,060	15,217
Operating profit	6,583	6,773	3,536	8,961	10,492
Interest Expense	141	445	598	700	758
Interest Income	508	229	210	532	821
PBT	6,950	6,557	3,148	2,148	10,555
Tax	1,867	1,986	1,019	687	3,378
PAT	5,083	4,571	2,130	1,461	7,177
Earnings per share	1.16	1.02	0.47	0.32	1.59
Dividend per share	0.81	0.81	0.50	0.33	1.54
Balance Sheet (R' mln)	FY 2014A	FY 2015A	FY 2016F	FY 2017F	FY 2018F
Assets					
Fixed assets	24,485	25,218	26,505	27,397	28,408
Inventories	20,293	21,013	19,278	19,085	20,239
Trade debtors	20,680	17,912	15,587	15,060	16,819
Cash and other bank balances	4,478	2,328	12,868	12,398	9,530
Total Assets	70,966	67,388	74,430	74,693	75,797
Liabilities					
Trade Creditors	21,898	17,835	25,716	25,791	25,709
Long Term Liabilities	4,475	4,152	3,932	3,947	4,021
Total liabilities	28,427	23,715	31,027	31,144	31,172
Shareholders' fund	42,539	43,672	43,403	43,549	44,626
Key Ratios	FY 2014A	FY 2015A	FY 2016F	FY 2017F	FY 2018F
Profitability margins					
Gross margin	26.3%	28.0%	24.9%	31.5%	31.7%
Operating margin	9.0%	9.3%	5.1%	11.9%	13.1%
PBT	9.5%	9.0%	4.5%	2.9%	13.2%
Net margin	7.0%	6.3%	3.1%	1.9%	9.0%
Valuation multiples					
EPS	1.16	1.02	0.47	0.32	1.59
P/E	31.13	18.26	39.73	57.57	11.72
P/B	3.36	1.69	1.71	1.70	1.66
EV/EBITDA	16.41	8.39	11.20	5.80	5.29
ROA	7.1%	6.6%	3.0%	2.0%	9.5%
ROE	11.4%	10.6%	4.9%	3.4%	16.3%

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	Minimise exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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