

PG p.l.c.



Update to Price Target and Investment Stance:

“We have reviewed our model and maintain our Buy recommendation on PG plc (“PG” or the “Group”) with a 12-month price target of €2.11 from our previous target of €1.90.

The increase in our price target primarily relates to the improvement registered by the Group during H1 2020 (year-end 30th April), whereby profitability increased by a healthy level of 28.3% over H1 2019, in line with the positive performance derived from the Group’s franchise operations given that post-refurbishment, the Zara® outlet in Sliema is now operating in a much larger store. Apart from the fact that such products typically involve higher margins than the supermarket chain, the EBIT margin in terms of the Group’s franchise operation is in line with that registered by Inditex Group. This segment represents circa 20% of the PG’s total operations.

In terms of the supermarket and associated retail operations, both Pama and Pavi kept operating at full capacity during H1 2020. However, we are of the opinion that both of the Group’s supermarkets are collectively approaching maturity stage, and as a result, we do not see any catalysts for abnormal growth in revenue in the near future.

The current P/E level (19.7x) at which the Group is trading at, is still considered to be relatively attractive in comparison to international industry peers. In arriving at our price target, we maintained the previously utilised P/E ratio of 23x, in which we deem to be in line with the foreign industry average, (P/E Tesco plc: 20x and P/E Walmart Inc: 23x), therefore we also still expect the share price to reflect such reality moving forward.

Given the strong cash position and capital structure of the Group, we see the current level of dividend pay-out ratio as sustainable. The shares currently offer a relatively attractive net dividend yield of 2.4%. This, coupled with the fact that PG is considered as a defensive stock, solidifies our Buy recommendation given the strong demand we are seeing for this sector.”

Update following issuance of 2019 interim financials:

PG plc is engaged in the retailing of food, household goods and other ancillary products through the Pavi Shopping Complex and Pama Shopping Village, and the selling of Zara® clothing and Zara Home® household goods as a franchisee of the Inditex Group. The Group also leases a number of retail outlets within Pavi Shopping Complex and Pama Shopping Village to third parties.

Replacing existing IT infrastructure with a modern, robust, multi-store IT system together with the construction of an additional car park floor at the Pavi Shopping Complex, remained the Group’s focus on improving its overall efficiency moving forward. These collectively are expected to amount to circa €3 million and are planned to commence in FY 2020/2021.

Stock Rating

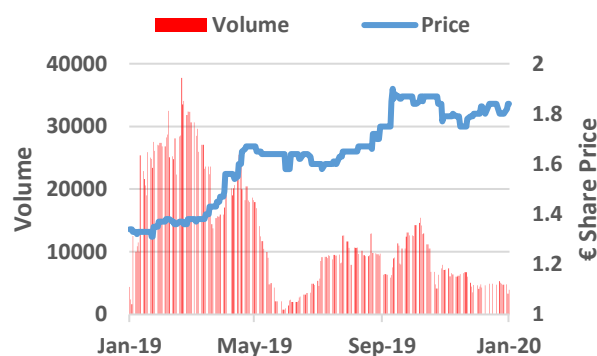
Price target (1Yr)

Buy
€2.11

Country	Malta
Industry	Retail
Ticker	PG
Price (as at 19/01/2020)	€1.85
Price Target (1 Year)	↑€2.11 -previous PT €1.90
Upside / Downside to PT	+14.1%
12m cash div. (Forecast)	€0.06
12m Total S’holder Return	17.1%
Market Cap	€199.8million
Shares Outstanding	108million
Free Float	25%
Net Dividend Yield*	2.4%
Current P/E*	19.8x
Forward P/E**	19.4x
*Based on the 2020 Last	
Twelve Months (LTM)	
** CC estimates	

Exchange	Malta Stock Exchange(MSE)
52-week range	€1.31 - €1.90

Price and Volume Movement (20 day moving average)



Source: Bloomberg

Market Research



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Valuation

Our one year price target is €2.11. The price target is calculated using a Price Earnings Model with a P/E ratio of 23.0x and a cost of equity of 7.3%. Based on our FY 2020 earnings, the forward P/E ratio is of 19.3x.

