PG p.l.c.

Executive Summary:

“We are downgrading our stance from a Buy to a Hold on PG plc with a 12-month price target of €2.00 from our previous target of €2.11.

Although PG registered an improved financial performance for FY20, the decline in our price target is mainly attributable to the implications brought about by the COVID-19 pandemic on the Group, more specifically in terms of PG’s retail mall and franchise operations.

In relation to the Group’s supermarket operations, management confirmed that other than incurring higher costs, this segment was not materially impacted. In line with company projections for FY21, we are factoring in a 3% and a 5% revenue increase from Pama and Pavi shopping villages respectively.

Additionally, in the face of such unprecedented circumstances, PG waived all rents due in March, April and May concerning tenants within the retail and catering units at Pama and Pavi shopping villages and is currently sticking to contracted percentage of sales, waiving minimum rents.

We expect this to have a significant impact on PG’s rental income and in accordance to projections provided by the Group, we are factoring a shortfall of 30% in relation to PG’s retail income segment for FY21.

Furthermore, given that the Group’s retail offering was classified as a non-essential service, the Group’s franchise operation was closed over a stretch of circa two months during 2020. Also as per guidance provided by management, we are anticipating revenue derived PG’s franchise operation to decline by approximately 38% during FY21.

As a result, in line with PG’s current limited growth opportunities in combination with the fact that both Pama and Pavi shopping villages have approached a saturation point, we believe that upon taking into consideration the current pandemic situation and the current price levels, a Hold recommendation on the shares of PG is justified.”

Company Update:

Dividends – The Group distributed an interim net dividend of €2m in December 2019. Despite the COVID-19 situation, a second net dividend of €2.8m was distributed in July 2020. The total net dividend relating to FY20 amounted to €4.8m.

Company Overview:

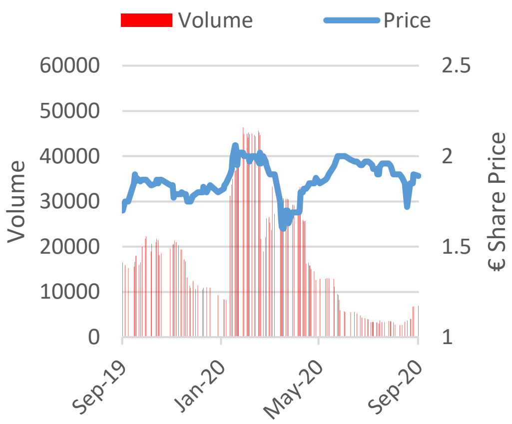
PG plc is engaged in the retailing of food, household goods and other ancillary products through the Pavi Shopping Complex and Pama Shopping Village, and the selling of Zara® clothing and Zara Home® household goods as a franchise of the Inditex Group. The Group also leases a number of retail outlets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

Stock Rating	**Hold**
Price target (1Yr)	**€2.00**
Country	Malta
Industry	Retail
Ticker	PG
Price (as at 10/09/2020)	€1.89
Price Target (1 Year)	€2.00
Upside / downside to PT	6.3%
12m cash div. (Forecast)	€0.05 / share
12m Total S’holder Return	8.9%
Market Cap	€204.1m
Shares Outstanding	108m
Free Float	25%
Net Dividend Yield	2.4%
Current P/E **	21.1x
1Yr Forward P/E ***	23.2x

**** Based on the FY20 results**
***** CC estimates**

Exchange	Malta Stock Exchange (MSE)
12-month range	€1.60 - €2.06

Price and Volume Movement (20 day moving average)



Source: Bloomberg

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SWOT Analysis

Strengths

- ✓ Malta's recent positive economic trend together with the sustained growth of the tourism industry all have contributed positively to the performance of the retail segment
- ✓ The Group has relatively low gearing, giving ample margin to increase debt for growth purposes, thus not impacting dividend payments
- ✓ The Group has ownership of the Pavi and Alhambra properties it operates in, both being considered as prime locations
- ✓ A positive track record of a strong year-on-year performances achieved both at Pama and Pavi
- ✓ The Group's franchise operation is supported by one of the largest textile companies in the world – Inditex SA
- ✓ The refurbishment at the Zara outlet in Sliema, proved to be successful.
- ✓ Cash healthy business
- ✓ Both net profit and dividends paid to shareholders have constantly increased over the last years
- ✓ Minimal COVID-19 impact in terms of the Group's supermarket operation

