Nestle Nigeria Plc.

Upward Revision to 2018-2019F Estimates; SELL Rating Maintained

Following Q3-17 result, we raise NESTLE's 2017F EBITDA estimate by 10% but cut net profit by 9.7%, on net, equating to growth forecasts of 51% (previously 37%) and 290% (previously 331%) respectively. While we cut sales forecasts for 2018-2019F by 0.4% average, we raise EBITDA and net profit by 15% and 14% respectively on (1) better margin assumptions and (2) lower finance cost estimates. On our revised estimates, we value NESTLE at NGN843.54/share and reiterate SELL rating on the stock. We roll forward our model estimates and valuation by one year.

We raise gross margin estimates for 2017F by 141 bps to 41% and by 216 bps to 42% in 2018-2019F on better-than-expected formation over 9M-17 (+85 bps vs. 9M-16). Our 2018-2019F gross margin estimate, at 200 bps discount to the 44% achieved in Q3-17, factors in the key risk of potential pricing pressure from competition – as stronger dollar liquidity encourages more imports – and is therefore conservative. We reiterate the tailwinds for gross margin as being the (1) significantly reduced FX risk to production costs, (2) stable raw materials price outlook, and (3) possible stable selling prices in view of election spending boost to aggregate demand. Also, vis-a-vis the possible impact of pricing on margin going forward, is the brand premium – hence stable market share – that NESTLE enjoys across key products.

We raise our finance cost estimate for 2017F by 58% on higher-than-expected amount recognized in Q3-17 (+190% vs. our estimate) and overall, 9M-17 (+49% vs. our estimate). We are surprised that both net FX losses and interest charges on borrowings realized over 9M-17 were way ahead of our estimates which assumed (1) 20% NGN devaluation rate (on NGN366/USD vs. NGN305/USD) and (2) average borrowing cost of 7%. That said, we have cut finance cost estimates over 2018-2019F by 39% average, on the back of (1) NESTLE's significantly deleveraged balance sheet (borrowings reduced by 42% over 9M-17) and importantly, (2) significantly reduced FX headwinds on stronger USD/NGN outlook, amidst the repayment of intercompany USD loans (NGN31.3 billion of the NGN38.3 billion due this year has been repaid YtD). Management is yet to provide guidance on the replacement of the repaid loans in 2018F, hence, we consider this a downside risk to our finance cost estimate.

From estimated 39% growth in 2017F, we forecast sales growth to moderate to 10% average over 2018-2019F, as the impact of price hikes wanes. Our 2018-2019F revenue growth forecast, 300 bps below NESTLE's five-year historical average growth rate, is conservative. We note downside risks such as possible cut to selling prices (as competition intensifies) and less-than-expected impact of election spending on aggregate demand. Yet, we reiterate tailwinds such as (1) NESTLE's brand premium, (2) products affordability via smaller package offerings, and (3) extensive distribution network.

On net, we forecast average EBITDA and net profit growth of 9% and 31% respectively in 2018-2019F. NESTLE's share price has gained 2% QtD and 54% YtD, and we estimate the stock is trading on 2018F P/E of 21.1x, a material discount to five-year historical P/E of 43x, and but at premium to Bloomberg's MEA 1-year forward peer average of 17.7x.

Income Statement (NGN'bn)	Q1-17a	Q2-17a	Q3-17a	Q4-17e	Q4-16a	Q4-17e y/y
Revenue	61.15	60.77	63.32	68.39	52.43	*30%*
Cost of Sales	-37.67	-35.91	-35.79	-39.67	-29.03	*37%*
Gross profit	23.48	24.86	27.54	28.72	23.39	*23%*
OPEX	-10.27	-11.37	-11.15	-14.36	-10.55	*36%*
EBIT	13.21	13.49	16.39	14.36	12.84	*12%*
Finance income	2.60	2.54	1.14	1.12	2.08	*-46%*
Financial charges	-1.53	-5.86	-7.50	-4.96	1.12	*-543%*
Profit before tax	14.28	10.18	10.02	10.52	16.04	*-34%*
Taxation	-5.92	-1.99	-3.59	-2.63	-8.60	*-69%*
Profit after tax	8.36	8.19	6.43	7.89	7.44	*6%*

