Procter & Gamble Co. (PG)

Updated July 2nd, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$78	**5 Year CAGR Estimate:**	8.7%	**Quality Percentile:**	7.7%
Fair Value Price:	$78	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	21.8%
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.0%	**Valuation Percentile:**	58.0%
Dividend Yield:	3.7%	**5 Year Price Target**	$100	**Total Return Percentile:**	52.0%

Overview & Current Events

Procter & Gamble is a consumer products giant that sells its products in more than 180 countries. It is 180 years old and generates 55% of its sales outside North America, with 35% of its sales in emerging regions. It has raised its dividend for 62 consecutive years and has paid uninterrupted dividends for *127 years in a row*.

Nevertheless, the stock has dramatically underperformed S&P in the last five years, as it has lost 4% while the index has rallied 62%. The main reason is the competition in the retail sector, which has become fiercer than ever. As consumers have become price-conscious, private-label products have gained market share. In addition, large retailers, such as Walmart and Target, exert great pressure on their suppliers for lower prices. Due to these headwinds, the gross and operating margins of Procter & Gamble have essentially remained flat for a whole decade, at 50% and 21%, respectively. The stock has also been hurt by the rising interest rates, which reduce the attractiveness of its dividend.

In its fiscal Q3 report, Procter & Gamble disappointed the market with its lower than expected growth. The stock plunged 10% in the two weeks following its report but it has retrieved its losses lately. Nevertheless, the market is not excited by the “core growth” or “adjusted growth” of the company anymore and requires solid reported growth to reward the stock. It is remarkable that the company has failed to meaningfully grow its sales for 6 consecutive years.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$3.64	$3.58	$3.53	$3.93	$3.85	$4.05	$4.22	$4.02	$3.67	$3.92	***$4.19***	***$5.35***
DPS	$1.45	$1.64	$1.80	$1.97	$2.14	$2.29	$2.45	$2.59	$2.66	$2.70	***$2.84***	***$3.24***

Due to the heating competition, the earnings per share have remained essentially flat in the last four years. Procter & Gamble has already expanded in almost every country in the world and has a market cap of $196 billion. In an attempt to return to growth, the company has been going through a major transformation in recent years. It has sold an unprecedented number of low-margin, low-growth brands and has thus reduced its brand count by almost two-thirds, from 170 to 65. In this way, the management will be able to focus solely on the most potent brands. After years of stagnation, these efforts finally seem to be bearing fruit, as the core earnings per share are expected by management and the analysts to grow by about 7% this fiscal year, from $3.92 to $4.19.

The management has provided guidance for 2% buybacks per year, which is equal to the recent rate. Because the recent results are somewhat positive, we are forecasting earnings-per-share growth of 5% per year moving forward. It is important to keep in mind that management has yet to prove its ability to tackle the great challenges facing the company. Still, we are pleased by its recent capital allocation decisions. The company sold two-thirds of its brands and used most of the proceeds in buybacks and debt reduction. Hence it is reasonable to expect the EPS to grow 5% per year until 2023, from $4.20 to $5.36, mostly thanks to buybacks.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	18.6	16.4	17.0	16.0	16.7	17.8	19.0	20.9	21.4	22.3	***18.6***	***18.6***
Avg. Yld.	2.1%	2.8%	3.0%	3.1%	3.3%	3.2%	3.1%	3.1%	3.4%	3.1%	***3.7%***	***3.2%***

Procter & Gamble is currently trading at a P/E ratio of 18.6, which is equal to its 10-year average valuation level. As it is reasonable to expect the stock to remain around its average valuation level over the next five years, its 5-year return is not likely to be meaningfully affected by its valuation.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	29.3%	28.2%	32.0%	29.8%	30.7%	28.8%	24.5%	26.0%	25.5%	27.0%	***27.0%***	***27.0%***
Debt/A	51.7%	53.2%	52.3%	51.1%	52.0%	51.1%	52.0%	51.8%	54.9%	54.2%	***56.3%***	***53.0%***
Int. Cov.	11.7	11.6	16.9	19.0	19.2	25.6	23.3	24.4	35.1	46.7	***30.0***	***40.0***
Payout	39.7%	45.8%	51.0%	50.1%	55.6%	56.5%	58.1%	64.4%	72.5%	68.9%	***67.8%***	***60.6%***
Std. Dev.	31.0%	24.7%	13.5%	15.2%	13.5%	16.2%	11.7%	16.2%	14.2%	10.9%	***12.0%***	***12.0%***

Due to lack of earnings growth, the dividend payout ratio has significantly increased in the last decade. As a result, the company has drastically reduced its dividend growth rate in the last three years. Nevertheless, as the payout ratio is not extreme, the company can easily keep growing its dividend for years, albeit at the recent slow pace.

Procter & Gamble is markedly resistant to recessions, as its products are essential to consumers. To be sure, in the Great Recession, when most companies saw their earnings collapse, Procter & Gamble saw its EPS fall only 1.6% in 2009 and 1.4% in 2010. Whenever the next recession shows up, this stock is likely to outperform the market once again.

Final Thoughts & Recommendation

After several years of stagnation and dramatic underperformance vs. the S&P, Procter & Gamble is in the middle of a major transformation. Its year-to-date results are somewhat positive but the company has a long way to go to prove that its growth is sustainable. Therefore, investors can reasonably expect 5% annualized EPS growth for the next five years, mostly thanks to share repurchases. Given the 3.7% dividend, the stock is likely to offer an 8.7% average annual return over the next five years. We also note that Procter & Gamble's dividend yield has risen to an almost 20-year high level, mostly thanks to the poor performance of the stock. Conservative, income-oriented investors will benefit – particularly on a risk-adjusted basis – by adding this high-quality dividend stock to their investment portfolios.

Total Return Breakdown by Year