

PZ Cussons Nigeria Plc

Nigeria | Equities | Consumer Goods | October 9, 2015

PAC RESEARCH

Operational inefficiency impacts valuation

1Q'15/16 revenue declines marginally by 0.4% y/y. In the first quarter to August 2015, PZ Cussons recorded a marginal decline in revenue by 0.4% to ₦14.95billion compared with ₦15.02billion in the corresponding period of the previous year. Also, the revenue in the review period is lower than ₦20.24billion posted in the last quarter of the previous year by 26.1%. Similarly, the revenue is lower than 8-quarter average of ₦18.24billion and our estimate of ₦15.17billion by 18.0% and 1.4% accordingly.

Gross profit margin improves on the back of lower input costs. For the review period, the company posted cost of sales (COS) of ₦10.83billion, down by 1.4% y/y and 23.4% against ₦10.98billion and ₦14.13billion respectively in the first and the last quarter of the previous year. Similarly, the COS is lower than 8-quarter average of ₦13.27billion by 18.4%. The higher year-on-year decline in COS relative to revenue resulted in a lower COS/revenue ratio of 72.4% compared with 73.1% in the preceding year. Moreover, the COS/revenue ratio of 72.4% in the review period is lower than 73.1% in the first quarter of the previous year, but higher than 69.8% in the fourth quarter. Also, it is marginally lower than 8-quarter average of 72.7%. Therefore, gross profit increased by 2.1% y/y to ₦4.13billion against ₦10.98billion and gross profit margin improved to 27.6% relative to 26.9% in the prior year.

A 7.5% year-on-year increase in operating expenses depressed operating profit. PZ Cussons' operating expenses of ₦3.49billion in the first quarter to August 2015 is higher than ₦3.24billion and ₦3.45billion by 7.5% and 0.9% respectively in the first quarter and the last quarter of the immediate past financial year; it is also higher than 8-quarter average of ₦3.40billion by 2.4%. Furthermore, our analysis revealed that the company recorded operating expenses/revenue ratio of 23.3% in the period, higher than 17.1% and 21.6% recorded in in 4Q2014/15 and 1Q2014/15 in that order.

Fig. 1: Quarterly results highlights

| | 1Q2015/16 | 4Q2014/15 | 1Q2014/15 | Q/q Δ | Y/y Δ |
|-------------------------|-----------|-----------|-----------|--------|--------|
| Revenue (₦'mn) | 14,953 | 20,236 | 15,019 | -26.1% | -0.4% |
| Operating profit (₦'mn) | 711 | 2,767 | 831 | -74.3% | -14.4% |
| Net profit (₦'mn) | 428 | 1,784 | 642 | -76.0% | -33.3% |

Source: NSE, PAC Research

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Price:

| | |
|------------------------|-------------|
| - Current | ₦25.00* |
| - Target | ₦18.14 |
| Recommendation: | SELL |

* As at Thursday October 08, 2015

Fig. 2: Stock data

| FYE | May |
|---------------------------|-----------------------|
| Price Mov't: YtD / 52wk | +5.04%/-21.87% |
| 52-week range | ₦17.50 - ₦35.00 |
| Average daily vol./val. | 1,027,244 / ₦28.509mn |
| Shares Outstanding (₦'mn) | 3,971 |
| Market Cap. (₦'mn) | 99,262 (US\$496.31mn) |
| EPS, ₦- 12months trailing | 1.10 |
| DPS, ₦- FY2014/15 | 0.81 |
| FCF, ₦- FY2014/15 | n/a |

Source: NSE, Company's Annual Reports, PAC Research

Fig. 3: Key ratios

| | 1Q2015/16 | 1Q2014/15 |
|---------------------|-----------|-----------|
| Gross profit margin | 27.59% | 26.91% |
| Net profit margin | 2.86% | 4.27% |
| Equity multiplier | 1.53x | 1.56x |
| Asset turnover | 1.08x | 1.08x |

