

PZ Cussons Nigeria Plc.

Q3-18 weak earnings echo management's earlier warning

Update: PZ just published 9M-18 and Q3-18 results which fell well-short of broad expectations, in line with management guidance two weeks ago. Management had guided that trading conditions have been unusually challenging thus far in H2, and expects its profits over the period, and indeed for the year ending May 2018, to fall short of expectations. Reported Q3-18 revenue and net profit fell short of our estimates by 15% and 49% respectively.

Revenue development: Q3 revenue was lower by 7% y/y and 0.4% q/q. This is the company's first q/q revenue decline, in a seasonally-supportive quarter, within the period of available data (February 2013). The key factors that management recently informed us are responsible for the current revenue challenge include (1) weak consumer's discretionary income, with subdued buying levels, (2) increased local competition, amidst improved dollar availability to importers, and (3) lower cross-border sales, affected by Sudan (inflation recently hit 54%), wherein currency devaluation impacted adversely on discretionary spending.

Weak margins: Gross and EBIT margins also weakened on y/y (412 bps and 602 bps respectively) and q/q (148 bps and 49 bps respectively) bases. Management mentioned in a recent trading update that intense competition is resulting in lower prices and margins in some product categories. We should state that compared to UNILEVER, PZ's margins are yet to recover from the 2015/16 and 2016/17 FX-induced pressures. Compared to our estimate, the published Q3-18 gross and EBIT margins are lower by 149 bps and 285 bps respectively. Although opex was lower than we estimated, the ratio was higher, owing to lower revenue outturn.

Proposed management response: Part of measures management said it is implementing to support sales in the immediate include sizeable discounting, improved (but on very selective basis) credit conditions, and better distribution. New product launches are also planned in the Electrical division.

And to ease margin pressure, the Group said it has initiated some remedial actions, including a (1) reassessment of the structure of its operating model to further reduce the overhead base, (2) review of product costs with a focus on areas such as packaging reduction, and (3) re-prioritisation of the new product pipeline to focus on fewer, bigger projects requiring lower levels of complexity.

Review of our estimates: In our note – "Parent company confirms challenging H2!" – published on 16th March 2018, we noted that the tone of PZ parent company's (PZC) communication of earnings warning (for the Group) at the time had raised concern for us that the decline in 2018E net profit might be bigger than the 7% we expected. The guidance provided by PZC was for 18-23% decline in Group 2018E PBT vs. 2017FY. On our revised estimate, we now expect the Nigeria 2018E net profit will be lower by 44%, following the downward revision of revenue and margin estimates, and the upward revision of estimate for finance charges. Net earnings estimate for 2019-2020E was revised lower by 6% average.

Valuation: We have rolled forward our model estimates and valuation to 2019E. Hence, impact of the above changes to estimates was insignificant on the stock's TP (NGN15.13, vs. NGN15.19 previously). SELL rating maintained. On our estimates, PZ is trading at 2018E P/E and EV/EBITDA multiples of 23.9x and 110x respectively, relative to MEA peer averages of 28.2x and 14.4x respectively.

SELL

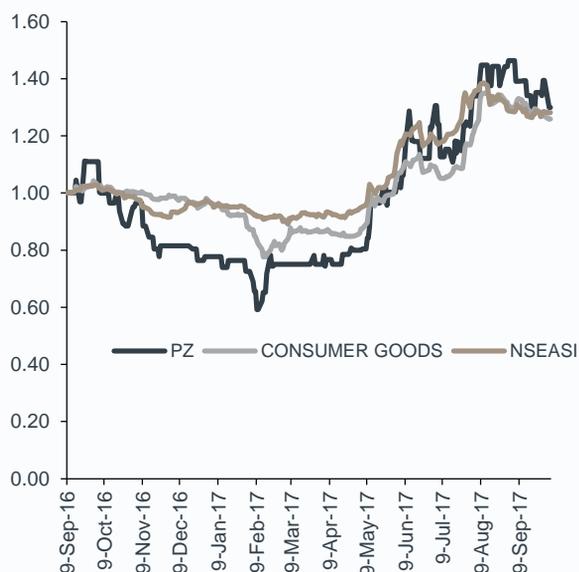
Target Price (NGN)	15.13
Current Price (NGN)	23.00
Implied Return (%)	-34.23

