

## PZ Cussons Nigeria Plc. (PZ.NL)

### Stock report

### Improved Outlook, but at a Hefty premium

Rating	<b>SELL</b>
Price	₦22.50
FVE	<b>₦16.56</b>
52-week range	₦14.00- <del>₦27.30</del>
Market Cap. (₦'bn)	89.34
1-month Avg. Vol	275,063
Curr. PE	27.8x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2016 A</b>	0.11	0.64	0.22	0.12
<b>2017 A</b>	0.40	0.33	0.48	0.53
<b>2018 A(E*)</b>	0.03	0.18	0.19	0.18*

### PZ:NL - Share Price Trend



### Analyst(s)

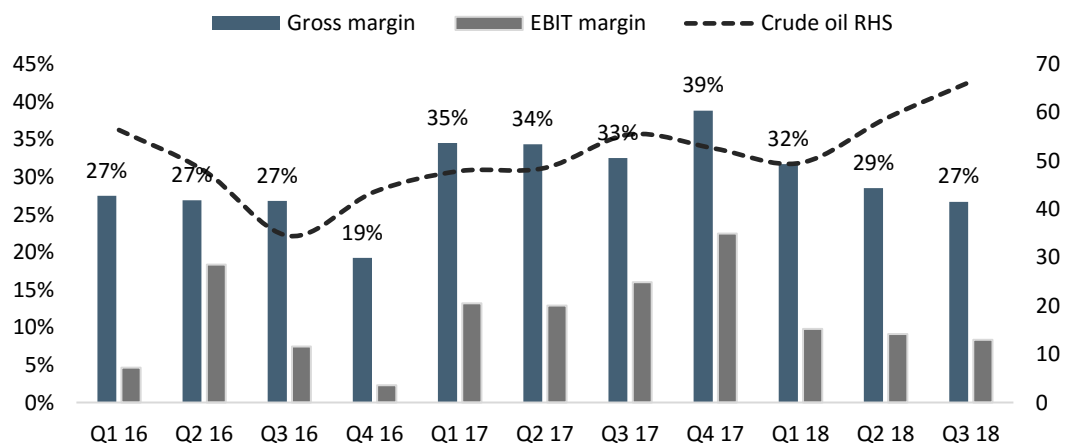
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- Earnings of PZ Cussons Nigeria (PZ) continues to disappoint as cost pressures and finance charge erodes profitability margins. EPS in nine-months 2018 declined 16.5% YoY to ₦0.34 (9M 17: ₦0.40) as higher input cost (+18.7% YoY to ₦45 billion) and operating expenses (+13.1% YoY to ₦12.5 billion) led to a 522bps contraction in operating margin to 9.1% (Gross margin: -481bps YoY to 28.8%). Further down, finance cost expanded 5.3x YoY to ₦1.1 billion. The expansion in finance charge remains a surprise considering the relatively low leverage. On a positive note, foreign exchange losses, which was a major pressure point on earnings in full year 2017, moderated 46.3% to ₦3.3 billion over 9M 18 although, the gains were not strong enough to outpace underlying operating weakness.
- Given nine-month numbers, we revise our FY 18E earnings lower to ₦2.1 billion (previous: ₦4.1 billion). Farther out in 2019, we expect weak recovery in volumes to drive modest topline growth of 2.3% YoY. That said, we expect faster rise in input cost (+4% YoY) – on the back of higher petrochemical inputs – to stoke pressure on gross margin (-150bps YoY to 26.5%). The foregoing, alongside higher operating cost should drive EBIT lower (-14.7% YoY). Irrespective, projected stability of the Naira guides to materially lower FX losses (-55% YoY) translating to PBT and PAT of ₦5.4 billion (+78% YoY) and ₦3.7 billion (+78.4% YoY) respectively.
- On our 2019 numbers, PZ trades at a P/E of 27.8x relative to Bloomberg Middle-East and Africa (MENA) peers of 22.2x. We retain our **SELL** rating on the stock with our FVE estimate of **₦16.56** (previous: ₦20.97).

### Third quarter earnings yield to cost pressure

- Over PZ's third quarter (FQ3 18), EPS declined 60.4% YoY to ₦0.19 due to disappointing revenue and prevailing input cost pressures. Precisely, revenue declined 7.2% YoY to ₦22.1 billion due to volume weakness, reflecting constrained consumer wallets and intense industry competition. According to commentary from its parent company – PZ Cussons UK – buying levels were subdued in Nigeria owing to weak discretionary income of consumers. Additionally, despite the third quarter being its seasonally peak period, FQ3 18 revenue declined 0.4% QoQ (vs. 27.8% QoQ increase on average in the last five years) which likely suggests ongoing volume pressures.
- Input cost pressures prevailed in the quarter, rising 0.8% YoY relative to revenue (-7.2% YoY). Much of the increase reflected higher petrochemical prices in line with the rise in Brent price (+19.7% YoY) while lower Crude Palm Oil (-27.3% YoY) tempered the impact. In our view, the need to maintain competitive share in the market to shore up volumes limited the company's ability to passthrough higher input prices to consumers. As a result, gross profit declined 23.8% YoY to ₦5.9 billion while related margin contracted 583bps to 26.7%. While we had thought that cost savings measures will be implemented to support operating margin, that didn't materialize as operating expenses rose 3.0% YoY to ₦4.1 billion owing to a 6.4% YoY increase in Admin expenses. Consequently, operating margin contracted 764bps to 8.4%.
- Over FQ3 18, finance cost jumped to ₦539 million (vs. ₦4.2 million and ₦197 million in FQ3 17 and FQ2 18 respectively) despite the absence of leverage on its balance sheet. We suspect its due to overdraft facility taken and paid during the quarter.