Source: NSE, PAC Research

Fig. 4: Valuations

| | FY2015 | FY2016E | FY2017F | FY2018F |
|------------|--------|---------|---------|---------|
| P/Sales | 1.36x | 1.35x | 1.33x | 1.31x |
| P/E | 21.72x | 21.12x | 22.11x | 21.42x |
| PEG | n/a | 21.12 | 1.84 | 5.35 |
| EV/EBITDA | 1.33x | 1.31x | 1.30x | 1.26x |
| P/B | 2.27x | 2.20x | 2.11x | 2.05x |
| ROE | 10.47% | 10.41% | 9.54% | 9.55% |
| ROA | 6.78% | 6.80% | 6.25% | 6.38% |
| Div. Yield | 3.24% | 3.24% | 2.60% | 3.20% |

Source: NSE, PAC Research

Fig. 5: PZ vs. NSE, 52-wk movement (rebased)



Source: Bloomberg, PAC Research

Similarly, the period's operating expenses/revenue ratio is higher than 8-quarter average of 19.0%. Therefore, operating profit declined by 14.4% to ₦711million compared with ₦831million in the first quarter of 2014/15, and operating profit margin dropped to 4.7% relative to 5.5% in 1Q2014/15. Overall, total costs increased by 0.7% to ₦14.31billion compared with ₦14.22billion in the previous period and total costs/revenue ratio increased to 95.7% relative to 94.7% in 1Q2014/15. Consequently, net profit declined by 33.4% y/y to ₦427million against ₦641million and net profit margin dropped to 2.9% relative to 4.3% in the preceding year.

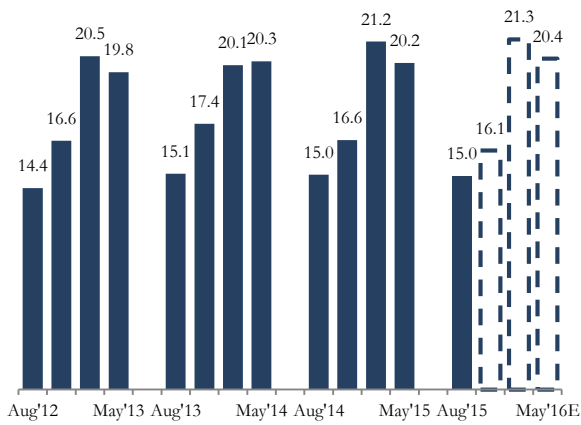
PZ Cussons under-performs the equity market in the review period. The company recorded total shareholders' returns (TSR) of -20.7% in the review period relative to -10.9% recorded by the equity market. Similarly, in the corresponding period of the previous year, PZ Cussons achieved total shareholders' returns of -6.4% compared with -2.1% recorded by the entire equity market. On the contrary, the company out-performed the market year-to-date with TSR of +13.5% compared with -6.6% achieved by the market. In addition, PZ Cussons recorded TSR of -29.3% in the past 52 weeks relative to -25.7% by the equity market in the same period. Overall, the company under-performed the market in a 5-year period with TSR of +11.9% compared with +48.7% posted by the equity market.

Valuation

Our revised valuation puts the target price of the stock of PZ Cussons Nigeria Plc at ₦18.14. In arriving at the target price, we employed multiples of price/earnings, price/sales, price/book, and EV/sales. We also employed the discounted cashflow valuation methodology. Consequently, we maintained a SELL recommendation on the stock of the company. Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the challenging operating environment in Nigeria, insecurity challenges in the northern part of the country, demographic factor, the strength of consumer spending and the intensity of competition in the market.