PG p.l.c. - €'000s unless otherwise stated	FY2017	FY2018	FY2019	2020LTM	FY2020P	FY2021P	FY2022P
Revenue	91,686	101,238	107,977	116,324	118,931	122,481	125,152
Cost of Sales	(76,259)	(84,885)	(90,166)	(96,308)	(97,523)	(100,435)	(102,624)
Gross Profit	15,427	16,353	17,811	20,016	21,407	22,047	22,527
Selling and marketing costs	(1,189)	(1,051)	(1,028)		(1,303)	(1,342)	(1,371)
Administrative Expenses	(2,347)	(3,179)	(3,439)	(3,082)	(2,379)	(2,450)	(2,503)
Other Income	764	771	886		900	900	900
EBITDA	12,655	12,894	14,230	16,934	18,626	19,155	19,553
Depreciation on right of use asset	-	-	-	(311)	(622)	(622)	(622)
Depreciation & Amortisation	(1,270)	(1,202)	(1,625)	(1,706)	(1,788)	(1,919)	(1,990)
EBIT	11,385	11,692	12,605	14,917	16,216	16,614	16,940
Investment Income	-	-	-	-	-	-	-
Finance Income	81	-	-	8	-	-	-
Finance Costs on right of use asset	-	-	-	(1,149)	(1,045)	(1,029)	(1,012)
Finance Costs	(638)	(589)	(632)		(562)	(481)	(399)
Share of results of associates	(21)	(26)	10	(2)	(300)	(287)	(273)
Profit Before Tax	10,807	11,077	11,983	13,774	14,308	14,817	15,256
Income tax expense	(3,447)	(3,417)	(3,046)	(3,666)	(4,006)	(4,149)	(4,272)
Profit Available to Ordinary Equity holders	7,360	7,660	8,937	10,108	10,302	10,668	10,984
<i>Earnings Per Share</i>	<i>0.068</i>	<i>0.071</i>	<i>0.083</i>	<i>0.094</i>	<i>0.095</i>	<i>0.099</i>	<i>0.102</i>

PG p.l.c. - €'000s unless otherwise stated	FY2017	FY2018	FY2019	2020LTM	FY2020P	FY2021P	FY2022P
Revenue Growth (YoY)	65.8%	10.4%	6.7%	7.7%	10.1%	3.0%	2.2%
EBIT Margin	12.4%	11.5%	11.7%	12.8%	13.6%	13.6%	13.5%
EBITDA Margin	13.8%	12.7%	13.2%	14.6%	15.7%	15.6%	15.6%
Net Margin	8.0%	7.6%	8.3%	8.7%	8.7%	8.7%	8.8%

Source: Financial Statements / CC Estimates

Investment Thesis Variables Update

- **Revenue** – During H1 2020, revenue increased by 16.8% in comparison to the previous corresponding period, resulting in an increase in turnover of 7.7% to €116.3 million as per 2020 LTM results. This increase is mainly attributable to an improvement in revenue generation across PG's all operating segments.

As at October 2019 (H1 2020), the 'supermarket and associated retail' segment remained the largest contributor towards the Group's revenue (82.1%), with an increase of 6.4% over H1 2019. This growth was predominantly derived from Pavi, whereas Pama registered a 1% growth over H1 2019, albeit still at record levels. Management also confirmed that revenue growth concerning Pama has gradually started slowing down, thus highlighting that the Pama Shopping Village has reached a saturation point.

In line with our view that both supermarkets collectively have approached maturity stage, we anticipate

revenue under this segment, including rental income derived from the associated retail outlets, to increase by 5% in FY 2020 to €97.5 million. Thereafter, we expect revenue under this division to increase by 3% in FY 2021 and by 2% in FY 2022.

The Group's other revenue stream relates to the operation of the Zara[®] outlet in Sliema and two Zara Home[®] outlets in Sliema and Mosta. As previously anticipated, during H1 2020 revenue under this division increased by 37.7% over H1 2018 (comparable period due to disruption during FY 19) to €10.4 million. This improvement is attributable to the refurbishment works implemented on the Zara[®] outlet in Sliema during FY 2019. In line with the fact that the Zara[®] outlet in Sliema will now operate in a much larger store, and given that the closure of the Sliema outlet during FY 2019 was a one-off disruption, we are projecting revenue generated under the franchise operations to increase by 30% in 2020 to €21.4 million.

- **Operating expenses** – These mainly consist of cost of sales, selling and marketing costs and administrative expenses. Cost of goods sold incurred as per 2020 LTM increased by 6.8% to €96.3 million, in line with the increase in revenue during H1 2020. We expect cost of goods sold to increase to €97.5 million in FY 2020 and to €100.4 million in FY 2021, reflecting the increase in revenue which is anticipated to be generated by the Group going forward. The cost of goods sold figures also incorporate the changes brought about by the adoption of IFRS16.

