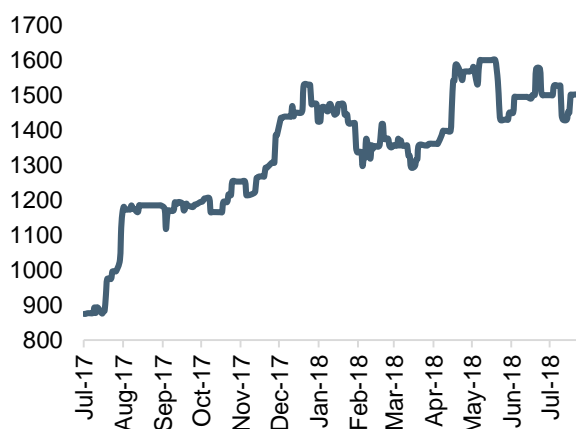


Rating	UNDER REVIEW
Price	₦1,502.00
52-week range	₦986.01-1,615.00
Market Cap. (₦'tn)	1.191
1-month Avg. Vol	110,142
Curr. PE	30.8x

NESTLE:NL - Share Price Trend



Analyst(s)

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Nestle Nigeria Plc. (NESTLE.NL)

Initial View

Impressive earnings performance

Nestle Nigeria (Nestle) first half 2018 earnings was remarkable with EPS of ₦27.07 (+30% YoY) outperforming our estimate of ₦25.78 (+5.0% deviation). The sturdy earnings performance was on the back of the confluence of stronger revenue (+11% YoY to ₦135.3 billion), expansion in EBIT margin (+187bps YoY to 23.8%) and lower finance costs (-76.4% YoY to ₦1.7 billion).

- EPS performance in the just released quarter was impressive as it more than doubled performance in the corresponding period of the prior year to print at ₦16.21 (vs. ARM forecast of ₦14.92). We note that the deviation of our forecast from actual was largely due to lower than expected finance costs.
- In terms of drivers, Q2 18 EPS growth (+59.6% YoY) benefited from higher revenue of ₦67.8 billion (+11.6% YoY) reflecting growth in its food (+11% YoY to ₦42 billion) and beverage (+12.5% YoY to ₦25.7 billion) segments. Decomposing growth, price checks revealed a modest 2% price increase for its food products, hence we attribute much of the growth therein to volume. We link the higher food volume growth to the just concluded Ramadan season which likely drove demand for *Maggi* whose popularity is predominant in the North. On its beverage business, our price check revealed average price increase of 7%, indicating volume growth on that end.
- Benefitting from lower commodity prices and improved dollar availability, Nestle reported a slower rise in cost of sales of ₦38 billion (+5.9% YoY) relative to revenue which led gross margin to expand 305bps YoY to 44% (vs. Q1 18: 38.2%; Q4 18: 42.4%; Q2

17: 40.9%). To add, breakdown revealed that the company reported an impairment loss of ₦1.04 billion on PPE¹ related to its food business which was classified in the cost of sales thus limiting gross margin expansion – excluding the loss, gross margin would have printed at 45.5%. Additional commentary from the company didn't reveal the food division that was impaired. We recall that Nestle in its Q1 18 result recorded an impairment loss of ₦3.4 billion on its beverage business – related to its water plant in Abaji, Abuja.

- In the review period, operating expenses of ₦12.2 billion (+7.2% YoY) rose at a slower pace than revenue thus driving a 75bps moderation in OPEX to sales. Against this backdrop alongside gross margin expansion, EBIT margin expanded 380bps with related profit higher by 30.7% to ₦17.6 billion, in line with our estimate of ₦17.8 billion. As stated earlier, the miss in our EPS forecast stemmed from lower than expected finance costs with Nestle reporting ₦586 million lower than our forecast of ₦1.2 billion. Precisely, we had expected the company to commence payment of some of its due FX obligations however, it didn't materialize as breakdown of its cash flow statement revealed that no loans were repaid in the review quarter. The confluence of lower finance cost and higher finance income of ₦1.2 billion – supported by its cash position of ₦25.9 billion (+4.9% QoQ) – ensured a net finance income of ₦597 million.
- Nestle trades at a current P/E of 30.8x vs 26.5x for Bloomberg Middle East and Africa peers.
- **Our model is under review.**

¹ Property Plant and Equipment

Summary of Results - Naira (₦)

Income statement – (₦'million)	Q2 18	YoY growth	QoQ growth	Deviation from forecast	H1 18	H1 17
Revenue	67,832	11.6%	0.5%	-1.0%	135,296	121,920
Cost of sales	38,012	5.9%	-8.9%	-2.7%	79,718	73,577
Gross profit	29,820	20.0%	15.8%	1.3%	55,578	48,343
OPEX	12,186	7.2%	8.4%	4.4%	23,424	21,644
Operating profit	17,634	30.7%	21.5%	-0.7%	32,153	26,699
Net interest expense	598	-118.0%	-168.1%	-170.9%	281	2,240
PBT	18,232	79.2%	33.7%	7.8%	31,873	7,912
PAT	12,852	56.9%	49.3%	8.7%	21,458	16,548

Key Ratios	Q2 18	Q2 17	Change(pps)	H1 18	H1 17	Change(pps)
Gross margin	44.0%	40.9%	3.1%	41.1%	39.7%	1.4%
EBIT margin	26.0%	22.2%	3.8%	23.8%	21.9%	1.9%
PBT margin	26.9%	16.7%	10.1%	23.6%	6.5%	17.1%
PAT margin	18.9%	13.5%	5.5%	15.9%	13.6%	2.3%
Effective tax rate	29.5%	19.5%	10.0%	32.7%	32.3%	0.3%

Source: ARM Research *unless otherwise stated

ARM ratings and recommendations

ARM now employs a two-tier rating system which is based on systemic importance of the security under review and the deviation of our target price for the stock from current market price. We characterize systemic importance as a function of a stock's ranking among the group of top 20 stocks by NSE market capitalization over a trailing 6-month period (minimum) to the review date. We adopt a 5-point rating system for this category of stocks and a 3-point rating system for stocks outside this group. The choice of top 20 stocks arises from the consideration that this group of stocks constitutes >75% of overall market capitalization and stocks outside this group are generally less liquid and individually account for <<1% of market capitalization. For stocks in both categories, the basis for ratings subject to target price deviation is outlined below:

TOP 20		NON-TOP 20	
Rating	Deviation	Rating	Deviation
STRONG BUY	>20%	BUY	>20%
OVERWEIGHT	10% — 20 %	NEUTRAL	5% — 20 %
NEUTRAL	0% — 10 %	SELL	<5%
UNDERWEIGHT	-5% — 0%		
SELL	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
BUY	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
OVERWEIGHT	Accumulate security to an extent moderated by cognizance of its benchmark weight
NEUTRAL	Maintain status quo for security with respect to current holding—i.e. keep if already holding and don't buy otherwise—subject to reasonable portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio
RESTRICTED	In certain circumstances, Asset & Resource Management ("ARM") Group policy and/or applicable law and regulations preclude certain types of communications, including an investment recommendation, during the course of ARM Securities' and/or ARM Group's engagement in an investment banking transaction and in certain other circumstances.

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