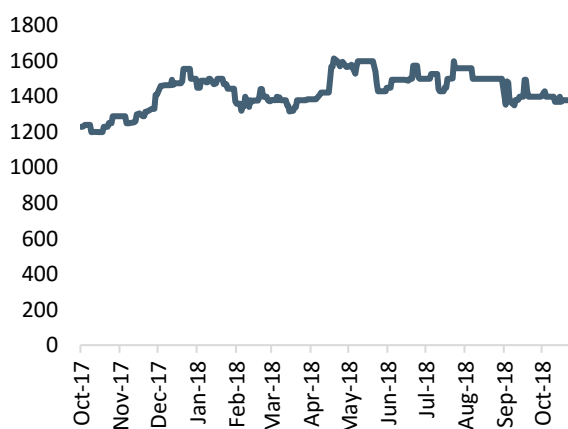




Rating	SELL
Price	₦1,380.00
52-week range	₦1230– ₦1645
Market Cap. (₦'bn)	1,094
1-month Avg. Vol	134,595
Current PE	24.94x

NESTLE: NL - Share Price Trend



Analyst(s)

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Nestle Nigeria Plc (NESTLE.NL)

Initial View

Lower FX losses offset operating cost pressures

- Late yesterday, Nestle Nigeria (Nestle) released its Q3 18 results reporting 81.3% YoY increase in EPS to ₦14.71. Much of the growth in earnings stemmed from lower FX losses following the repayment of its related party foreign currency borrowings in H2 17 as well as the relative stability in the currency. Earnings reported in the period was, however, weaker than our estimate of ₦16.03 majorly due to higher than forecasted interest expense. With the strong performance in Q3, Nestle's EPS for the nine-month period was up 44.1% YoY to ₦41.78. **Accordingly, the company declared an interim dividend of ₦20.00 (+33.3% YoY), representing a dividend yield of 1.45% based on current pricing.**
- Revenue growth slows on poor showing in beverage:** Revenue in the review quarter increased 7.1% YoY to ₦67.8 billion. Although positive, we note that the YoY revenue growth is slower than earlier quarters (YoY - Q2: 11.6%; Q1: 10.3%), reflecting weaker revenue in the beverage segment which declined 1.3% YoY to ₦23.9 billion in Q3 18. Since the beginning of the year, the beverage segment has been rising double-digit (H1 18: 14.6% YoY) hence, the decline to us is quite worrying and might be due to loss on volumes following the 6% average increase in product prices in the beverage segment. On the other hand, strong demand for Maggi and Golden Morn continued to support food revenue, as the segment sustained its double-digit growth pace, rising 12.4% YoY in Q3 18.

-
- **Higher operating expenses erodes gross margin gains:** Over the period, Nestle reported 11% YoY increase in gross profit while gross margin expanded 158bps YoY to 45.1%, driven by a slower increase in cost to sales (+4.1% YoY) relative to topline growth. The improvement in margin reflects moderation in the prices of its major inputs¹. In addition, against trend seen in H1 18 where Nestle booked impairments of ₦4.4 billion, the company did not report impairments on its PPE² in Q3 18. For us, this is positive, as it somewhat signals that the company is done with booking impairments on its assets in 2018. Despite the positive outturn in gross margin, EBIT margin contracted 51bps YoY to 25.4% due to higher operating expenses, largely from selling and distribution, while EBIT rose by 5% YoY to ₦17.2 billion.
 - **Finance expense slumps 79% on lower FX losses:** As stated earlier, the marked increase in Nestle's Q3 18 EPS stemmed from lower finance expense. Precisely, the company reported finance expense of ₦1.54 billion, representing a 79.4% YoY decline from ₦7.5 billion in Q3 17. Although actual interest expense remained flat (declining by a modest 2% to ₦1.50 billion), the substantial decline in overall finance expense reflected lower FX losses of ₦46 million (Q3 17: ₦5.9 billion) following the duo of FX stability at ₦360/\$ and payment of 74% of its FCY borrowings since Q3 17.
 - Overall, while we find the growth in EPS decent, we note that it was majorly driven by lower FX losses which offset pressures from a slowdown in beverage revenue and higher operating expenses. Nonetheless, we remain optimistic into Q4 18, as we expect the festive season to drive higher revenue, particularly for its food segment. We expect this alongside sustained moderation in the prices of its key input costs to support Q4 and overall FY 18 bottomline.
 - Our last communicated FVE on Nestle is ₦1,287.54 which translates to a **SELL** rating on the stock. NESTLE trades at a current P/E and EV/EBITDA of 24.94x and 14.99x relative to Bloomberg Mena peer average of 18.85x and 12.10x.
 - **More analysis to follow.**

¹ Maize (-8%), Sorghum (-24%) and Sugar (-26%)

² Property, Plant and Equipment

Summary of Results and Forecast

Income statement – (¥ million)	Q3 18	YoY growth	QoQ growth	Deviation from forecast	9M 18	YoY growth
Revenue	67,839	7.1%	0.0%	-1.0%	203,135	9.7%
Cost of sales	37,267	4.1%	-2.0%	-1.0%	116,985	7.0%
Gross profit	30,572	11.0%	2.5%	-1.0%	86,150	13.5%
OPEX	13,366	19.9%	9.7%	5.7%	36,790	12.2%
Operating profit	17,207	5.0%	-2.4%	-5.6%	49,360	14.6%
Finance expense	-991	-84.4%	-265.7%	-521.1%	1,271	-85.2%
PBT	16,216	61.8%	-11.1%	-12.2%	48,089	318.2%
PAT	11,661	81.3%	-9.3%	-8.3%	33,118	44.1%

*N/M means not meaningful

Key Ratios	Q3 18	Q3 17	Change(pps)	9M 18	9M 17	Change(pps)
Gross margin	45.1%	43.5%	1.6%	42.4%	41.0%	1.4%
EBIT margin	25.4%	25.9%	-0.5%	24.3%	23.3%	1.0%
PBT margin	23.9%	15.8%	8.1%	23.7%	6.2%	17.5%
PAT margin	17.2%	10.2%	7.0%	16.3%	12.4%	3.9%
Effective tax rate	28.1%	35.8%	-7.7%	31.1%	33.4%	-2.2%

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 engagement in an investment banking transaction and in certain other circumstances.

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