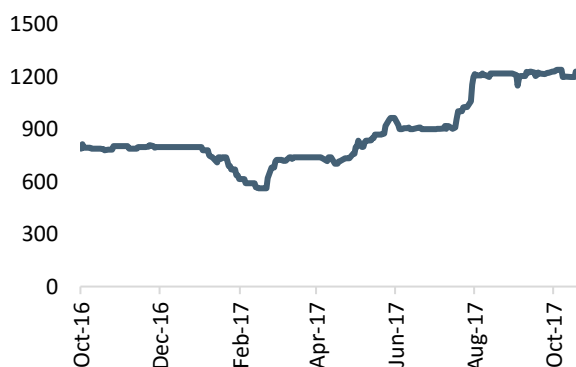


Rating	<b>SELL</b>
Price	₦1,250.0
FVE	<b>₦879.62</b>
52-week range	₦562.35 – ₦1252.00
Market Cap. (₦mn)	990,820
1-month Avg. Vol	237,174
Curr. PE	32.57x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2015 A</b>	3.73	7.48	10.53	8.20
<b>2016 A</b>	8.43	(7.75)	(0.06)	9.39
<b>2017A(E*)</b>	10.55	10.33	8.11	13.61*

#### NESTLE:NL - Share Price Trend



#### Analyst(s)

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## Nestle Nigeria Plc. (NESTLE.NL)

### Stock Report

#### Earnings growth momentum, scope for upside?

- We recently posed a salient question, “Is there still a strong case for a potential upside in Nestle<sup>1</sup>?” In this note, we update our views on the stock subsequent to the release of Nestle’s 9M result, revise our FY 17 estimate to incorporate recent developments as well as revise our forecast for the company beyond 2017 with a view to ascertaining the possibility of further upside. In our view, market timing remains a risky exercise, and especially in the case of the sentiment-driven rally where fundamentals speak otherwise.

- Over the nine-months of 2017 (9M 2017), Nestle posted EPS of ₦28.99 which is 46.4x higher YoY (9M 2016: ₦0.61) and reflects a strong turnaround story from 2016’s performance which was plagued with significant FX losses and persisting input cost inflation. For context, higher sales of ₦185.2 billion (43% YoY), mirroring price increases relative to last year, combined with 57% decline in net finance cost to underpin the sturdy performance. In view of this, the company declared an interim dividend of ₦15<sup>2</sup> (vs. nil in Q3 16), which translates to dividend yield of 1.2% using the stock’s last trading price of ₦1250.

- **Higher prices underpin sturdy topline.** Although Nestle modestly cut back on product prices in the Q3 17 (QoQ: -2%), higher prices relative to prior year (YoY: ~30%-50%) still supported top-line with the company posting a 29% YoY increase in revenue to ₦63.3 billion. The foregoing combined with easing

<sup>1</sup> See our report titled “Nestle Nigeria Plc: Has the bull run its course?”

<sup>2</sup> ₦15 dividend comprises ₦13 from pioneer profit of the company as at 31 December 2015 and ₦2 from retained earnings as at same date.

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cost pressures drove a 43.4% YoY rise in gross profit to ₦27.5 billion with gross margin printing 4.3pps higher on a year ago basis at 44%.

- Consequently, despite higher operating expenses in the period (+27% YoY to ₦11.2 billion), pass-through from higher prices drove a 58% YoY expansion in operating profit to a record high of ₦16.4 billion in the quarter while EBIT margin expanded 4.7pps to 25.9% as opex-sales contracted marginally (-0.3pps YoY to 17.6%). In terms of operating expenses, we note that pressures stemmed from both S&D (+19.2% YoY to ₦8.4 billion) and admin expenses (+56.5% YoY to ₦2.8 billion) likely reflected higher labour cost stemming from re-negotiated wages by labor unions, and intensive distribution activities in the quarter to stimulate volumes.
- Furthermore, despite cutback in borrowings (-46% YoY to ₦18.4 billion, QoQ: -12%), Nestle faced moderate pressures from finance expenses (+6% YoY to ₦7.5 billion). We link the jump in finance expense to currency impact on its foreign currency denominated intercompany loans which grew by 95.3% YoY to ₦2.1 billion even as effective rates on borrowings tracked higher (+400bps YoY to 5%). Nestle realized ₦6 billion in FX losses which we link to losses incurred on the repayment of the company's outstanding FCY denominated loans at the NAFEX rate. Concurrently, Nestle's finance income also declined modestly (-55.4% YoY to ₦1.1 billion) underpinned by narrowing cash balances as Nestle made a part repayment of ₦32.5 billion on its outstanding loan balances (₦38.3 billion loan payments due in 2017). Irrespective, pass-through from higher prices, as well as lower taxes in the period<sup>3</sup> drove EPS of ₦8.11
- ***Price to support 2017 earnings.*** Going into the last quarter of 2017, the onset of harvest season should drive improved domestic cereal supplies. Thus, we expect the pace of input cost inflation to moderate over the last quarter of 2017 even though it is likely to remain higher on a YoY basis. In view of this, we have lowered our 2017 COGS projection to ₦145.8 billion (+37% YoY vs prior: ₦148.1 billion) while retaining our expectation for FY 17E revenue at ₦250.1 billion. Overall, these assumptions translate to gross profit of ₦104.3 billion (+38.6% YoY) with gross margin now at 42%.
- We have revised our projection for Nestle's S&D expenses lower to ₦34.1 billion (+19% YoY) to capture the run rate over the nine-month period with projected OPEX and EBIT of ₦44.4