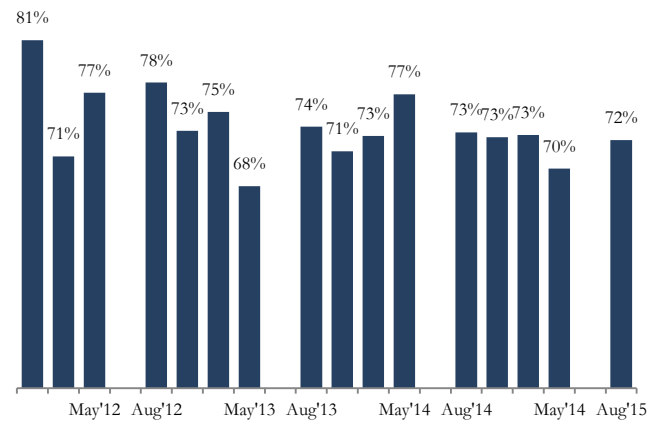
“ Our revised valuation puts the target price of the stock of PZ Cussons Nigeria Plc at ₦18.14. ”

Fig. 6: Quarterly sales revenue (₦'billion)



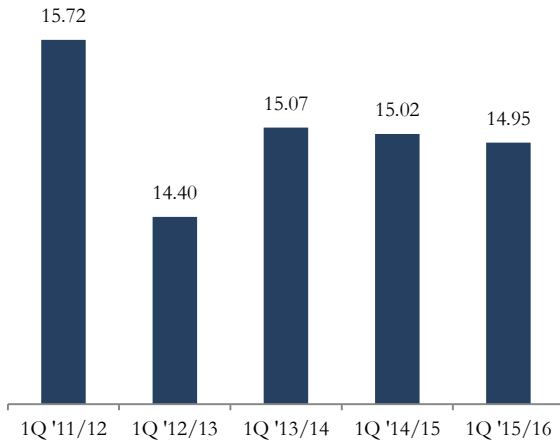
Source: NSE, PAC Research

Fig. 7: Quarterly COS/revenue ratio



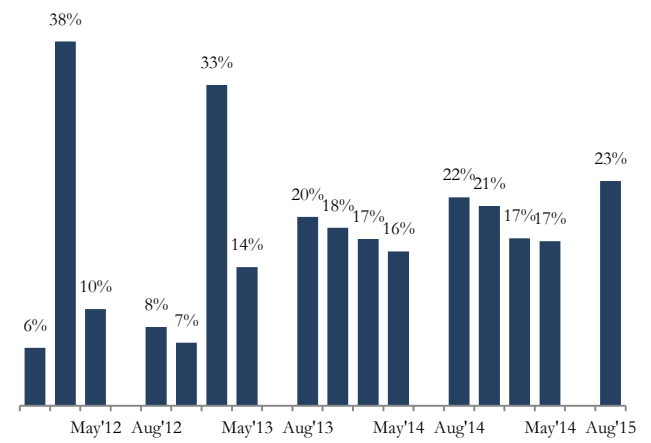
Source: NSE, PAC Research

Fig. 8: First quarter sales revenue (₦'billion)



