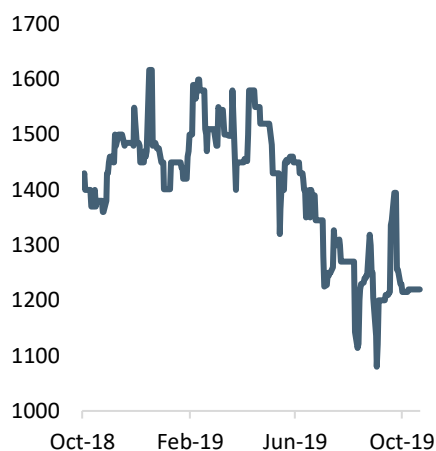


Price	₦1220
52-week range	₦1,070-1,617.1
Market Cap. (₦bn)	967,041
1-month Avg. Vol	386,267
Curr. PE	20.7x

Nestle.NL - Share Price Trend



Analyst

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Nestle Nigeria Plc. (Nestle.NL)

Initial View

Disappointing sales, cost pressure dampens earnings

- Nestle released 9M 19 result yesterday, with reported EPS expanding 11.2% YoY to ₦46.48 driven largely by the absence of impairment charge, which created a high base for input cost same period in the prior year. However, the quarterly numbers revealed a different story, as the ongoing competition in the seasoning market coupled with new cost pressures left earnings lower over Q3 19, with EPS declining 9.1% YoY to ₦13.37. Relative to our estimate, revenue fell short by 4.7%, while higher than expected cost estimate and taxes drove material deviation in PAT. On the 9M numbers, Nestle declared an interim dividend of ₦25 per share. Our full year dividend expectation of ₦68.75 translates to a dividend yield of 5.6% using the last closing price.
- Disappointing sales points to intense competition in seasoning market.** The revenue picture over Q3 19 was quite disappointing with revenue ticking up by just 2.4% over the period – the least YoY revenue growth recorded since Q1 15. This largely reflects the increasing competition in the seasoning market from the smaller brands – given the seasoning accounts for almost 40% to 50% of the company's product portfolio by our estimate. Consequently, revenue from food segment was flat over the period (-0.9% YoY to ₦43.6 billion). On the flipside the company seems to be holding its grip in the beverage segment, with sales expanding 8.3% YoY to ₦25.9 billion – giving a mild boost to overall sales.
- Surprisingly, cost pressure re-surfaces.** Unlike H1 19 wherein Nestle reported expansion in gross margin excluding the base effect from impairment cost booked over 2018, Q3 standalone was bedevilled by cost pressure, with gross margin contracting 153bps YoY to 43.5% over Q3 19. The input cost (+5.2% YoY to ₦39.2 billion) pressure is surprising, as our channel checks reveals that prices of key raw materials were down over the period. Coupled with a relatively flat operating expense (+1.9% YoY), EBIT margin weakened further by 144bps to 23.9%. PBT was down by 0.6% to ₦16.1 billion and PAT down by 9.1% YoY to ₦10.6 billion mirroring higher taxes – with effective tax at 34.3% (+620bps YoY).
- Cash position drops.** Q3 19 saw receivables days increase to 75 days from an average of 50 days over the last 7 quarters, which gives further credence to the company's challenge in growing sales. For us, we believe the need to support revenue growth amidst the challenging

environment drove the increase in receivable days. On that note, trade receivables went up by ₨17.1 billion between Q1 and Q3 19 with cash balance dropping to ₨12.6 billion from ₨33 billion reported for Q1 19.

Nestle's Q3 performance raises some concerns since we expected its brand loyalty to support sales growth above mid-single digit, as seen in prior years. For us, on expectation of flat pricing in a bid to support volumes amidst intense competition from smaller brands, we worry about what the future holds for the two top players in the seasoning market (Nestle and Unilever). Nonetheless, it is fair to state that Nestle's history of being a defensive stock leaves the company as our top pick in the consumer space. We have an **OVERWEIGHT** rating on Nestle with a FVE of ₨1447.39 which presents 18% upside using last closing price. Nestle trades at a P/E of 20.7x which is a premium to Bloomberg MENA peer average of 20.6x, respectively. Albeit, relative to other Nestle peers, it's at a significant discount (Nestle Pakistan: 35.18x, Nestle India:85.5x. Nestle Malaysia: 51.9x, Nestle SA: 33.81x).

Summary of Results

	Q3 19	YoY growth	QoQ growth	9M 19	9M 18	YoY growth
Revenue	69,438	2.4%	-2.12%	211,347	203,135	4.04%
Cost of sales	39,206	5.2%	7.92%	115,035	116,985	-1.67%
Gross profit	30,232	-1.1%	-12.65%	96,312	86,150	11.80%
Operating expenses	13,616	1.9%	19.61%	39,263	36,790	6.72%
Operating profit	16,616	-3.4%	23.93%	57,050	49,360	15.58%
Net interest expense	-499	-55.68%	63.02%	1,572	2,661	-40.92%
PBT	16,117	-0.6%	23.21%	56,554	48,089	18%
PAT	10,595	-9.1%	15.26%	36,841	33,118	11.24%

	Q3 19	Q3 18	Change(pps)	9M 19	9M 18	Change(pps)
Gross margin	43.54%	45.07%	-1.53%	42.41%	41.31%	1.10%
EBIT margin	23.93%	25.36%	-1.44%	24.30%	22.81%	1.49%
PBT margin	23.21%	18.47%	4.74%	23.67%	19.18%	4.49%
PAT margin	15.26%	15.66%	-0.40%	16.30%	13.81%	2.49%
Effective tax rates	34.26%	15.20%	19.06%	28.02%	27.98%	0.04%

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 real portfolio constraints
UNDERWEIGHT	Minimize exposure to security taking cognizance of its index weighting
SELL	Sell-off security completely from portfolio

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