Weaknesses

- ✗ High dependency on the Maltese economy
- ✗ The retail industry is highly competitive, thus increasing pressure on margins
- ✗ PG's franchise operation is considered to be a cyclical industry which can be materially impacted in a down cycle and by consumer trends as clearly highlighted through the implications brought about by the COVID-19 pandemic
- ✗ From a clients' perspective, switching costs to other products are low

Opportunities

- The Group is backed by world renowned brand values both in the brands they manage (Zara®) and the shop-in-shop concepts, including Burger King, KFC, The Body Shop and Pizza Hut; as well as locally known companies such as GO, Atlas, Agenda, Sterling, Gasan Mamo and more
- The Group's management expect the replacement of their existing IT infrastructure to boost efficiency
- The proposed development of the Pama extension together with the development of the old pasta factory might increase the profitability potential of the Group
- In line with the volatility witnessed in several markets following the COVID-19 outbreak in Malta, the Group is actively looking for potential opportunities to grow their business.

Threats

- ! Aggressive competition experienced in the retail market
- ! Changes in consumer trends
- ! Further escalation of the COVID-19 pandemic, might continue hindering the Group's revenues and underlying profits, especially in terms of the Group's franchise and retail mall operations.

Investment Stance

We are downgrading our stance from a Buy to a Hold on PG plc with a 12-month price target of €2.00 from our previous target of €2.11. The decline in our price target is mainly attributable to the implications brought about by the COVID-19 pandemic on the Group, more specifically in terms of PG's retail mall and franchise operations.

It is worth mentioning however that as per latest results (FY20), PG performed particularly well in the first ten months, which overall resulted in the Group recoding a robust and a record financial performance. This improved financial performance was bolstered by the successful operation of its Zara® outlet in Sliema and the overall franchise operation (+29.9%), a steady performance at Pama (+3%) and sustained growth at Pavi (+16%), which has benefited from a substantial refurbishment programme that is now in its final stages.

However, in the final two months of FY20, the Group's operations were materially impacted by the COVIID-19 outbreak. In terms of the Group's supermarket operations, management confirmed that other than incurring higher costs, this segment was not materially impacted. It is key to note that for FY21, in line with direction provided by management, we are projecting a 3% and a 5% revenue increase from the Pama and Pavi shopping villages respectively.

Contrarily, management also pointed out that PG's tenants within the retail and catering units at Pama and Pavi shopping villages, have been hit hard. As a reusult, in the face of such unprecedented circumstances, PG waived all rents due in March, April and May in terms of the aforementioned tenants and is currently sticking to contracted percentage of sales, waiving minimum rents. We deem this to have be significant impact on PG's rental income and in accordance to projections provided by the Group, we are factoring a shortfall of 30% in relation to PG's retail income segment for FY21.

Moreover, in line with the fact that the Group's retail offering was classified as a non-essential service, the Group's franchise operation was closed over a stretch of two months during 2020, more specifically from end of March 2020 till beginning of May 2020. Also as per guidance provided by management, we are anticpating revenue derived PG's franchise operation to decline by by 50% up to August and by 40% and to 25% in following quarters.

It is crucial to point out that such expectations implemented within our valuation model are built on the assumption that there will be no further lockdowns in Malta, especially throughout the Christmas period.

Notwithstanding the points discussed above, it is important for investors to keep in mind that the PG Group is fully geared to benefit mainly from their franchise and retail mall operations once the current COVID-19 situation will push the local economy to sail within calmer waters. Once this situation is overturned, we should see an increase in consumption in terms of the Group's franchise operations.

As a further positive note, despite the COVID-19 situation, a second net dividend of €2.8m was distributed in July 2020. The total net dividend relating to FY20 amounted to €4.8m, translating into a net dividend yield of 2.3%, which given the current fluid circumstances, we deem as attractive.