Company Data

NSE Code	PZ
Bloomberg Code	PZ:NL
Reuters Code	PZ.LG
Sector	CONSUMER GOODS
Market Cap. (NGN'bn)	91.32
Free Float (%)	26.73

Ratios	Q3-18	Q3-17	2018F
Gross margin (LFL)	23.51%	27.63%	24.40%
Opex margin	18.34%	16.52%	18.49%
EBIT margin (LFL)	5.26%	11.27%	5.96%
PAT margin	3.38%	7.93%	3.64%
EPS (NGN)	0.17	0.46	0.84

Price movement (PZ vs. Benchmark Indices)



Financial Statement (NGN'billion).

Income Statement (N'bn)	28-Feb-18	28-Feb-17	y/y	Q3 Feb-18	y/y	q/q	Nov'17	Aug'17	30-Nov-17	May'17	Feb'17	Nov'16
Revenue	63.26	57.15	10.7%	22.14	-7.2%	-0.4%	22.22	18.90	41.12	22.48	23.85	16.55
Cost of sales	45.02	37.93	18.7%	16.23	0.8%	2.1%	15.89	12.91	28.80	13.76	16.09	10.86
Gross profit	18.24	19.22	-5.1%	5.91	-23.8%	-6.7%	6.33	5.99	12.33	8.72	7.76	5.69
Operating expenses	12.51	11.06	13.1%	4.06	3.0%	-5.7%	4.31	4.14	8.45	3.67	3.94	3.55
Other income	0.08	0.15	-44.6%	0.02	-51.0%	-37.7%	0.03	0.03	0.06	0.05	0.04	0.05
Net finance cost	-3.85	-5.95	-35.4%	-0.77	-28.3%	-23.5%	-1.01	-2.07	-3.07	-2.65	-1.08	-0.18
Profit before tax	1.97	2.35	-16.5%	1.10	-60.5%	4.6%	1.05	-0.18	0.87	2.46	2.78	2.01
Taxation	0.63	0.75	-16.5%	0.35	-60.6%	3.9%	0.34	-0.06	0.28	0.37	0.89	0.71
Profit after tax	1.34	1.60	-16.5%	0.75	-60.4%	4.9%	0.71	-0.12	0.59	2.09	1.89	1.30

Gross margin	28.83%	33.64%		26.70%			28.50%	31.71%	29.97%	38.80%	32.53%	34.36%
LFL gross margin	23.65%	22.96%		23.51%			24.99%	22.22%	23.72%	26.83%	27.63%	32.92%
OPEX margin	19.77%	19.36%		18.34%			19.38%	21.90%	20.54%	16.33%	16.52%	21.45%
EBIT margin	4.01%	3.86%		5.26%			5.75%	0.48%	3.33%	10.73%	11.27%	11.77%
PBT margin	3.11%	4.12%		4.96%			4.72%	-0.96%	2.11%	10.93%	11.66%	12.12%
PAT margin	2.11%	2.80%		3.38%			3.21%	-0.65%	1.43%	9.28%	7.93%	7.84%
Tax rate	32.00%	32.00%		31.90%			32.11%	32.00%	32.13%	15.10%	32.01%	35.35%
*RoAE	7.80%	4.85%										
*RoAA	3.75%	2.45%										
EPS (N)	0.34	0.40										
*EPS (N)	0.86	0.52										
PE	26.68x	51.32x										
BVPS(N)	11.27	10.84										
PBV	2.04x	2.48x										

*Trailing

Source: Company Accounts, Cordros Research

Financial Statement (NGN'billion).