Selling & distribution costs together with administrative expenses and other income incurred during H1 2020 collectively decreased by circa €0.5 million over H1 2019. Such decline is attributable to several cost saving measures in terms of storage rental expenses implemented by the Group over H1 2020.

- **Depreciation and amortisation** – Following the adoption of IFRS 16 as from January 2019, the Group is expected to recognise a depreciation charge concerning the lease asset amounting to €0.6 million during 2019. Furthermore, in line with the Group's planned capital expenditure relating to the continued refurbishment at Pavi, the replacement of existing IT structure, together with the construction of an additional car park floor, we expect annual depreciation to increase to €1.8 million in FY 2020 and to €1.9 million in FY 2021 and FY 2022 respectively.
- **EBIT** – EBIT during H1 2020 increased by 40% over H1 2019 to €8.1 million, primarily due to the initiation of operations of the new Zara[®] outlet in Sliema and the effect of IFRS 16. In line with the expected increase in revenue to be generated by the Group, together with the anticipated decline in operating expenses as discussed above, we expect EBIT margin to improve to 13.6% during FY 2020, from 11.7% during FY 2019.
- **Finance costs** – Following the adoption of IFRS 16 as from January 2019 onwards, the Group is expected to recognise an interest expense on the lease liability amounting to €1 million during 2020. Moreover, we expect the Group to incur finance costs amounting to €0.6 million in 2020 and €0.5 million in 2021. The expected decline in finance costs relates to the fact that the Group is expected to utilise its cash reserves to repay and settle portions of its existing loans on a yearly basis.
- **Taxation** – The Group is subject to a corporate tax rate of 35% on its profit before tax concerning income generated from both supermarkets and the franchise operations. However, the Group benefits from a favourable tax rate of 15% on the lease income pertaining to the renting out of retail outlets.
- **Net profit and earnings per share** – As per 2020 LTM results, net profit increased to €10.1 million from €8.9 million during FY 2019. This translates to an EPS of €0.083 in FY 2019 to €0.094 as per 2020 LTM results. In line with the increase in revenue anticipated to be generated by the Group, we expect net profit to increase to €10.3 million in FY 2020, translating to an EPS of €0.095.