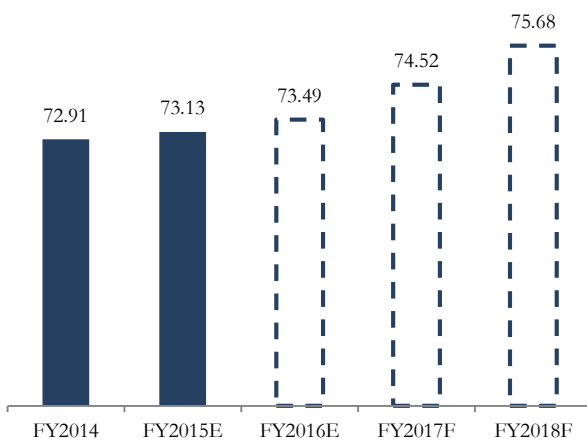
Source: NSE, PAC Research

Fig. 9: Quarterly operating expenses/revenue ratio



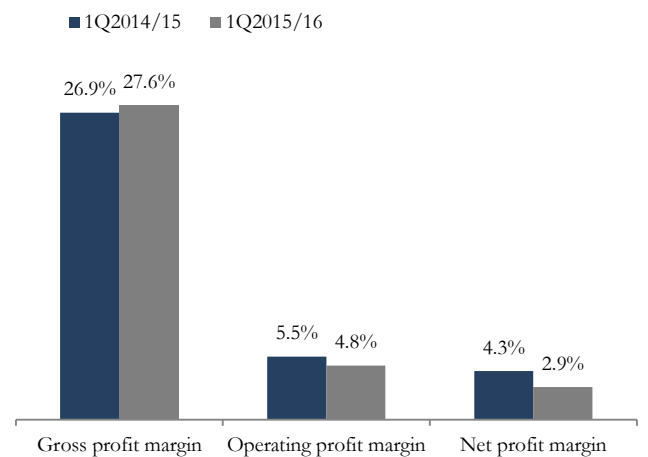
Source: NSE, PAC Research

Fig. 10: Annual sales revenue (₦'billion)



Source: NSE, PAC Research

Fig. 11: Profit margins



Source: NSE, PAC Research

Fig. 12: Statement of Profit or Loss, ₦mn

| | FY2015 | FY2016E | FY2017F | FY2018F |
|------------------------|--------|---------|---------|---------|
| Revenue | 73,126 | 73,492 | 74,521 | 75,638 |
| Change | | 0.50% | 1.40% | 1.50% |
| Cost of sales | 52,672 | 53,061 | 54,102 | 54,838 |
| Change | | 0.74% | 1.96% | 1.36% |
| Gross profit | 20,454 | 20,431 | 20,419 | 20,801 |
| Change | | -0.11% | -0.06% | 1.87% |
| Operating expenses | 13,803 | 13,596 | 13,935 | 14,296 |
| Change | | -1.50% | 2.50% | 2.59% |
| Other operating income | 122 | 117 | 107 | 128 |
| Change | | -4.10% | -8.55% | 20.00% |
| Operating profit | 6,773 | 6,952 | 6,590 | 6,633 |
| Change | | 2.64% | -5.20% | 0.65% |
| Interest income | 229 | 234 | 259 | 311 |
| Change | | 2.00% | 11.00% | 20.00% |
| Interest expenses | 445 | 472 | 434 | 417 |
| Change | | 6.00% | -8.00% | -4.00% |
| Profit before tax | 6,557 | 6,714 | 6,416 | 6,528 |
| Change | | 2.39% | -4.44% | 1.75% |
| Income tax expenses | 1,986 | 2,014 | 1,925 | 1,893 |
| Change | | 1.41% | -4.44% | -1.64% |
| Profit for the year | 4,571 | 4,700 | 4,491 | 4,635 |
| Change | | -2.81% | -4.44% | 3.20% |

Fig. 13: Statement of Financial Position, ₦mn

| | FY2015 | FY2016E | FY2017F | FY2018F |
|-------------------------------------|--------|---------|---------|---------|
| Non-Current Assets | | | | |
| Property, plant & equipment | 25,218 | 25,975 | 27,178 | 27,722 |
| Total non-current assets | 25,218 | 25,975 | 27,178 | 27,722 |
| Current Assets | | | | |
| Inventories | 21,013 | 20,803 | 21,219 | 20,795 |
| Trade & other receivables | 18,829 | 19,582 | 20,757 | 20,342 |
| Cash & cash equivalents | 2,328 | 2,782 | 2,680 | 3,749 |
| Total Current assets | 42,170 | 43,167 | 44,656 | 44,885 |
| Total assets | 67,388 | 69,142 | 71,834 | 72,607 |
| Equity | 43,672 | 45,155 | 47,065 | 48,523 |
| Non-Current Liabilities | | | | |
| Deferred tax | 3,904 | 4,339 | 4,165 | 3,957 |
| Provisions | 249 | 183 | 183 | 183 |
| Loans and borrowings | | | | |
| Total non-current fin. liab. | 4,153 | 4,522 | 4,348 | 4,140 |
| Current Liabilities | | | | |
| Trade & other payables | 17,835 | 17,389 | 18,432 | 17,972 |
| Current tax liabilities | 1,671 | 2,014 | 1,925 | 1,893 |
| Total current liabilities | 19,506 | 19,403 | 20,357 | 19,865 |
| Total equity and liabilities | 67,388 | 69,142 | 71,834 | 72,607 |

