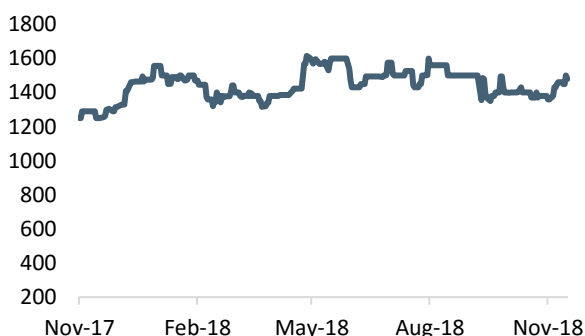


Rating	<b>SELL</b>
Price	₦1,500.00
FVE	₦1,330.35
52-week range	₦1,250-₦1,645
Market Cap. (₦'bn)	1,173
1-month Avg. Vol	141,310
Curr. PE	27.1x

Quarterly EPS	Q1	Q2	Q3	Q4
<b>2016 A</b>	8.43	(7.75)	(0.06)	9.39
<b>2017 A</b>	10.55	10.33	8.11	13.55
<b>2018 A (E*)</b>	10.86	16.21	14.71	15.11*

#### NESTLE:NL - Share Price Trend



#### Analyst(s)

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**Click link below for recent report on Nestle**

**[9M 2018 Initial View: Lower FX losses offset operating cost pressures](#)**

## Nestle Nigeria Plc. (NESTLE.NL)

### Stock Report

#### *Impressive earnings outlook, expensive valuation*

- **Nestle's 9M 18 result was decent and broadly in line with our expectation. The only surprise was on the interest expense which came in higher than expectation and already tracking higher than our FY 18 estimate. Accordingly, we revise our FY 18E earnings forecast lower by 5% to ₦56.82 after adjusting interest expense higher for the rest of the year. Farther out, we raise our EPS expectation over our forecast horizon (FY 19-23F) by 2.6% on average following moderation to our cost of sales ratio. We have observed improvement in gross margin (excluding impairments) since Q1 18 helped by the stability in FX and moderation in domestic cereal prices. Following adjustments and having rolled forward our model, we raised our FVE on Nestle to ₦1,330.35 (previous: ₦1,287.54) but maintain our SELL rating on the stock. On our numbers, Nestle trades at a 2019 P/E of 21.7x compared to 5-year historical average of 27.3x and Bloomberg MENA peer average of 24.7x.**

- ***Food Segment to drive sales:*** Revenue growth over the nine-month period has been decent (+9.7% YoY). However, we are concerned about the recent downturn in Nestle's beverage segment which declined 1.3% YoY after rising double-digit in Q1 and Q2. In our initial view on Nestle's 9M 18 result, we attributed the decline to possible loss of volumes following the 6% price increase on beverage products. Given this, as well as slight underperformance of our 9M 18 revenue estimate, we revise our FY 18E revenue forecast lower by 0.8% to ₦272 billion -

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with the festive season and strong performance in the food division (key products - Maggi and Golden Morn) expected to support topline in Q4 18F. Over our forecast horizon, we have left our revenue forecast unchanged. The implementation of the 67% hike in minimum wage is looking more possible in 2019 and we expect this alongside Nestle's strong market presence to support volumes and revenue growth.

- While we have maintained our cost to sales ratio forecast for FY 18E, we lowered the ratio over our forecast horizon to average 53.8% (previous: 54.2%) based on our expectation of a further increase to its local content and moderation in domestic commodity prices. Precisely, over the nine-month period, cost to sales ratio (excluding impairments<sup>1</sup>) moderated to 55.4% in 9M 18 vs. 59% in 9M 17 which in turn led gross margin (excluding impairments) to expand 364bps to 44.6%, higher than 5-year historical average of 42.5%. We believe much of this reflects its increased local raw material sourcing (currently at 80%) alongside tamer prices for Maize, Sorghum and Palm Olein. The company is also committed towards increasing its local content beyond current levels which informed our moderation in cost to sales ratio and gross margin estimate of 46.2% on average over our forecast horizon.
- With our OPEX to sales ratio of 18.7% in FY 18E and 19% over our forecast horizon, we project EBITDA margin of 28.7% in FY 18 and 29.7% on average in FY 19-23F, higher than 5-year historical EBITDA margin average of 25%.
- ***Lower FCY loans to drive moderation in finance cost:*** Nestle's total FCY debt currently stands at \$41.2 million with \$26 million due to be paid in 2018. With the FX debt already valued at ~₦360/\$ on its balance sheet and our expectation of exchange rate stability, we do not envisage any material FX loss if the amount is fully settled in Q4 18. We further highlight that as at 9M 18, Nestle has a net position of ₦15.7 billion, indicating its ability to sufficiently meet its debt obligations. Given this alongside upward review of our interest expense forecast following the surprise in Q3 18, we project finance expense of ₦3.2 billion (FY 17: ₦15.1 billion) in FY 18E. With the exchange rate stability and sizeable moderation in FX debt (-60% since 9M 17), our expectation going forward is for finance costs to be more reflective of interest expense rather than FX losses which materially impacted on earnings in FY 16 and FY 17.
- Net impact of the above translates to an EPS of ₦56.89 and ₦68.58 in FY 18E and FY 19F. Over our forecast horizon, we project EPS to rise by a 5-year CAGR of 9.4%. In line with