In line with PG's current limited growth opportunities in combination with the fact that both Pama and Pavi shopping villages have approached a saturation point, we believe that upon taking into consideration the current pandemic situation and the current price levels, a Hold recommendation on the shares of PG is justified. It is important to clarify that we still believe that PG is a defensive stock and we look forward to continue monitoring the situation for any further developments.

Valuation

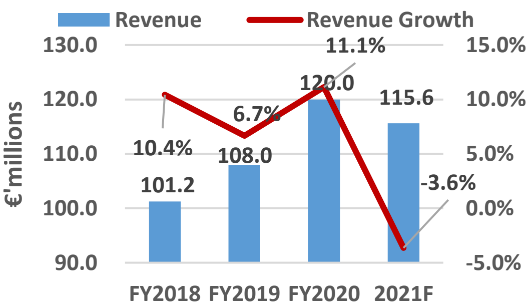
Our one-year price target is €2.00. The price target is calculated using a Price to Earnings (P/E) model of 25x, utilising a discount rate of 7.5%.

€'000s unless otherwise stated	FY 2018	FY 2019	FY2020	FY2021P	FY2022P
	€'000	€'000	€'000	€'000	€'000
Revenue	101,238	107,977	119,997	115,633	120,860
Cost of Sales	(84,88)	(90,166)	(99,375)	(96,363)	(100,719)
Gross Profit	**16,353**	**17,811**	**20,622**	**19,270**	**20,141**
Selling and marketing costs	(1,051)	(1,028)	(852)	(1,155)	(1,208)
Administrative Expenses	(3,179)	(3,439)	(2,683)	(2,313)	(2,417)
Other Income	771	886	726	700	700
EBITDA	**12,894**	**14,230**	**17,813**	**16,502**	**17,216**
Depreciation of right of use asset	-	-	(694)	(622)	(622)
Depreciation & Amortisation	(1,202)	(1,625)	(2,001)	(2,185)	(2,275)
EBIT	**11,692**	**12,605**	**15,118**	**13,695**	**14,319**
Investment Income	-	-	-	-	-
Finance Income	-	-	5	-	-
Finance Costs on right of use asset	-	-	(1,018)	(1,029)	(1,012)
Finance Costs	(589)	(632)	(574)	(361)	(256)
Share of results of associates	(26)	10	(94)	(100)	(100)
Profit Before Tax	**11,077**	**11,983**	**13,437**	**12,205**	**12,951**
Income tax expense	(3,417)	(3,046)	(3,784)	(3,417)	(3,626)
Profit Available to Ordinary Equity holders	**7,660**	**8,937**	**9,653**	**8,788**	**9,325**
Earnings Per Share	*0.071*	0.083	0.089	0.081	0.086

Ratio Analysis	FY2018	FY2019	FY2020	FY2021F	FY2022P
Revenue Growth (YoY)	10.4%	6.7%	11.1%	-3.6%	4.5%
EBIT Margin	11.5%	11.7%	12.6%	11.8%	11.8%
EBITDA Margin	12.7%	13.2%	14.8%	14.3%	14.2%
Net Margin	7.6%	8.3%	8.0%	7.6%	7.7%
Shares Outstanding (million)	108	108	108	108	108
Growth in EPS (YoY)	4.1%	16.7%	8.0%	-9.0%	6.1%
Earnings Yield	n/a	n/a	4.7%	4.5%	3.7%
Dividend per Share (€)	0.039	0.042	0.044	0.049	0.052
Dividend pay-out-ratio	55.5%	50.4%	49.7%	60.0%	60.0%
Dividend Yield	n/a	n/a	2.3%	2.6%	2.7%

Investment Thesis Variables

- **Revenue –** The Group's revenue in FY20 amounted to circa €120m, reflecting an improvement of 11.1% over FY19. As per latest results, PG performed particularly well in the first ten months of FY20, bolstered by the successful operation of its Sliema Zara outlet and the overall franchise operation (+29.9%), a steady performance at Pama (+3%) and sustained growth at Pavi (+16%), which has benefited from a substantial refurbishment programme that is now in its final stages.

