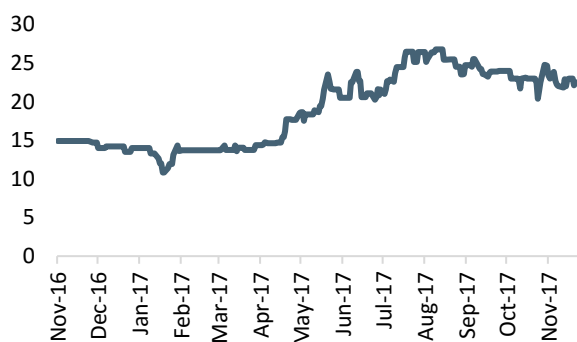


Rating	<b>SELL</b>
Price	₦22.50
FVE	<b>₦20.78</b>
52-week range	₦11.04-27.30
Market Cap. (N'tn)	0.89
1-month Avg. Vol	598,873
Curr. PE	19.6x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2015 A</b>	0.11	0.64	0.22	0.12
<b>2016 A</b>	0.40	0.33	0.48	0.53
<b>2017A(E*)</b>	0.03	0.18	0.40*	0.49*

#### PZ:NL - Share Price Trend



#### Analyst(s)

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## PZ Cussons Plc. (PZ.NL)

### Stock Report

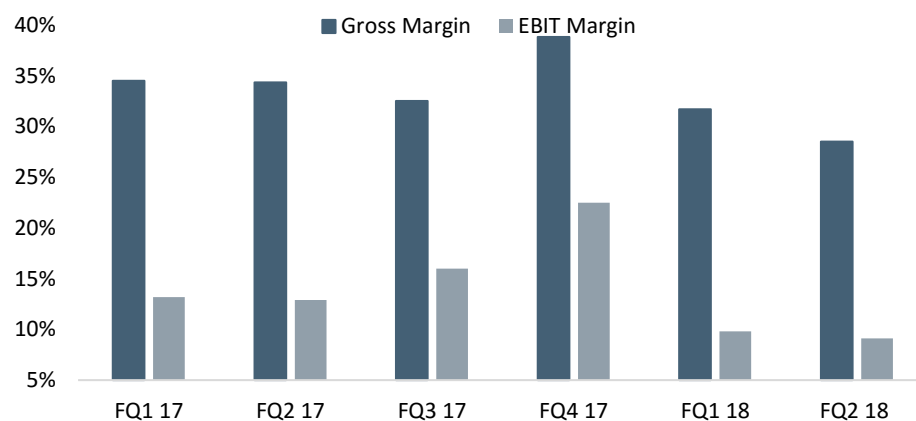
#### *Fundamentally speaking, valuation is rich*

- PZ's six-months 2018 earnings performance was weak on many fronts. True, revenue was higher 24% YoY to ₦41.1 billion, but that was driven by higher YoY prices across its key products. In the review period, gross margin contracted sharply by 45bps to 30% from 35% in 6M 17 largely on the back of subsisting cost pressures (+32% YoY) arising from higher crude oil prices and exchange rate. The foregoing alongside higher admin expenses drove a contraction in operating profit (-10.7% YoY to ₦3.8 billion). Irrespective, slower foreign exchange losses in the period of N2.6 billion (relative to ₦4.9 billion in 6M 2017), supported PBT of ₦868 million (6M 17: pre-tax loss of ₦429 million) – EPS: ₦0.15.
- Isolating the Q2 18 standalone result also reveals a weak earnings picture with EPS declining 45% YoY to ₦0.18. Despite posting higher revenue (34% YoY) largely underpinned by higher prices, input cost pressures and foreign exchange loss (net short FCY position from trade payables) weighed on top-line performance to neuter earnings.
- We have lowered our estimates for PZ as we plug in recent results and our expectations of higher costs and slower sales growth. For FY 18, we still hold the view that margins will be subdued due to the impact of depressed real income levels, intense industry competition as well as weaker sales from the electricals segment. However, lower FX losses relative to 2017, should drive stronger earnings performance in the current financial year. Overall, the stock continues to feel richly values relative to its peers (MENA)

trading a forward P/E of 25x relative to peers of 19.05x. Thus, we retain our SELL rating on the stock.

- **Subsisting cost pressures prevail in the quarter.** Looking through provided breakdowns, we note that input cost pressures was more pronounced in the quarter with growth in COGS (+46% YoY) outpacing that of revenue (+34% YoY). According to trading commentary provided by parent, competitor pricing pressure in Food (bulk milk) and Electrical segment constrained the company's ability to fully pass-on cost to consumers. Consequently, despite robust revenue growth in its Personal Care, Home Care, and PZ Wilmar joint venture divisions, tougher market conditions in other segments (electricals) impacted on margins to contract 590bps YoY to five-quarter low of 28.5%. Given the subsisting top-line pressures, PZ intensified cost-cutting on other fronts with its tight rein on admin expenses (-2.4pps YoY) driving OPEX-Sales to 19.4% (-2.1pps YoY). Nevertheless, operating profit declined 5.1% YoY to ₦2 billion while related margin contracted to a five-quarter low of 9.1% (-3.8pps YoY).
- **FX losses further compress earnings.** Further worsening earnings performance in the review quarter, PZ reported foreign exchange loss of ₦779 million (+2.3x YoY, -57% QoQ) in the quarter. In our view, we think this loss captures the impact of naira weakness (switch to NAFEX) on outstanding dollar denominated liabilities. Overall PZ reported a decline in PBT and PAT of ₦1 billion (-48% YoY) and ₦713 million (-45% YoY) respectively.