Income Statement (NGN'bn)							Profitability Ratios						
	2015a	2016a	2017a	2018e	2019e	2020e		2015a	2016a	2017a	2018e	2019e	2020e
Revenue	73.13	69.53	79.63	83.85	93.07	102.38	Gross profit margin	28.0%	24.9%	24.0%	23.4%	24.5%	24.6%
Cost of sales	-52.67	-52.21	-60.48	-64.26	-70.27	-77.19	EBITDA margin	12.1%	8.2%	8.7%	7.4%	8.6%	8.8%
Gross profit	20.45	17.32	19.15	19.59	22.80	25.18	EBIT margin	9.3%	5.1%	5.8%	4.5%	5.8%	6.0%
Operating expenses	-13.80	-14.07	-14.73	-15.90	-17.56	-19.21	PBT margin	9.0%	4.5%	6.0%	3.6%	6.0%	6.2%
Other income	0.12	0.29	0.20	0.11	0.13	0.15	Net profit margin	6.3%	3.1%	4.6%	2.46%	4.1%	4.2%
Net finance (cost)/income	-0.22	-0.39	0.20	-0.80	0.18	0.20	RoAE	10.6%	4.9%	8.3%	4.6%	8.2%	9.1%
Profit before tax	6.56	3.15	4.81	3.00	5.56	6.33	RoAA	6.6%	3.0%	4.5%	2.3%	4.1%	4.4%
Tax	-1.99	-1.02	-1.12	-0.94	-1.74	-1.98							
Profit after tax	4.57	2.13	3.69	2.06	3.82	4.35	Liquidity Ratios						
							Working capital (NGN'bn)	22.6	20.8	18.2	18.6	19.7	18.4
Financial Position (NGN'bn)							Current ratio	2.2x	1.8x	1.4x	1.4x	1.5x	1.4x
PPE	25.22	26.50	28.51	28.70	29.84	32.82	Quick ratio	1.1x	1.1x	0.8x	0.8x	0.8x	0.8x
Intangible assets	-	-	1.02	1.01	1.05	1.15	Cash ratio	0.1x	0.5x	0.2x	0.3x	0.3x	0.3x
Total non-current assets	25.22	26.50	29.53	29.71	30.88	33.97	Efficiency Ratios						
Inventories	21.01	19.28	28.71	26.34	27.38	30.11	Fixed assets turnover	2.9x	2.6x	2.8x	2.9x	3.1x	3.1x
Trade and other receivables	17.91	15.59	17.22	18.32	19.05	20.95	Current assets turnover	1.7x	1.5x	1.3x	1.4x	1.5x	1.5x
Deposit for imports	0.92	0.19	6.60	4.22	4.39	4.83	Total assets turnover	1.1x	0.9x	0.9x	0.9x	1.0x	1.0x
Cash & cash equivalents	2.33	12.87	8.02	11.85	12.31	13.55	Inventory turnover	0.4x	0.4x	0.4x	0.4x	0.4x	0.4x
Total current assets	42.17	47.93	60.56	60.73	63.13	69.44	Receivables turnover	0.3x	0.2x	0.2x	0.2x	0.2x	0.2x
Total Assets	67.39	74.43	90.09	90.44	94.01	103.41	Payables turnover	0.4x	0.4x	0.5x	0.6x	0.6x	0.6x
Bank overdraft	-	-	-	-	-	-	Days inventory outstanding	143	141	145	156	139	136
Trade and other payables	17.83	25.72	39.72	41.90	43.19	50.70	Days collection/sales outstanding	96	88	75	77	73	71
Current taxation payable	1.67	1.29	2.56	0.20	0.21	0.24	Days payable outstanding	124	180	240	238	224	240
Warranty provisions	0.06	0.09	0.09	0.06	0.06	0.07	Cash conversion cycle	116	49	-20	-4	-12	-33
Total current liabilities	19.56	27.10	42.37	42.16	43.46	51.02	Investment Ratios						
Deferred taxation	3.90	3.69	2.40	2.93	3.02	3.54	Earnings per share (NGN)	1.15	0.54	0.93	0.52	0.96	1.10
Warranty provisions	0.25	0.24	0.18	0.14	0.15	0.17	Dividend per share (NGN)	0.81	0.50	0.50	0.41	0.77	0.88
Total non-current liabilities	4.15	3.93	2.58	3.07	3.17	3.72	Payout	70.4%	93.2%	53.9%	80.0%	80.0%	80.0%
Total liabilities	23.72	31.03	44.95	45.23	46.63	54.73	Dividend yield	3.0%	2.3%	2.7%	1.8%	3.3%	3.8%
Total Equity	43.67	43.40	45.14	45.21	47.38	48.68	PE	23.4x	40.4x	20.1x	44.3x	23.9x	21.0x
							EV/EBITDA	11.9x	12.9x	9.5x	12.8x	9.9x	8.6x

Source: Company Accounts, Cordros Research

Disclosures

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