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<sup>1</sup> We recall that Nestle Nigeria booked impairments of ₦3.4 billion and ₦1.04 billion on PPE related to its water and food division in Q1 18 and Q2 18 respectively.

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historical trend, we expect 100% dividend payout which translates to an expected dividend yield of 3.8% and 4.7% in FY 18E and FY 19F respectively based on the stock current market price.

- Following revision to our forecasts and having rolled forward our model, we raise our FVE to ₦1,330.35 (previous: ₦1,287.54) which implies an 11.3% discount to current pricing thus, we maintain our **SELL** recommendation on the stock. On our numbers, Nestle trades at a 2019 P/E of 21.7x compared to 5-year historical average of 27.3x and Bloomberg MENA peer average of 24.7x.

## Summary of Results and Forecasts - Naira (₦)

ANNUAL					
Income Statement (₦' m) *					
	2016A	2017A	2018E	2019F	2020F
Revenue	181,911	244,151	272,165	294,708	316,731
COGS	106,583	143,280	154,590	159,143	171,035
Gross Profit	75,328	100,871	117,575	135,566	145,696
Operating Cost	37,114	45,173	50,895	55,995	60,179
Operating Profit	38,213	55,698	66,681	79,571	85,517
Interest Income	4,199	6,239	1,906	1,806	1,352
Interest Expense	20,864	15,109	3,230	2,597	2,593
PBT	21,548	46,829	65,357	78,781	84,277
Tax	13,623	13,105	20,261	24,422	26,126
PAT	7,925	33,724	45,096	54,359	58,151
Balance Sheet (₦ '000) *					
Fixed Assets	71,850	74,299	69,681	69,929	70,271
Stocks	20,638	23,910	27,826	27,054	29,076
Trade debtors	25,747	33,456	39,464	42,733	45,926
Cash & other bank balances	51,351	15,139	22,083	27,381	28,959
Total Assets	169,586	146,804	159,054	167,097	174,231
Liabilities					
Trade Creditors	64,662	49,056	61,836	63,657	68,414
Non-current Liabilities	17,674	22,245	21,767	22,222	22,412
Total liabilities	138,708	101,926	106,694	108,615	113,226
Shareholders' fund	30,878	44,878	52,360	58,481	61,006
Key Ratios					
	2016A	2017A	2018E	2019F	2020F
Gross Margin	41%	41%	43%	46%	46%
EBIT Margin	21%	23%	25%	27%	27%
PBT Margin	12%	19%	24%	27%	27%
Net Margin	4%	14%	17%	18%	18%
EPS	10.00	42.55	56.89	68.58	73.36
P/E	81.02	36.57	27.35	22.69	21.21
EV/EBITDA	14.51	19.98	16.67	14.10	13.11
ROA	5%	21%	29%	33%	34%
ROE	23%	89%	93%	98%	97%

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
<b>STRONG BUY</b>	>20%	<b>BUY</b>	>20%
<b>OVERWEIGHT</b>	10% – 20 %	<b>NEUTRAL</b>	5% – 20 %
<b>NEUTRAL</b>	0% – 10 %	<b>SELL</b>	<5%
<b>UNDERWEIGHT</b>	-5% – 0%		
<b>SELL</b>	<-5%		

RECOMMENDATION KEY	
Rating	Recommendation
<b>BUY</b>	Accumulate security to a substantial extent constrained only by portfolio diversification considerations
<b>OVERWEIGHT</b>	Accumulate security to an extent moderated by cognizance of its benchmark weight
<b>NEUTRAL</b>	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
<b>UNDERWEIGHT</b>	Minimize exposure to security taking cognizance of its index weighting
<b>SELL</b>	Sell-off security completely from portfolio
<b>RESTRICTED</b>	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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