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



Source: Company financials, ARM Research

- 
- ***Sales growth momentum set to moderate.*** Over the rest of its fiscal year, management guides to driving improved performance through distribution expansion and new product launches. That said, given pressured consumer spending and intense competition in the key segment (particularly electricals, where volumes have been sizably lower), we envisage marginal volume growth from this strategy. However, in line with performance over the first half of the fiscal year, we adjust our FY18E sales projections 11% higher on a year-ago basis to ~~₹~~88.8 billion albeit with tamer growth in YoY revenue over H2 18 given the base effect from elevated prices over H2 17 (vs prior forecast: + 6% YoY, FH1 17: +24%).
  - We have also revised our projection for input cost higher (+20% YoY to ~~₹~~62.1 billion) to capture the impact of increasing cost of petrochemical inputs and inability to fully pass-on cost in the electrical segment. This, together with a milder top-line growth expectation, should see gross margin shed 5pps YoY to 30% (FH1 17: 30%) with related profit at ~~₹~~26.7 billion (-5% YoY). Similarly, we have revised PZ's operating costs higher to N17.5 billion (+19% YoY) to capture higher distribution costs over FH2 18 which should result in lower EBIT of ~~₹~~9.3 billion (-31% YoY).
  - Going by recent stability in FX markets, our view remains that PZ will unlikely experience significant troubles on the FX front in coming quarters. This underpins our decision to retain projected FX losses at ~~₹~~2.5 billion (-72% YoY). Net impact of our model revisions which translates to PBT and PAT of ~~₹~~6 billion (+26% YoY) and ~~₹~~4.1 billion (+11% YoY) respectively.
  - PZ trades at a forward P/E of 19.6x vs. 19.3x for Bloomberg Middle East and Africa. We have a **SELL** rating on the stock with a FVE of ~~₹~~20.78 (previously N22.15).
  - The key upside risk to our recommendation and earnings outlook for PZ is overperformance from upcoming product lines, lower Brent crude prices and improved ability to pass on costs over FH2 18.
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## Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦'m) *	2015A	2016A	2017A	2018E	2019E
Revenue	73,126	69,528	79,630	88,760	90,825
COGS	52,672	49,326	51,682	62,132	61,761
Gross Profit	20,454	20,201	27,948	26,628	29,064
Operating Cost	13,803	14,068	14,733	17,486	17,438
Operating Profit	6,773	6,419	13,414	9,320	11,807
Interest Expense	445	598	290	1,093	377
Interest Income	229	210	486	313	32
PBT	6,557	3,148	4,811	6,041	11,462
Tax	1,986	1,019	1,125	1,933	3,668
PAT	4,571	2,130	3,687	4,108	7,794
Balance Sheet (₦ '000) *					
Fixed Assets	25,218	26,505	28,514	30,227	31,442
Stocks	21,013	19,278	26,710	23,610	23,469
Trade debtors	17,912	15,587	17,222	18,640	19,982
Cash & other bank balances	2,328	12,868	8,022	(5,891)	349
Total Assets	67,388	74,430	90,088	74,574	79,783
Liabilities					
Trade Creditors	17,835	25,716	39,723	21,746	22,852
Non-current Liabilities	4,152	3,932	2,584	2,626	2,707
Total liabilities	23,715	31,027	44,950	27,053	28,365
Shareholders' fund	43,672	43,403	45,138	47,521	51,418
Key Ratios	2014A	2015A	2016A	2017E	2018E
Gross Margin	28.0%	29.1%	35.1%	30.0%	32.0%
EBIT Margin	9.3%	9.2%	16.8%	10.5%	13.0%
PBT Margin	9.0%	4.5%	6.0%	6.8%	12.6%
Net Margin	6.3%	3.1%	4.6%	4.6%	8.6%
EPS	1.02	0.47	0.84	0.90	1.71
P/E	22.04	47.95	26.88	25.00	13.17
P/B	2.05	2.06	1.98	1.88	1.74
EV/EBITDA	10.13	9.22	5.35	8.47	6.47
ROA	6.6%	3.0%	4.5%	5.0%	10.1%
ROE	10.6%	4.9%	8.3%	8.9%	15.8%

Source: ARM Research \*unless otherwise stated

**Ratings, Disclosure & Disclaimer** – [Click here](#)