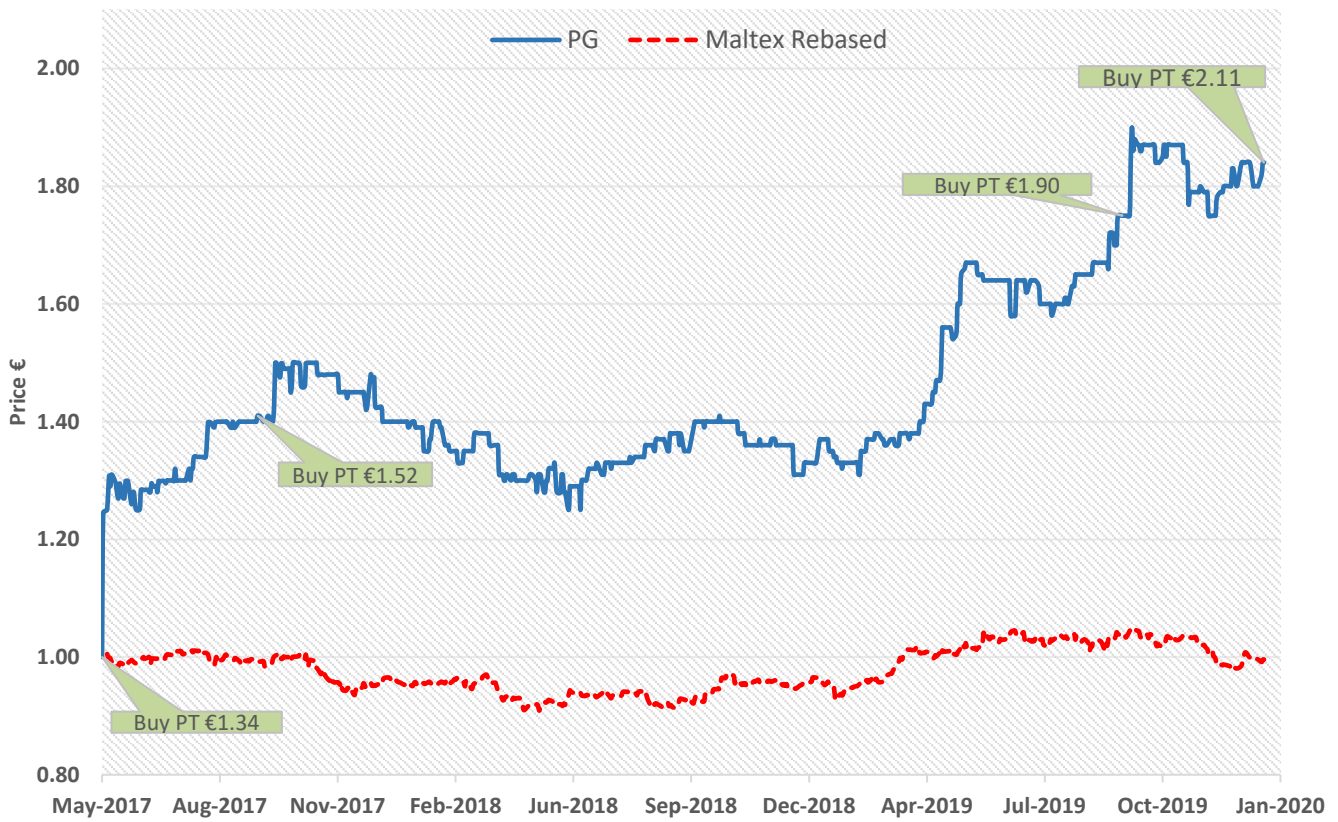
Key Financial Indicators

PG plc - €'000s (unless otherwise indicated)	Apr-2017	Apr-2018	Apr-2019	2020 LTM
Income Statement				
Revenue	91,686	101,238	107,977	116,324
<i>Growth in Revenue (YoY)</i>	65.8%	10.4%	6.7%	7.7%
EBITDA	12,655	12,894	14,230	16,934
EBITDA Margin (EBITDA / Revenue)	14%	13%	13%	15%
Operating Income (EBIT)	11,385	11,692	12,605	14,917
Operating (EBIT) Margin (EBIT / Revenue)	12.4%	11.5%	11.7%	12.8%
Net Income	7,360	7,660	8,937	10,108
Net Margin (Net Income / Revenue)	8.0%	7.6%	8.3%	8.7%
Earnings per Share (EPS)	0.068	0.071	0.083	0.094
<i>Growth in EPS (YoY)</i>	58%	4%	17%	13%
Sustainable Growth Rate in Dividends	30%	11%	12%	13%
Balance Sheet				
Cash and Cash Equivalents	1,320	3,013	1,546	n/a
Current Assets	12,227	15,755	14,404	15,531
Non-Current Assets	58,276	63,049	71,565	88,175
Total Assets	70,503	78,804	85,969	103,706
Current Liabilities	21,247	23,369	28,073	28,066
Non-Current Liabilities	21,431	21,650	19,424	34,660
Total Liabilities	42,678	45,019	47,497	62,726
Total Financial Debt	23,911	20,705	23,989	n/a
Total Equity	27,825	33,785	38,472	40,980
Net Debt	22,591	17,692	22,443	n/a
Shares Outstanding	108,000	108,000	108,000	108,000
Cash flow				
Cash Flow from Operating Activities (CFO)	6,841	10,230	10,026	14,574
Capex	(1,394)	(3,631)	(10,527)	n/a
Free Cash Flow (FCF)	5,447	6,599	(501)	14,574
Cash Flow from Investing Activities	(1,256)	(3,631)	(10,527)	(7,469)
Cash Flow from Financing Activities	(2,556)	(2,889)	(4,271)	(5,247)
Ratios				
Profitability				
Return on Common Equity (Net Income / Common Equity)	29.6%	24.9%	24.7%	25.4%
Return on Assets (Net Income / Total Assets)	10.4%	9.7%	10.4%	9.7%
Solvency				
Gearing Ratio Level 1 (Net Debt / Total Equity)	81.2%	52.4%	58.3%	n/a
Gearing Ratio Level 2 (Total Liabilities / Total Assets)	60.5%	57.1%	55.2%	60.5%
Net Debt / EBITDA	1.8x	1.4x	1.6x	n/a
Current Ratio (Current Assets / Current Liabilities)	0.6x	0.7x	0.5x	0.6x
Interest Coverage Ratio (EBITDA)	19.8x	21.9x	22.5x	26.8x
Cash from Operations / EBIT	0.6x	0.9x	0.8x	1.0x