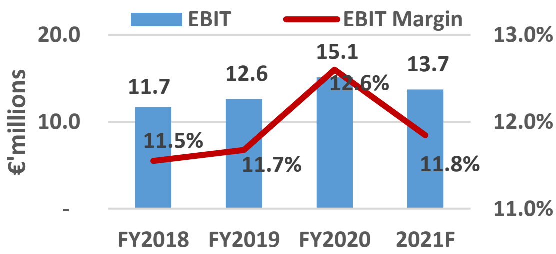


Source: PG's Financial Statements / CC Workings

However, in the final two months of FY20, the Group's operations were materially impacted by the COVIID-19 outbreak. Management confirmed that whilst no disruptions were experienced in terms of the Group's supermarket operations, the shopping complex at Pama and the Group's franchise operation, were closed over a stretch of two months during 2020, more specifically from end of March 2020[1] till beginning of May 2020, in line with the recently implemented health authorities' policies and restrictions. In the face of such an unprecedented pandemic, management confirmed that in terms of the shopping complex, PG waived all rents due in March, April and May and is currently sticking to contracted % of sales, waiving minimum rents.

Upon receiving guiadance from management, we expect revenue derived from the Group's supermarket operation to increase by 3.8% during FY21. However, in line with the implications brought about by the COVID-19 pandemic, we expect revenue derived from PG's rental income and the Group's franchise operations to decline by 23% and 38.3% respectively. As a result, we expect total revenue to amount to €115.6m during FY21, representing an overall decline of 3.6% on a comparative basis.

- **EBIT –** Notwithstanding the increase in operating expenses exclusive of depreciation (+8.7%) followed by the aforementioned improvement in revenue (+11.1%) for FY20, EBIT margin as per FY20 results overall improved from 11.7% during FY19 to 12.6% as per FY20. In line with implications brought about by the COVID-19 pandemic on the Group, we expect EBIT margin to taper down to the 11.8% during FY21.



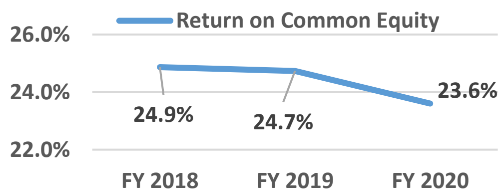
Source: PG's Financial Statements / CC Workings

- **Operating expenses –** These mainly consist of cost of sales, selling and marketing costs and administrative expenses. Cost of goods sold incurred as per FY20 results increased by 10.2% to €99.4m, which is deemed to be in line with the increase in revenue during the period. Selling & distribution costs together with administrative expenses and other income incurred during FY20 collectively decreased by circa €0.9m over FY20. Such decline is attributable to several cost saving measures implemented by the Group throughout the period. We expect operating expenses to collectively amount to €99.8m during FY21. It is important to note that the operating expenses figure in our valuation incorporates the changes brought about by the adoption of IFRS16.

- **Depreciation –** The overall increase in depreciation and amortisation incurred by the Group during FY20 is attributable to adoption of IFRS16 and the refurbishment implemented at Pavi. We anticipate the Group's depreciation charge to amount to €2.8m during FY21.

- **Net finance costs –** Due to the implementation of IFRS16, the Group's net finance costs increased to €1.6m during FY20. 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.

- **Net Profit and Earnings per Share –** As per FY20 results, PG registered a net profit figure of circa €9.7m, translating into an EPS of €0.089. Following the COVID-19 developments, we expect the Group to register a net profit of circa €8.8m during FY21, meaning an EPS of €0.081.