**Figure 1: Trend in Crude oil vs. core profitability margins**



Source: ARM Research, Company's financial

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### *Lower FX losses to drive earnings growth in 2019*

- Going into FQ4 18, weak income levels, subsisting input cost pressures, and limited pricing power to passthrough higher input prices to consumers suggests a weak finish to its 2018 financial year. Incorporating FQ3 18 results, we have revised our FY 18 revenue estimate lower by 3.8% to ₦85.4 billion (previous: ₦88.8 billion), representing a 7.2% YoY increase from FY 17. Given our outlook that input cost pressures will linger in the final quarter, we revise our input cost estimate lower by a modest 1.0% to ₦61.5 billion (previous: ₦62.1 billion). Against this backdrop, we estimate FY 18 gross margin to contract 710bps to 28%. Net impact of this, including expectation of higher operating expenses (+11.3% to ₦16.4 billion) and finance costs (+354% YoY to ₦1.3 billion) translates to a 43.8% YoY decline in earnings to ₦2.1 billion in FY 18.
  - Farther out into 2019, with improved dollar liquidity, we expect competition in the Home and Personal Care (HPC) industry to remain intense owing to sustained influx of imported HPC products. This combined with slow rebound in consumer wallets guides to weak recovery in volume over FY 19. Given this, we forecast FY 19E revenue to print at ₦87.4 billion which represents a modest 2.3% YoY increase (vs. 9M 17: +10.7% YoY, FY 18E: +7.2% YoY).
  - We have revised our FY 19E input cost higher (+4% YoY to ₦64.2 billion) to capture the impact of rising petrochemical prices. This, together with our marginal top-line growth expectation, should see gross margin shed 150bps YoY to 26.5% (vs. 9M 17: 28.8%, FY 18E: 28%) with related profit at ₦23.2 billion (-3.1% YoY). Also, with our FY 19E operating costs expectation of ₦16.8 billion (+2.3% YoY), we expect EBIT to print lower at ₦6.6 billion (-14.7% YoY).
  - With the recent stability in the Naira, we do not envisage material foreign exchange losses in FY 19. Thus, we project FX losses at ₦1.5 billion (vs. ₦3.3 billion reported as at 9M 18). Net impact of our revisions translates to PBT and PAT of ₦5.4 billion (+78% YoY) and ₦3.7 billion (+78.4% YoY) respectively.
  - On our 2019 numbers, PZ trades at a P/E of 27.8x relative to Bloomberg Middle-East and Africa (MENA) peers of 22.2x. We retain our **SELL** rating on the stock with our revised FVE estimate of **₦16.56** (previous: ₦20.97).
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## Summary of Results and Forecasts - Naira (₦)

<b>ANNUAL</b>					
Income Statement (₦' m) *					
	2016A	2017A	2018E	2019F	2020F
Revenue	69,528	79,630	85,390	87,387	89,509
COGS	49,326	51,682	61,481	64,230	62,656
Gross Profit	20,201	27,948	23,909	23,158	26,853
Operating Cost	14,068	14,733	16,395	16,778	17,723
Operating Profit	6,419	13,414	7,685	6,554	9,309
Interest expense	598	290	1,319	377	271
Interest income	210	486	679	757	166
PBT	3,148	4,811	3,045	5,434	9,204
Tax	1,019	1,125	974	1,739	2,945
PAT	2,130	3,687	2,071	3,695	6,259
Balance Sheet (₦ '000) *					
Fixed Assets	26,505	28,514	30,076	30,291	30,553
Stocks	19,278	26,710	26,437	26,976	25,063
Trade debtors	15,587	17,222	16,224	16,604	17,007
Cash & other bank balances	12,868	8,022	15,257	17,951	19,255
Total Assets	74,430	90,088	94,825	96,192	94,563
Liabilities					
Trade Creditors	25,716	39,723	43,036	42,392	37,594
Non-current Liabilities	3,932	2,584	2,605	2,643	2,708
Total liabilities	31,027	44,950	48,322	47,841	43,084
Shareholders' fund	43,403	45,138	46,503	48,350	51,479
Key Ratios					
	2016A	2017A	2018E	2019F	2020F
Gross Margin	29.1%	35.1%	28.0%	26.5%	30.0%
EBIT Margin	9.2%	16.8%	9.0%	7.5%	10.4%
PBT Margin	4.5%	6.0%	3.6%	6.2%	10.3%
Net Margin	3.1%	4.6%	2.4%	4.2%	7.0%
EPS	0.47	0.84	0.45	0.81	1.37
P/E	45.18	25.33	49.59	27.79	16.41
EV/EBITDA	8.62	5.03	7.22	7.74	5.80
ROA	3.0%	4.5%	2.2%	3.9%	6.6%
ROE	4.9%	8.3%	4.5%	7.8%	12.5%

Source: ARM Research \*unless otherwise stated

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