Source: Audited Financial Statements

Historical 1-Year Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
PG	20.01.2020	€1.85	€2.11	Andrew Fenech & Rowen Bonello	Buy
PG	17.09.2019	€1.75	€1.90	Simon Psaila & Andrew Fenech	Buy
PG	13.09.2017	€1.41	€1.52	Simon Psaila	Buy
PG	30.03.2017	€1.00	€1.34	Simon Psaila	Buy



Source: Audited Financial Statements

Glossary and Definitions

Income Statement	
Revenue	Total revenue generated by the Group/Company from its principal business activities during the financial year.
EBITDA	EBITDA is an abbreviation for earnings before interest, tax, depreciation and amortisation. It reflects the Group's/Company's earnings purely from operations.
Operating Profit (EBIT)	EBIT is an abbreviation for earnings before interest and tax.
Depreciation and Amortisation	An accounting charge to compensate for the decrease in the monetary value of an asset over time and the eventual cost to replace the asset once fully depreciated.
Net Finance Costs	The interest accrued on debt obligations less any interest earned on cash bank balances and from intra-group companies on any loan advances.
Net Income	The profit made by the Group/Company during the financial year net of any income taxes incurred.
Profitability Ratios	
EBITDA Margin	EBITDA as a percentage of total revenue.
Operating (EBIT) Margin	Operating margin is the EBIT as a percentage of total revenue.
Net Margin	Net income expressed as a percentage of total revenue.
Return on Common Equity	Return on common equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing the net income by the average common equity (average equity of two years financial performance).
Return on Assets	Return on assets (ROA) is computed by dividing net income by total assets.
Earnings per Share (EPS)	Earnings per share (EPS) is the amount of earnings per outstanding share of a Group's/Company's share capital. It is computed by dividing net income by total shares outstanding as at the statement of financial position date.
Dividends Ratios	
Dividend per Share	Dividend per Share is the amount of dividends per outstanding share of a Group's/Company's share capital. It is computed by dividing net dividends by total shares outstanding as at the statement of financial position date.
Sustainable Growth Rate in Dividends	This ratio indicates the sustainable growth rate of dividends given the profitability of the Group/Company and the respective level of dividends distribution.
Dividends Yield as at year-end	This ratio indicates how much a Group/Company pays out in dividends each fiscal year relative to its share price. It is computed by the dividing the Dividend per Share by the share price as at year-end.
Cash Flow Statement	
Free Cash Flows (FCF)	The amount of cash the Group/Company has after it has met its financial obligations. It is calculated by taking Cash Flow from Operating Activities less the Capex of the same financial year.
Balance Sheet	
Total Debt	All debt obligations inclusive of long and short-term debt.
Net Debt	Total debt of a Group/Company less any cash and cash equivalents.
Shares Outstanding	Outstanding shares refer to the Group/Company stock currently held by all its shareholders.
Financial Strength Ratios	
Current Ratio	The Current ratio (also known as the Liquidity Ratio) is a financial ratio that measures whether or not a company has enough resources to pay its debts over the next 12 months. It compares current assets to current liabilities.
Quick Ratio (Acid Test Ratio)	The quick ratio measures a Group's/Company's ability to meet its short-term obligations with its most liquid assets. It compares current assets (less inventory) to current liabilities.
Interest Coverage Ratio	The interest coverage ratio is calculated by dividing EBITDA of one period by cash interest paid of the same period.
Gearing Ratio	The gearing ratio indicates the relative proportion of shareholders' equity and debt used to finance total assets.
Gearing Ratio Level 1	Is calculated by dividing Net Debt by Total Equity.
Gearing Ratio Level 2	Is calculated by dividing Total Liabilities by Total Assets.
Net Debt / EBITDA	The Net Debt / EBITDA ratio measures the ability of the Group/Company to repay its debt through EBITDA generation.
Cash from Operations / EBIT	This ratio measures the ability of the Group/Company to convert its earnings into cash.

Explanation of Equity Research Ratings

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, we do not recommend either a Buy or Sell. Current shareholders should consider buying on dips and selling on peaks.

Newly issued research recommendations and target prices supersede previously published research.

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