

Nigerian Consumers: Nestle and Unilever

Competition gradually blighting the Food business.

NESTLE: NL

Rating	OVERWEIGHT
Price	₦1,299.50
FVE	₦1,447.39
52-week range	₦1,225 - ₦1,645.00
Market Cap. (₦'bn)	1,038
1-month Avg. Vol	151,051
Curr. PE	21.73x

UNILEVER: NL

Rating	UNDERWEIGHT
Price	₦32.00
FVE	₦31.95
52-week range	₦27.95 - ₦55.00
Market Cap. (₦'bn)	246.62
1-month Avg. Vol	1,967,280
Curr. PE	19.39x

Analyst(s)

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- Central to the Q2 19 earnings of Nestle and Unilever is the telling impact of increased competition in the food business and improved input cost management. For Nestle, EPS grew 4.3% YoY to ₦16.90 due to gains from increased local sourcing of raw materials and higher sales. On the flipside, having restated its Q2 18 financials, Unilever reported 30% YoY decline in EPS to ₦0.35 reflecting increased input and finance cost following exchange rate differentials relative to prior year.
- Over the rest of 2019, we expect normalization in margins for both companies while we expect the competition from other brands to remain drag on sales. However, after adjusting for the improved cost management over H1 19, we raised our NESTLE FVE to ₦1,447.39 which translates to an **OVERWEIGHT** rating. Nestle trades at a 2019P/E of 23.01x, relative to Bloomberg MENA peers of 15.49x. Elsewhere slow recovery in revenue guides our downward revision of Unilever FVE to ₦31.95 (previously: ₦35.82), which translates to **UNDERWEIGHT** rating. Unilever trades at a 2019 P/E of 26.1x relative to Bloomberg MENA peers of 16.1x.
- Food business faces increasing challenge:** Amidst flat pricing, competition in food business from smaller seasoning brands (*Ginomax, Terra cubes, Onga cubes*) became more apparent over Q2 19, with both companies recording low to mid-single digit growth in revenue, relative double digit recorded in prior years. To begin, Nestle's revenue from the food business grew by just 1.6% YoY over the review period. However, support from its beverage business drove the 4.6% YoY expansion in its overall revenue. Elsewhere Unilever's revenue recovered from a downbeat in Q1 19, with food business expanding by 6.3%, following the measures put in place to drive topline. To clarify, we recall management's guidance during its Q1 19 conference call to drive sales by partnering with banks to provide liquidity to its distributors. However, persistent struggle in the HPC segment drove overall revenue lower by 1.7% YoY to ₦23.4 billion.

- Expect margin normalization:** Over the review period, Nestle booked lower cost of sales over Q2 19, which was further magnified by ₦1.0 billion impairment recorded in Q2 18. On the raw materials, domestic maize prices fell by 4% YoY while palm olein dropped by 1.5% YoY. Consequently, cost of sales dipped by 4.4% YoY to ₦36.3 billion, driving a 483bps expansion in gross margin to 48.8%. On the flipside, Unilever's input cost expanded by 4.7% YoY which we believe mirrors convergence of NIFEX&NAFEX rates coupled with increased pricing of its HPC¹ inputs. In its Q1 release, the company highlighted that it now sources FX within a range of ₦360/\$ - ₦365/\$, compared to the prior year wherein it was sourced within the range of ₦320/\$ - ₦330/\$. Consequently, gross margin dipped by 416bps to 31.9% in Q2 19 (H1 19: 26.6%). Over the rest of 2019, we expect a normalization in Nestle's margins as the base effect from impairment charge ended with the half year result. That said, we expect gross margin for FY 19 to print at 46% (+322bps YoY). Elsewhere, while we expect a recovery towards Q4 19, given the NIFEX and NAFEX convergence occurred in the later part of last year, full year margin will remain lower relative to prior year. That said, Unilever's gross margin for FY 19 is expected to print at 28% (-238bps YoY).
- Moderating Cashflows:** Following the increased receivables (+₦3.2 billion) and a reduction in its trade payables (-₦9.4 billion) over Q2 19, Nestle's operating cash position declined to ₦33.3 billion over H1 19, compared to ₦53.5 billion recorded over H1 18. Unilever at the other end reported negative cashflow from operations (- ₦16.0 billion) mirroring the ₦20.5 billion increase in the company's receivables over first half of 2019. For us, while this reflects the Unilever's aggressive stance to drive sales, we remain worried about its cash collection as receivable turnover printed at 1.84x as at H1 19, compared to 3.21x at the end of 2018.
- We are positive on Nestle:** As earlier stated, Nestle still posted modest performance notwithstanding the tensed environment due to savings from its cost. Elsewhere, exchange loss worth ₦219.5 million, recorded in Unilever's finance cost coupled with input cost pressure drove earnings lower. In coming quarters, we expect the competitive environment to remain unchanged, albeit with a normalization in gross margin. That said, gains from improved sales and lower cost is expected to support growth in Nestle FY 19 EPS by 26.5% YoY to ₦68.7. On other hand, Unilever's EPS is expected to decline by 22.9% YoY to ₦1.23 due to struggling sales, impact of currency convergence on its input cost and less shield from its finance income, given its lower cash balance.

