

Milder FX loss to flatter earnings
(BUY: ₦28.81)

- PZ Cussons Nigeria Plc (PZ) released its financial statements for 12 months ended 31st May 2017, which revealed a 73% YoY growth in PAT to ₦3.7 billion that was largely underpinned by higher prices. The sturdy bottom-line occurred in spite of an ₦8.8 billion (+205% YoY) FX loss reported over the period. Excluding the FX loss, PZ would have realized a PBT of ₦12.5 billion (nearly six-fold higher YoY). In any case, with earnings performance still reasonably upbeat, PZ left its dividend per share at ₦0.50 with implied dividend yield printing at 2% as at last market close.
- Interestingly, we expect the company's earnings momentum to subsist into FY 18 in view of sustained naira stability and price-induced top-line growth. Given the foregoing, we have upgraded our rating on the stock to a **BUY** with a **FVE** of **₦28.81**.

Price hikes drive top-line growth

- Over FY 17, PZ's revenue grew by a record 14.5% YoY to ₦79.6 billion largely reflecting the impact of price hikes across its product portfolio (YoY: Olympic Milk +55%, Zip +35%, Canoe +27%, Imperial Leather +29%). The price increases helped offset volume weaknesses, which was more pronounced in the white goods segment, amidst subsisting pressures on consumers discretionary income.

Income Statement Data			
	FY 2017	FY 2016	%chg
Revenue	79,630	69,528	15%
PBT	4,811	3,148	53%
Tax	1,019	1,018	10%
PAT	3,687	2,130	73%
Balance Sheet Data			
	FY 2017	FY 2016	%chg
Inventory	26,710	19,278	38%
Receivables	17,222	15,587	10%
Cash	8,022	12,868	-33%
Payables	39,723	25,716	54%
Net Assets	45,138	43,403	4%
Stock Data			
Price	₦25.96		
52 week range	₦11.04- ₦27.3		
Market Cap. (N'm)	102,994		
1-month Avg. Vol	671,113		
Curr. PE	30.94x		
Bloomberg Ticker	PZ:NL		
PZ Cussons Nigeria Plc- Share Price Trend			

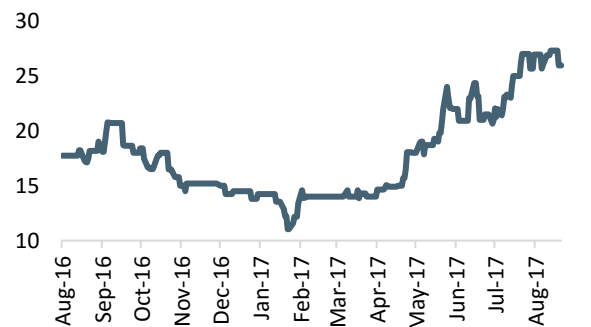
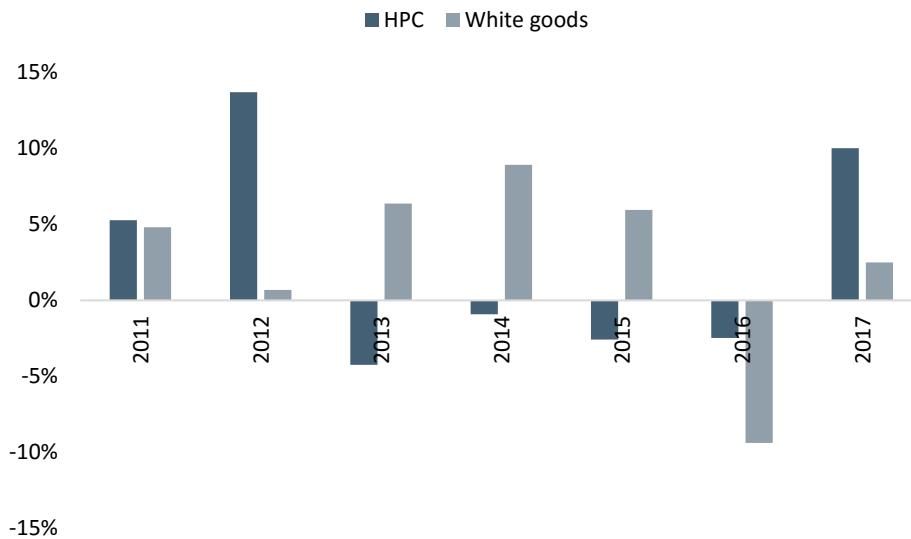