Fig. 14: Profitability & return

| | FY2015 | FY2016E | FY2017F | FY2018F |
|-------------------------|--------|---------|---------|---------|
| Gross profit margin | 27.97% | 27.80% | 27.40% | 27.50% |
| Operating profit margin | 9.269% | 9.46% | 8.84% | 8.77% |
| Net profit margin | 6.25% | 6.39% | 6.03% | 6.13% |
| ROCE | 15.51% | 15.40% | 14.00% | 13.67% |
| ROE | 10.47% | 10.41% | 9.54% | 9.55% |
| ROA | 6.78% | 6.80% | 6.25% | 6.38% |

Source: Company's Annual Reports, PAC Research

Fig. 15: DuPont Analysis

| | FY2015 | FY2016E | FY2017F | FY2018F |
|-------------------------|--------|---------|---------|---------|
| Total assets turnover | 1.67x | 1.63x | 1.58x | 1.56x |
| Operating profit margin | 9.269% | 9.46% | 8.84% | 8.77% |
| Equity multiplier | 1.54x | 1.53x | 1.53x | 1.50x |
| ROCE | 15.51% | 15.40% | 14.00% | 13.67% |

Fig. 16: Efficiency ratios

| | FY2015 | FY2016E | FY2017F | FY2018F |
|-----------------------------|--------|---------|---------|---------|
| Fixed assets turnover | 2.90x | 2.83x | 2.74x | 2.73x |
| Current assets turnover | 1.73x | 1.70x | 1.67x | 1.69x |
| Total assets turnover | 1.67x | 1.63x | 1.58x | 1.56x |
| Inventory turnover | 2.70x | 2.54x | 2.57x | 2.61x |
| Receivables turnover | n/a | n/a | n/a | n/a |
| Payables turnover | n/a | n/a | n/a | n/a |
| Days inventory outstanding | 135 | 144 | 142 | 140 |
| Days collection outstanding | n/a | n/a | n/a | n/a |
| Days payable outstanding | n/a | n/a | n/a | n/a |
| Operating cycle (days) | n/a | n/a | n/a | n/a |

Fig. 17: Liquidity ratios

| | FY2015 | FY2016E | FY2017F | FY2018F |
|-----------------------------|--------|---------|---------|---------|
| Working capital (₦millions) | 22,607 | 23,702 | 24,235 | 24,941 |
| Current ratio | 2.16 | 2.22 | 2.19 | 2.25 |
| Quick ratio | 1.08 | 1.15 | 1.15 | 1.21 |
| Cash ratio | 0.12 | 0.14 | 0.13 | 0.19 |

Fig. 18: Long-term solvency & stability ratios

| | FY2015 | FY2016E | FY2017F | FY2018F |
|----------------------|--------|---------|---------|---------|
| Gearing | 0.00% | 0.00% | 0.00% | 0.00% |
| Equity multiplier | 1.54x | 1.53x | 1.53x | 1.50x |
| Total debt-to-equity | 0.35x | 0.35x | 0.34x | 0.33x |
| Total debt-to-assets | 54.30% | 53.12% | 52.63% | 49.64% |
| Proprietary | 64.81% | 65.31% | 65.52% | 66.83% |
| Interest coverage | 15.22x | 14.74x | 15.19x | 15.12x |
| Cash coverage | n/a | n/a | n/a | n/a |

Fig. 19: Shareholders' investment ratios

| | FY2015 | FY2016E | FY2017F | FY2018F |
|----------|--------|---------|---------|---------|
| EPS, ₦ | 1.15 | 1.18 | 1.13 | 1.17 |
| DPS, ₦ | 0.81 | 0.81 | 0.65 | 0.80 |
| Payout | 70.37% | 68.44% | 57.47% | 68.54% |
| FCFPS, ₦ | n/a | n/a | n/a | n/a |

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

| Deviation from current price | Recommendation |
|------------------------------|----------------|
| >30% | STRONG BUY |
| 10% to < 30% | BUY |
| -10% to < 10% | HOLD |
| <-10% | SELL |

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