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<sup>3</sup> After facing heavy effective tax burden following the expiration of pioneer tax status on its flower gate factory located in Ogun State in Q3 16, normalization of taxes saw the company report lower taxes in the latest quarter

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billion (+20% YoY) and ₦60 billion (+57%) respectively. Similarly, we have revised our forecast finance expense higher to ₦17.6 billion (-16% YoY, prior estimate: ₦10.9 billion, 9M 17: ₦14.9 billion) to capture the impact of higher than expected FX losses over 9M 17 and elevated interest payments relative to the prior year. Likewise, we have reviewed Nestle's finance income lower to ₦7.3 billion (+79% YoY, prior estimate: ₦10.2 billion, 9M 17: ₦6.3 billion) to capture our expectations for lower cash balances. Net impact of these revisions translates to PBT and PAT of ₦49.7 billion (+2.3x YoY) and ₦33.8 billion (+4.3x YoY) respectively – EPS of ₦42.6 with a final dividend expectation of ₦23.

- As previously stated, beyond 2017, we view price-induced revenue growth as unsustainable and expect the company to tilt towards volume growth strategies over the rest of our forecast horizon (2018-2022). Hence, we project a 9% revenue CAGR over our forecast horizon (vs. 13% in the five years ending December 2015). Elsewhere, we project a slowdown in COGS (CAGR: +8%) over our forecast horizon as the transitory nature of transport-induced food inflation wanes. This deceleration of revenue growth should apply downward pressure on growth rate of gross profit although we expect gross margin to improve over our forecast period (average 44%) In addition, we have revised our projections for net finance expense lower as Nestle repays its outstanding FX debt to its parent (2017-2022 CAGR: -31% vs. 45% between 2010 and 2015). That said, leaving our OPEX growth unchanged at 14%, combined with benign topline growth, we project slower rise in earnings (2017-2022 CAGR: +10%) going forward.
  - Nestle trades at a current P/E of 32.7x vs 26.3x for Bloomberg Middle East and Africa. We have a **SELL** rating on the stock with a FVE of **₦879.62**.
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## Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦'m) *	2014A	2015A	2016E	2017E	2018E
Revenue	143,329	151,272	181,911	250,116	278,347
COGS	82,099	83,926	106,583	145,817	158,658
Gross Profit	61,230	67,346	75,328	104,298	119,689
Operating Cost	32,030	33,598	37,114	44,371	57,896
Operating Profit	29,200	33,747	38,213	59,928	61,793
Net Finance expense	4,754	4,425	16,665	10,273	2,030
PBT	24,446	29,322	21,548	49,654	59,763
Tax	2,210	5,586	13,623	15,889	19,124
PAT	22,236	23,737	7,925	33,765	40,639
Balance Sheet (₦'000) *					
Fixed Assets	68,673	70,500	71,850	72,874	74,849
Stocks	10,956	10,814	20,638	28,434	30,145
Trade debtors	22,729	24,971	25,747	18,759	19,484
Cash & other bank balances	3,705	12,930	51,351	17,027	4,968
Total Assets	106,062	119,215	169,586	137,094	129,446
Liabilities					
Trade Creditors	26,657	36,662	64,662	58,327	47,597
Non-current Liabilities	25,484	21,476	17,674	16,237	16,684
Total liabilities	70,122	81,208	138,708	102,994	93,314
Shareholders' fund	35,940	38,007	30,878	34,224	36,256
Key Ratios					
	2014A	2015A	2016A	2017E	2018E
EPS	28.05	29.95	10.00	42.60	51.27
BVPS	45.34	47.95	38.96	43.18	45.74
P/E	43.67	40.91	122.53	28.76	23.89
EV/EBITDA	28.57	24.90	21.96	14.97	14.68
ROA	21%	21%	5%	22%	30%
ROE	58%	64%	23%	104%	115%
Gross Margin	43%	45%	41%	42%	43%
Operating margin	20%	22%	21%	24%	22%
PBT margin	17%	19%	12%	20%	21%
Net margin	16%	16%	4%	13%	15%

Source: ARM Research \*unless otherwise stated

Ratings, Disclosure & Disclaimer – [Click here](#)