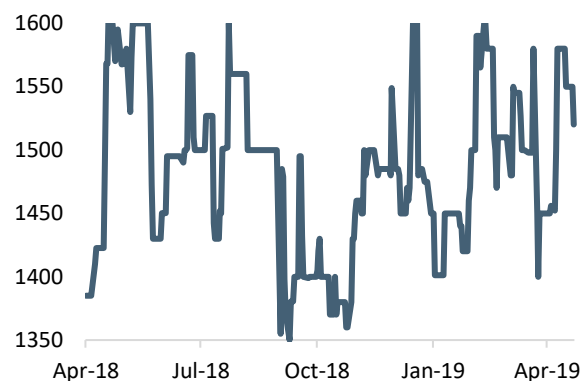


| | |
|--------------------|--------------|
| Rating | SELL |
| Price | ₦1,520.00 |
| 52-week range | ₦1340– ₦1645 |
| Market Cap. (₦'bn) | 1,205 |
| 1-month Avg. Vol | 168,740 |
| Current PE | 25.5x |

NESTLE: NL - Share Price Trend



Analyst(s)

Olamide Adeboboye
Olamide.adeboboye@arm.com.ng

Nestle Nigeria Plc (NESTLE.NL)

Initial View

Absence of one-off cost magnifies gross profit

- Nestle Nigeria Plc (Nestle) released its Q1 19 results this afternoon, showing double-digit growth in gross profit to ₦31.5 billion (+22.2% YoY), to miss our estimate of ₦30.1 billion. The strong outing stemmed from increase in revenue (+5.2% YoY) and a much faster decline in cost (-5.3% YoY). Although the revenue growth was much slower than we expected (+9.2% YoY), the decline in cost was more surprising, as we had expected an expansion during the year (+4.4% YoY). Coupled with moderate growth in opex, which was largely in line with our estimate, PBT expanded 40.2% YoY to ₦19.1 billion and EPS for the year printed at ₦16.21 (+49.3% YoY).
- Given the strong numbers, we remain positive on the company's resilience to drive its sales given its close competitor (Unilever) recorded a 25% decline in revenue from its food segment, when compared to the prior year. For context, while competition from smaller local and imported brands continue to encroach the market, Nestle's Q1 result just shows its stronghold across key markets.
- Going by provided breakdown, the growth in sales was driven by both the food and beverage segment. Given our market survey reveals the retail prices of the key products (Maggi: -2.1% YoY and Milo: -15% YoY) fell during the review period, we believe most of the gains emanated from higher volumes. Sales at the food segment increased by 5.7% YoY, while beverage sales expanded by 4.3% YoY. On cost, recall that Nestle's H1 2018 production cost was impacted by the ₦4 billion (₦3.4 billion in Q1 18)

impairment charge on its Abaji Water Plant. With the absence of such one-off cost in Q1 19, cost of sales came in much lower. Coupled with the decline in raw sugar (-6% YoY), and maize (-18.2% YoY) prices, gross margin expanded by 620bps YoY to 44.3%.

- Though operating expense expanded by 10.2% YoY to ₦12.4 billion, the stronger margin left operating income higher by 31.5% YoY to ₦19.1 billion. Elsewhere, contrary to the net finance cost reported in the prior year, the company reported a finance income of ₦34.6 million, with PAT printing at ₦12.8 billion.
- Our last communicated FVE on Nestle is ₦1,411.29 which translates to a **SELL** rating on the stock. NESTLE trades at a current P/E of 25.5x relative to Bloomberg Mena peer average of 20.98x.
- **More analysis to follow.**

Summary of Results and Forecast

| Income statement – (N' million) | Q1 19 | YoY growth | QoQ growth | Deviation from forecast | FY 18 | YoY growth |
|------------------------------------|--------|---------------|------------|-------------------------------|----------|------------|
| Revenue | 70,967 | 5.2% | 12.40% | 3.80% | 266,275 | 9.06% |
| Cost of sales | 39,498 | -5.3% | 11.67% | 10.30% | -152,354 | 6.33% |
| Gross profit | 31,469 | 22.2% | 13.32% | -4.30% | 113,920 | 12.94% |
| OPEX | 12,382 | 10.2% | 17.45% | 1.50% | -53,279 | 17.95% |
| Operating profit | 19,087 | 31.5% | 26.90% | -7.60% | 60,641 | 8.87% |
| Finance expense | 34.65 | NA | -90.92% | 14.30% | -890 | -89.97% |
| PBT | 19,121 | 40.2% | 26.94% | -5.10% | 59,751 | 27.59% |
| PAT | 12,846 | 49.3% | 18.10% | 6.00% | 43,008 | 27.53% |

| Key Ratios | Q1 19 | Q4 18 | Change(pps) | FY 18 | FY 17 | Change(pps) |
|--------------------|--------|--------|-------------|---------|---------|-------------|
| Gross margin | 44.34% | 43.98% | 0.36% | 42.78% | 41.31% | 1.47% |
| EBIT margin | 26.90% | 17.87% | 9.03% | 22.77% | 22.81% | -0.04% |
| PBT margin | 26.94% | 18.47% | 8.47% | 22.44% | 19.18% | 3.26% |
| PAT margin | 18.10% | 15.66% | 2.44% | 16.15% | 13.81% | 2.34% |
| Effective tax rate | 32.82% | 15.20% | 17.62% | -28.02% | -27.98% | -0.04% |

Source: ARM Research

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. |

All rights reserved. Unauthorized use, reproduction, distribution, or disclosure of this document is strictly prohibited.

This material has been issued by ARM Securities Limited, a member of the Asset and Resource Management (“ARM”) Group, and a Company regulated by the Nigerian Securities & Exchange Commission. The analyst(s) primarily responsible for preparing this research report, in whole or in part, certifies that with respect to each security or issuer covered; all the views expressed accurately reflect his/her personal views about the subject securities and issuers and no part of his/her compensation was, is, or will be, directly or indirectly, related to the inclusion of specific recommendations or views in the report.

This research report is based on information from sources that ARMS and its analysts believe to be reliable. Neither ARMS nor any of its research analysts, nor any member of the ARM Group, gives any representation or warranty, express or implied, or undertaking of any kind or assumes responsibility or liability of any kind with respect to the accuracy or completeness of the information set out in this report or any third party’s use (or the results of such use) of such information. This report is provided solely for informational purposes and is not to be construed as providing advice, recommendations, or endorsements of any kind whatsoever. The investments and strategies discussed here may not be suitable for all investors; counsel of investment advisor should be obtained with regard to such investments and or strategies. This research report is not a replacement for advice from an accountant, lawyer, personal finance advisor or other category of investment advisor. The investments discussed in this report may oscillate in price or value. Opinions and information provided are made as of the date of the report issue and are subject to change without notice. This research report is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Reference herein to any specific security or financial instrument does not necessarily constitute or imply its endorsement or recommendation by ARMS, its directors, officers, employees, or designated agents. Members of ARM may act as broker, advisor, or lender, or make a market in any investments or issuers referenced in this report. Further information on any of the securities discussed herein may be obtained upon request to ARMS. By accepting this document, you agree to be bound by the foregoing limitations.