

Soaring Interest Expense Underscores Pessimism

Topline Growth in Q1:2020 Masks Underperformance in Q2

In H1:2020, Berger Paints Plc reported a revenue growth of 10.98% to NGN1.69bn (vs NGN1.53bn in H1:2019) despite the -2.43% drop in Q2:2020. The increase was realized from higher sale of paints (+10.98%) and significantly higher (+237.62%) contract services rendered during the period. Although we observed that trade receivables increased by 29.81% from 2019FY, suggesting increased credit sales. The company also shows no letup in its efforts to increase market share in the highly fragmented and competitive industry as it intensifies on marketing and rebranding, evinced by a 4.97% increase in selling and distribution expenses. It is noteworthy that the company recently completed its 7-year long automated plant project. This new plant puts the company's installed capacity at 8 million liters per annum (vs 5.6million liters per annum) and, when considered in line with marketing efforts and the potential demand (especially in the decorative segment), is expected to positively impact the momentum of topline growth. *Going forward, as lockdown measures are eased, we expect demand to pick up gradually in Q3:2020 and beyond as we begin to see a rebound in economic activities. Thus, we project revenue to settle at NGN3.83bn in 202FY; a 7.00% growth compared to NGN3.59bn in 2019FY.*

Finance Costs Undermine Bottomline Performance

During the period, the company witnessed a surge in direct costs (+31.82% YoY) to NGN1.11bn as raw material expenses increased by 22.27% YoY (as a result of the FX adjustment), while contract services expense also spiked by 166.32% - in line with the rise in contract services rendered. The rise in direct costs clearly pared gross margin to 39.10% in H1:2020 (vs 46.05% in H1:2019). The effect of the cost build-up on operating margin was exacerbated by an elevated operating expense. OPEX climbed higher by 18.59% on account of increased sales and marketing personnel and higher distribution costs (+8.92%). Consequently, operating margin sank to 5.09% in H1:2020 (vs 13.60% in H1:2019). Moreover, we reckon that interest obligations on lease liabilities and payment of accrued interest on its Bank of Industry loan led finance costs to increase 3.51x to NGN40.04mn (vs NGN8.87mn in H1:2019). This weighed heavily on profit after tax as it declined by -71.79% to NGN41.09mn (vs 145.65mn). Thus, net margin was visibly lower at 2.25% (vs 9.30% in H1:2019). *Going forward, we expect the just completed automated plant to yield some cost savings for the company through the reduction in material handling and process lead time. However, we are not oblivious of the effect of the CBN's FX adjustment on cost of import requirements. On a balance of factors, we expect direct cost to increase by 15.84% at the end of the year. Also, we expect finance costs to increase by 240.31%, mainly on the back of subsequent payments of interest obligations on its lease liability. Thus, we project a lower profit of NGN171.68mn (vs NGN448.73mn in 2019FY) for the year.*

Lackluster Earnings in 2020FY to Dampen Shareholders Return

The outlook for return to shareholders is not helped by our expectations of pressured earnings in 2020FY. Although the company's annualized ROE currently stands at 11.31% (peer average - 12.56%), it lags 2019FY performance (14.95%) - mainly a result of the weaker net margin in 2020 so far. Also, while the company's liquidity metrics suggest a comfortable standing (working capital of NGN349.88mn and a current ratio - 1.21x), we express our worry over its long term cash generating abilities following the elongated operating cycle - 45 days in H1:2020 (vs. 21 days in 2019FY, **CAP**; - 36days).

Recommendation

For 2020FY, we project an EPS of NGN0.59 and P/E ratio of 5.10x to arrive at our December 2020 target price of NGN3.02 (a downside potential of 50.08%). Hence, we maintain our **SELL** rating on the counter.

Company	BERGER
Valuation	
Trailing EPS	1.19
BVPS	10.50x
P/E	5.09x
P/BV	0.58x
Target P/E	5.10x
Dec-2020 Exp. EPS	1.17
Dec 2020 Target price	3.02
Current Price	6.05
Up/Downside Potential	-50.08%
Ratings	SELL
Key metrics	
ROE	11.31%
ROA	6.59%
Net margin	8.59%
Asset Turnover	0.74x
Leverage	0.13x
Yr Hi	7.45
Yr Lo	6.10
YTD return	10.37%
Beta	0.02
Adjusted Beta	0.35
52-Week average volume ('000)	66.34
Shares outstanding	289.82mn
Market cap [NGN'000]	1.75 bn
Financial year end	Dec
Most Recent Period (MRP)	H1:2020

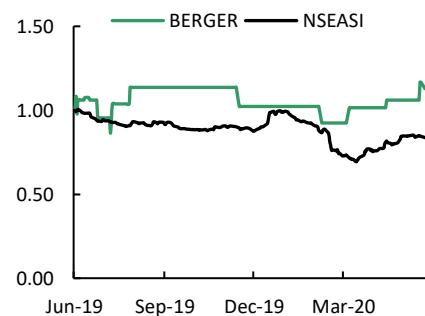


Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	2.84
EPS						Max	3.21
Target P/E		0.57	0.58	0.59	0.60	0.61	
	4.95x	2.84	2.89	2.93	2.97	3.02	
	5.02x	2.89	2.93	2.98	3.02	3.07	
	5.10x	2.93	2.98	3.02	3.07	3.11	
	5.18x	2.97	3.02	3.07	3.11	3.16	
	5.25x	3.02	3.07	3.11	3.16	3.21	

Financial Highlights (NGN million) H1:2020 Financial result			
<i>Profit & Loss Account</i>	H1:2020	H1:2019	y/y Growth
Revenue	1,828.40	1,565.84	16.77%
Cost of Sales	1,113.56	844.78	31.82%
Gross Profit	714.84	721.07	-0.86%
Investment Income	7.34	10.12	-27.50%
Other Income	19.13	32.25	-40.67%
Operating Expense	640.83	540.37	18.59%
Finance Cost	40.04	8.87	351.25%
PBT	60.43	214.19	-71.79%
PAT	41.09	145.65	-71.79%
<i>Balance Sheet</i>	H1:2020	2019FY	
Inventories	1,000.11	812.05	23.16%
Trade and other Receivables	429.08	330.54	29.81%
Cash and bank	157.19	216.69	-27.46%
Property, Plant and Equipment	2,756.85	2,823.81	-2.37%
Other Assets	878.92	883.36	-0.50%
Total Assets	5,222.14	5,066.45	3.07%
Shareholders' fund	3,042.04	3,073.40	-1.02%
Trade and Other Payables	973.56	804.59	21.00%
Tax Liabilities	74.89	72.03	3.97%
Debt Liabilities	409.87	395.34	3.68%
Other Liabilities	721.79	721.09	0.10%
Total Liabilities	2,180.11	1,993.05	9.39%

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Movements in Price Target

Company Name: Berger Paints Plc.

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
12-June-2020	7.45	4.87	5.97	SELL	SELL
27-August-2020	6.05	5.97	3.02	SELL	SELL

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Berger Paints Plc	

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