¹ Home and personal care

Summary of Results and Forecasts - Naira (₦) – Unilever Nigeria

ANNUAL					
Income Statement (₦' m) *					
	2017A	2018A	2019F	2020F	2021F
Revenue	85,193	92,900	91,696	99,189	105,927
COGS	57,679	64,675	66,021	69,432	72,031
Gross Profit	27,514	28,225	25,675	29,757	33,897
Operating Cost	15,267	18,952	17,944	19,410	20,822
Operating Profit	12,231	9,198	7,914	10,396	13,135
Net finance Cost	-1,635	3,424	2,285	2,179	1,620
PBT	10,596	12,622	10,200	12,575	14,755
Tax	3,526	3,490	3,162	3,898	4,574
PAT	7,070	9,132	7,038	8,677	10,181
Balance Sheet (₦ '000) *					
Fixed Assets	29,881	29,678	32,615	68,702	67,501
Stocks	11,479	13,929	13,436	14,130	14,659
Total Assets	121,084	131,843	131,607	135,421	139,195
Liabilities					
Trade Creditors	33,409	38,611	33,011	34,716	36,015
Non-current Liabilities	8,481	5,887	6,193	6,570	7,013
Total liabilities	36,695	43,167	38,370	40,072	41,367
Shareholders' fund	75,908	82,790	83,800	85,535	87,571
Key Ratios					
	2016A	2017A	2018E	2019F	2020F
Gross Margin	32%	30%	28%	30%	32%
EBIT Margin	14%	10%	9%	10%	12%
PBT Margin	12%	14%	11%	13%	14%
Net Margin	8%	10%	8%	9%	10%
EPS	1.69	1.59	1.23	1.51	1.77
P/E	24.23	23.28	29.24	23.72	20.21
EV/EBITDA	7.44	13.17	13.96	14.48	9.73
ROA	7.30%	7.22%	5.34%	6.50%	7.41%
ROE	9.31%	9.31%	11.03%	8.40%	10.14%

Summary of Results and Forecasts - Naira (₦) – Nestle Nigeria

ANNUAL					
Income Statement (₦' m) *					
	2017A	2018E	2019F	2020F	2021F
Revenue	244,151	266,275	288,558	313,993	337,952
COGS	-143,280	-152,354	-155,821	-169,556	-186,888
Gross Profit	100,871	113,920	132,737	144,437	151,065
Operating Cost	-45,173	-53,279	-57,712	-62,799	-66,915
Operating Profit	55,698	60,641	75,025	81,638	84,150
Net finance Cost	8870	890	-559	-186	110
PBT	46,829	59,751	75,584	81,825	84,040
Tax	13,105	16,743	21,164	22,911	23,531
PAT	33,724	43,008	54,421	58,914	60,509
Balance Sheet (₦ '000)					
*					
Fixed Assets	74,533	79,600	75,983	75,633	75,676
Stocks	72,271	82,734	85,647	94,525	102,589
Trade debtors	33,222	43,403	44,107	47,995	49,003
Cash & other bank balances	15,139	15,762	18,946	22,793	27,422
Total Assets	146,804	162,334	161,630	170,158	178,264
Liabilities					
Trade Creditors	45,668	60,384	61,758	67,202	74,071
Non-current Liabilities	22,245	19,996	20,293	20,417	20,544
Total liabilities	101,926	112,114	107,896	113,444	120,450
Shareholders' fund	44,878	50,220	55,119	58,099	59,199
Key Ratios					
Gross Margin	41%	43%	46%	46%	45%
EBIT Margin	23%	23%	26%	26%	25%
PBT Margin	19%	22%	26%	26%	25%
Net Margin	14%	16%	19%	19%	18%
EPS	42.55	54.26	68.66	74.32	76.34
P/E	36.57	29.12	23.01	21.26	20.70
EV/EBITDA	19.98	17.54	15.00	13.77	13.32
ROA	21%	28%	34%	36%	35%

ARM ratings and recommendations

M 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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