Source: PG's Financial Statements / CC Workings

[1] The Group's year-end is 30th April

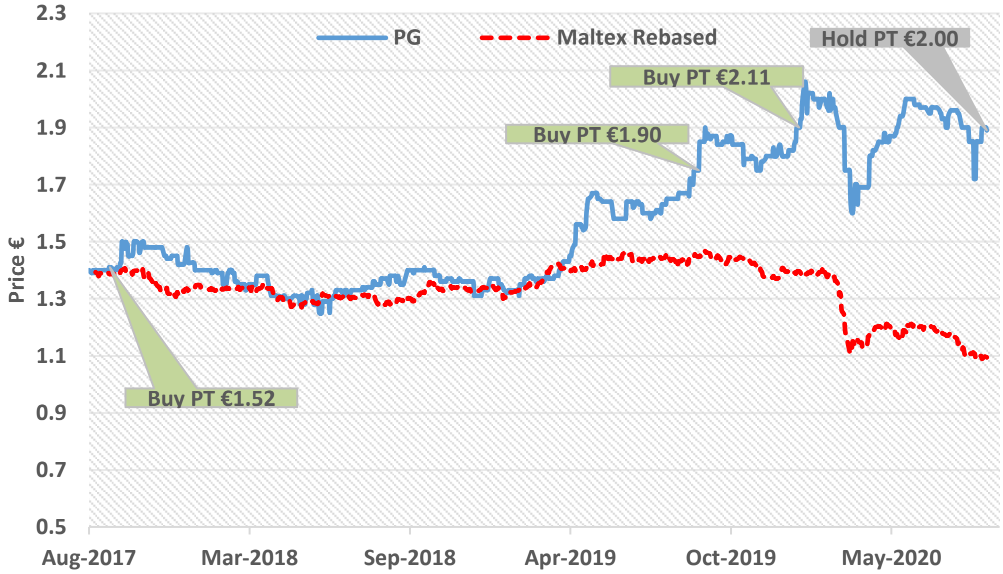
Key Financial Indicators

For the years ending 30th April	2018 €'000	2019 €'000	2020 €'000
Balance Sheet			
Cash and Cash Equivalents	3,013	1,546	2,720
Current Assets	15,755	14,404	15,732
Non-Current Assets	63,049	71,565	87,103
Total Assets	78,804	85,969	102,835
Current Liabilities	23,369	28,073	31,063
Non-Current Liabilities	21,650	19,424	28,447
Total Liabilities	45,019	47,497	59,510
Total Financial Debt	20,705	23,989	34,461
Total Equity	33,785	38,472	43,325
Net Debt	17,692	22,443	31,741
Shares Outstanding	108,000	108,000	108,000
Cash flow			
Cash Flow from Operating Activities (CFO)	10,230	10,026	15,516
Capex	(3,631)	(10,527)	(3,253)
Free Cash Flow (FCF)	6,599	(501)	12,263
Cash Flow from Investing Activities	(3,631)	(10,527)	(3,253)
Cash Flow from Financing Activities	(2,889)	(4,271)	(11,971)
Ratios			
Profitability			
Return on Common Equity (Net Income / Common Equity)	24.9%	24.7%	23.6%
Return on Assets (Net Income / Total Assets)	10.3%	10.8%	10.2%
Solvency			
Gearing Ratio Level 1 (Net Debt / Net Debt and Total Equity)	34.4%	36.8%	42.3%
Gearing Ratio Level 2 (Total Liabilities / Total Assets)	57.1%	55.2%	57.9%
Net Debt / EBITDA	1.4x	1.6x	1.8x
Current Ratio (Current Assets / Current Liabilities)	0.7x	0.5x	0.5x
Interest Coverage Ratio (EBITDA)	21.9x	22.5x	11.2x
Cash from Operations / EBIT	0.9x	0.8x	1.0x

Source: PGs Financial Statements / CC Workings

Historical 1-Year Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
PG	11.09.2020	€1.89	€2.00	Andrew Fenech & Rowen Bonello	Hold
PG	20.01.2019	€1.85	€2.11	Simon Psaila & Andrew Fenech	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: Bloomberg

Explanation of Equity Research Ratings

Buy: Based on a current 12- month view of total shareholder 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.

Disclaimer

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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 the average total assets (average assets of two years financial performance).
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 interest bearing 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 Gearing Ratio Level 1 Gearing Ratio Level 2	The gearing ratio indicates the relative proportion of shareholders' equity and debt used to finance total assets. Is calculated by dividing Net Debt by Net Debt and Total Equity. 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.