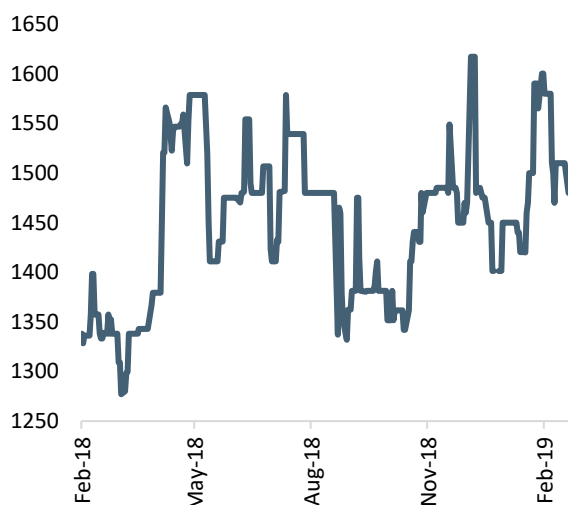


Rating	SELL
Price	₦1,549.90
FVE	₦1,411.29
52-week range	₦1,317-₦1,645
Market Cap. (₦'bn)	1,173
1-month Avg. Vol	163,372
Curr. PE	28.6x

Quarterly EPS	Q1	Q2	Q3	Q4
2017 A	10.55	10.33	8.11	13.55
2018 A	10.86	16.21	14.71	13.55
2019 (E*)	17.17	20.34	18.39	12.57

NESTLE:NL - Share Price Trend



Analyst(s)

Olamide Adeboboye
olamide.adeboboye@arm.com.ng

Click link below for recent report on Nestle

FY 2018 Initial View: Topline gains eroded by operating cost pressures

Nestle Nigeria Plc. (NESTLE.NL)

Stock Report

Compelling Story but Valuation appears pricey

- Nestle Nigeria Plc had an impressive performance in 2018 with EPS expanding 28% YoY to ₦54.26, as the benefits of lower FX loss (-83% YoY to ₦2.6 billion) following the pay down of its FCY borrowings provided strong support for earnings growth. While, earnings was in line with our expectation of ₦56.89, the lower than expected numbers largely stemmed from elevated marketing & distribution expenses (+24% YoY to ₦43.5 billion) over 2018, without a corresponding translation into revenue (+9.1% YoY to ₦266.3 billion). Notably, our market survey revealed that the company embarked on series of promotional offers during the year targeted at both distributors and consumers – including the ‘NESCAFE Get Started’ promotion – and series of advertisements.
- Over 2019, we remain optimistic on the company’s earnings, driven by moderation in the prices of its key inputs – even with expectation of stable/declining product prices – which should translate into expansion in gross margin by 172bps YoY to 44.5%. However, with our forecast opex to sales maintained at same level with FY 18 of 20% (previous: 19%), we expect slower expansion in EBIT margin to 25% (previous: 27%) over 2019. Further down, with the company extinguishing ~71% of its FCY loans in 2018, which necessitated lower FX loss during the period, we see further moderation on that line in 2019. Overall, we lowered our EPS estimate to ₦65.58 (previous: ₦68.58) in 2019. That said, while we think earnings growth story is compelling, it looks expensive from a valuation standpoint. Accordingly, we maintain our SELL recommendation with FVE of ₦1,411.29. On our numbers, Nestle

trades at a 2019 P/E of 22.39x compared to 5-year historical average of 33.8x and Bloomberg MENA peer average of 18.7x.