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Figure 1: Historical Revenue growth (YoY) across PZ's operating segments



Source: Company financials, ARM Research

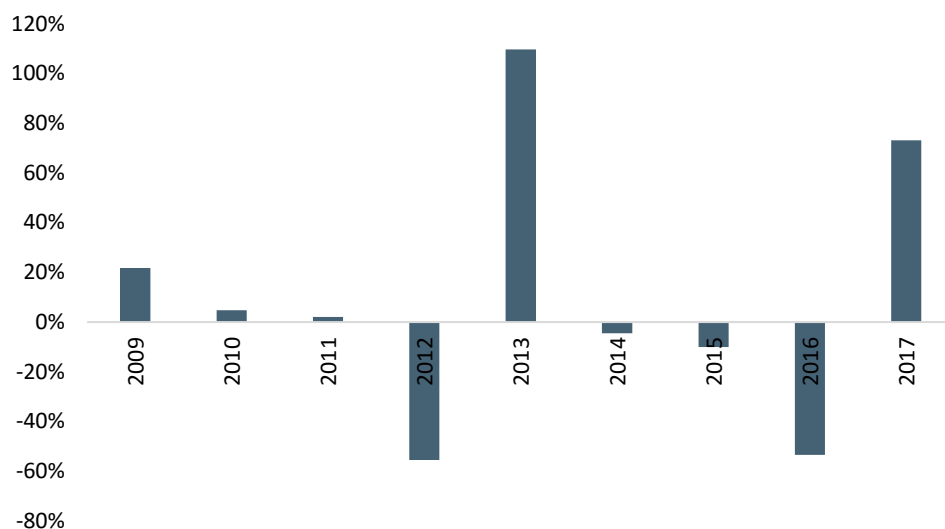
Sturdy top-line powers earnings

- However, the company endured input cost pressures in the review quarter with reported COGS printing 5% higher YoY (at ₹51.7 billion) despite the step-down in output. Specifically, the cost of raw materials rose by 9% YoY¹ to water down pass-through from lower personnel cost—an offshoot of production staff lay-off (-14% YoY to 888 people). Irrespective, knock-on effect from elevated prices across product portfolio saw the company report its fastest gross margin expansion in ten years (+6pps YoY to 35.1%).
- Despite reported belt tightening measures and a further reduction in staff (-7% YoY to 699 people), OPEX was also higher (+5% YoY). That said, aided by PZ's removal of FX loss from the COGS line—a segregation that began in FY 16—pass-through from price gains stoked a more than two-fold YoY jump in operating profit to ₹13.4 billion with corresponding margin expanding 7.6pps YoY to a record high of 17%.

¹ The rise in raw material cost was reflective of bullish commodity prices in the period (Global CPO: +17.3% YoY, and Brent: +11.4% YoY)

- Instructively, we note that FX loss previously lumped up as part of input cost was aggregated to that from revaluation of trade payables—with the latter expanding over three-fold YoY following sharp naira depreciation². That said, gains from operating performance still filtered through to bottom-line, with PBT rising 53% YoY to ₦3.7 billion and experiencing a first earnings growth in four years.

Figure 2: Historical PAT growth



Source: Company financials, ARM Research

Improved FX environment to bolster FY18 earnings

- Going into FY 18, feelers from PZ’s parent suggest that its upward price adjustment would extend into coming periods as the company looks to make up for inflationary pressures. However, given the price-sensitive nature of consumers of HPC segment, we expect consumer response to translate to further trim down in volumes. In addition to this, we expect increased competition from cheaper imported substitutes to weigh on revenue from HPC and white goods segment. Consequently, we forecast FY18 revenue growth 6% higher YoY at ₦84.7 billion.
- Similarly, we expect rising crude oil prices to translate to higher costs of petrochemical inputs and leave COGS at elevated levels. Consequently, we retain gross margin at 35% with associated profit expected to come in at ₦30.6 billion

² FY 17 straddled the period when CBN adopted a flexible FX regime which resulted in a 43% USD/NGN depreciation.

(YoY: +4%). Akin to FY 17, we expect PZ to record a modest increase in operating costs to ₦15.9 billion (+ 5% YoY) on the back of management's drive to curtail expenses in light of the tough operating environment.

- Given PZ's sizable import-COGS ratio (FY 2017: 78%), the company is susceptible to sizable foreign currency losses in the near term which should impact earnings. Using the closing NAFEX rate of ₦359.7/\$ as a guide to naira depreciation over FY 18, we estimate FX losses of ₦2.5 billion. That said, associated FX losses should be 72% lower YoY in our view owing to expectations of tamer naira declines. This, in our view, will be the principal support for earnings over FY 18.
 - Net impact of our model revisions translates to PBT and PAT of ₦12.3 billion (+155% YoY) and ₦8.3 billion (+126% YoY) respectively.
 - PZ trades at a forward P/E of 14.2x vs. 17.5x for Bloomberg Middle East and Africa. We upgrade our rating on the stock to a **BUY** (vs. NEUTRAL previously) with a FVE of **₦28.81**.
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Summary of Results and Forecasts

QUARTERLY

Income Statement (R' mln)*	FO1 2018E	FO2 2018E	FO3 2018E	FO4 2018E
Sales	18,265	19,764	25,082	21,600
COGS	11,416	12,594	15,676	15,376
Gross profit	6,849	7,169	9,406	6,225
Operating cost	3,196	3,526	4,389	4,305
Operating profit	3,653	3,643	5,016	2,089
Net finance cost	443	489	608	597
Profit before taxation	2,733	2,628	3,753	3,151
Tax	814	898	1,117	1,096
Profit after taxation	1,919	1,730	2,636	2,055
Earnings per share	0.48	0.44	0.66	0.52

ANNUAL

Income Statement (R' 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	55,062	55,484
Gross profit	20,454	20,201	27,948	29,649	31,210
Operating cost	13,803	14,068	14,733	15,417	17,079
Operating profit	6,773	6,419	13,414	14,401	14,304
Interest Expense	445	598	290	188	136
Interest Income	229	210	486	522	628
Foreign Exchange Loss		2,884	8,798	2,470	
PBT	6,557	3,148	4,811	12,264	14,797
Tax	1,986	1,019	1,125	3,925	4,735
PAT	4,571	2,130	3,687	8,340	10,062
Earnings per share	1.02	0.47	0.84	1.83	2.20
Dividend per share	0.81	0.50	0.50	1.05	1.30

Balance Sheet (R' mln)	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
Assets					
Fixed assets	25,218	26,505	28,514	30,045	31,109
Inventories	21,013	19,278	26,710	20,924	21,084
Trade debtors	17,912	15,587	17,222	17,789	19,073
Cash and other bank balances	2,328	12,868	8,022	17,099	27,284
Total Assets	67,388	74,430	90,088	93,481	102,884
Liabilities					
Trade Creditors	17,835	25,716	39,723	38,543	42,645
Long Term Liabilities	4,152	3,932	2,584	2,670	2,778
Total liabilities	23,715	31,027	44,950	43,844	48,068
Shareholders' fund	43,672	43,403	45,138	49,637	54,815

Key Ratios	FY 2015A	FY 2016A	FY 2017A	FY 2018F	FY 2019F
Profitability margins					
Gross margin	28.0%	29.1%	35.1%	35.0%	36.0%
Operating margin	9.3%	9.2%	16.8%	17.0%	17.0%
PBT	9.0%	4.5%	6.0%	14.5%	17.6%
Net margin	6.3%	3.1%	4.6%	9.8%	11.9%
Valuation multiples					
EPS	1.02	0.47	0.84	1.83	2.27
P/E	25.43	53.33	31.01	14.21	11.44
P/B	2.36	2.37	2.28	2.08	1.88
EV/EBITDA	11.69	10.82	6.23	5.33	4.59
ROA	6.6%	3.0%	4.5%	9.1%	10.5%
ROE	10.6%	4.9%	8.3%	17.6%	19.8%

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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