- ***Sales growth is expected to slow.*** As mentioned earlier, revenue over full year 2018 expanded by 9.1% YoY. However, it was slightly disappointing as growth in the food segment slowed in the last quarter of 2018, which is atypical (being the festive season) with Q4 18 revenue to FY 18 revenue printing at 24% relative to average in the last six years (excl. 2017) of 28%. To add, product prices remained low. Therefore, we foresee a new trend in the company's receipts in coming years as we expect slower growth in volumes and lower prices to drive a modest revenue growth expectation over 2019. Thus, we expect revenue to grow by 9.8% YoY to ₦292.4 billion. Over our forecast period (2019F – 2023F), we expect revenue growth of 7.4% (5-yr CAGR) as we remain optimistic on the implementation of the minimum wage bill, coupled with Nestle's aggressive promotional offers aimed at driving volumes.
 - ***...but lower input prices will support margin.*** On input cost, we reduced our cost to sales forecast for FY 19 to 56% (-112bps YoY) based on our expectation of a further moderation in the prices of its key inputs (Sugar, Maize and Sorghum). In addition, we foresee a non-recurrence of the impairment charge booked in 2018, which further supports our guidance of a moderation in its cost of sales. For clarity, over the first half of 2018, the company booked an impairment charge of ₦4.4 billion on its Abaji water factory and other assets which was included in its cost of sales. That said, we expect cost of sales to increase by 6.5% YoY to ₦162.3 billion, which in turn translates to a gross profit of ₦130.1 billion, with related margin of 44.5% (+172 bps YoY).
 - ***Aggressive S&D will tame margin expansion:*** Over 2018, Nestle operating expense increased with OPEX to sales at 20% (FY 17: 18.5%), propelled mainly by higher selling and distribution expenses as the company embarked on diverse promotional offers aimed at driving growth in volumes. With the impact not reflected on the company's revenue growth over the period, we do not expect the company to backdown just yet given the increasing competitive landscape. That said, we leave our OPEX to sales unchanged at 20% - which overlaid with gains from the topline translates to an operating profit of ₦71.6 billion (+18.1% YoY).
 - Following the dollar debt repayment in 2018, to its parent company, which has led to sizable decline in its borrowings to ₦8.3 billion (2017: ₦24.2 billion) with FCY loan accounting for 71% of the total debt (2017: 88%), we expect further moderation in interest expense over 2019. Also, we highlight the company's cash position, which stands at ₦14.4 billion,
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indicating the company's ability to pay its obligations and earn a decent interest income, given the earliest debt maturity stands at 2020. That said, we expect the company to report a net interest income of ~~₹~~559.1 million (2018: net interest expense of ~~₹~~889 million)

- Net impact of the above translates to an EPS of ~~₹~~65.58. Over our forecast horizon, we project EPS to rise by a 5-year CAGR of 9.2%. In line with historical trend, we expect 100% dividend payout. Following revision to our forecasts we raise our FVE to ~~₹~~1,411.29, 8.9% discount to current pricing, translating to **SELL** recommendation on the stock. On our numbers, Nestle trades at a 2019 P/E of 22.39x compared to 5-year historical average of 33.8x and Bloomberg MENA peer average of 18.7x.
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Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦' m) *	2017A	2018E	2019F	2020F	2021F
Revenue	244,151	266,275	292,412	318,191	342,481
COGS	-143,280	-152,354	-162,288	-176,596	-189,392
Gross Profit	100,871	113,920	130,123	141,595	153,089
Operating Cost	-45,173	-53,279	-58,482	-63,638	-67,811
Operating Profit	55,698	60,641	71,641	77,957	85,278
Interest Income	8870	890	-559	-186	110
Interest Expense	46,829	59,751	72,200	78,143	85,168
PBT	13,105	16,743	20,216	21,880	23,847
Tax	33,724	43,008	51,984	56,263	61,321
PAT	244,151	266,275	292,412	318,191	342,481
Balance Sheet (₦ '000) *					
Fixed Assets	74,533	79,600	80,581	85,278	90,684
Stocks	72,271	82,734	82,027	85,944	89,096
Trade debtors	33,222	43,403	44,696	48,636	49,660
Cash & other bank balances	15,139	15,762	13,800	12,585	12,921
Total Assets	146,804	162,334	162,609	171,222	179,780
Liabilities					
Trade Creditors	45,668	60,384	64,322	69,993	75,064
Non-current Liabilities	22,245	19,996	20,293	20,417	20,544
Total liabilities	101,926	112,114	110,459	116,234	121,442
Shareholders' fund	44,878	50,220	53,534	56,373	59,722
Key Ratios	2017A	2018E	2019F	2020F	2021F
Gross Margin	41%	43%	45%	45%	45%
EBIT Margin	23%	23%	24%	24%	25%
PBT Margin	19%	22%	25%	25%	25%
Net Margin	14%	16%	18%	18%	18%
EPS	42.55	54.26	65.58	70.98	77.36
P/E	36.57	29.12	22.57	20.85	19.13
EV/EBITDA	19.98	17.54	14.70	13.51	12.39
ROA	21%	28%	32%	34%	35%
ROE	70%	90%	97%	102%	105%

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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