SELL

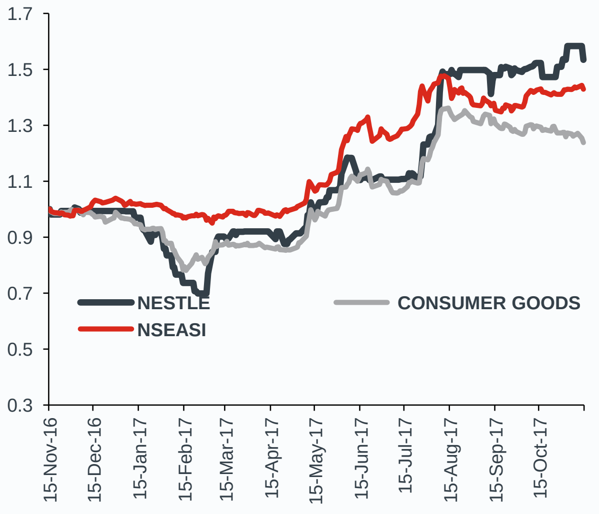
Target Price (NGN)	843.54
Current Price (NGN)	1,250.00
Implied Return (%)	-32.52

Company Data

NSE Code	NESTLE
Bloomberg Code	NESTLE:NL
Reuters Code	NESTLE.LG
Sector	CONSUMER GOODS
Market Cap. (NGN'bn)	990.82
Free Float (%)	36.25

Ratios	Q3-2017	Q3-2016	2016FY
Gross margin	43.49%	39.16%	41.41%
Opex margin	17.61%	17.95%	20.40%
EBITDA margin	28.47%	24.45%	24.29%
EBIT margin	25.88%	21.21%	21.01%
PAT margin	10.16%	-0.10%	4.36%
EPS (N)	8.11	-0.06	9.99

Price movement (NESTLE vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros research

Financial Statement (NGN'million).

Income Statement	2015a	2016a	2017e	2018e	2019e
Turnover	151,272	181,911	253,631	278,994	308,288
Cost of sales	-83,926	-106,583	-149,027	-161,817	-178,792
Gross profit	67,346	75,328	104,604	117,178	129,497
Gross opex	-33,598	-37,114	-47,157	-55,799	-61,673
EBIT	33,747	38,213	57,447	61,379	67,823
Interest income	444	4,199	7,402	3,128	3,365
Interest exp	-4,869	-20,864	-19,850	-1,946	-1,946
PBT	29,322	21,548	44,999	62,561	69,243
Tax	-5,586	-13,623	-14,129	-15,640	-17,311
PAT	**23,737**	**7,925**	**30,870**	**46,921**	**51,932**

Financial Position	2015a	2016a	2017e	2018e	2019e
PPE	69,148	70,172	75,747	82,188	88,412
Intangible assets	-	-	-	-	-
LT receivables	1,352	1,678	2,041	2,214	2,382
Non-current assets	**70,500**	**71,850**	**77,788**	**84,403**	**90,794**
Inventories	10,814	20,638	27,211	29,525	31,761
Trade and other receivables	24,446	24,035	32,187	34,924	37,569
Prepayments	525	1,712	2,484	2,695	2,900
Cash and cash equivalents	12,930	51,351	35,247	38,245	41,141
Current assets	**48,715**	**97,736**	**97,130**	**105,389**	**113,370**
Total Assets	**119,215**	**169,586**	**174,918**	**189,792**	**204,165**
Trade and other payables	36,662	64,662	67,225	68,666	73,128
Bank overdraft	305	155	-	-	-
Short term borrowings	17,109	40,130	10,837	10,837	10,837
Current tax liabilities	5,040	15,490	15,871	16,211	17,264
Provisions	616	597	301	301	301
Current liabilities	**59,732**	**121,033**	**94,233**	**96,015**	**101,531**
Long term borowings	12,530	10,384	18,369	18,369	18,369
Deferred tax liabilities	6,564	5,186	16,600	17,582	20,649
Employee benefits	2,382	2,104	2,559	2,614	2,783
Non-current liabilities	**21,476**	**17,674**	**37,527**	**38,564**	**41,801**
Total Liabilities	**81,208**	**138,708**	**131,761**	**134,585**	**143,331**
SHF	**38,007**	**30,878**	**43,157**	**55,207**	**60,833**

Profitability Ratios	2015a	2016a	2017e	2018e	2019e
Gross profit margin	44.5%	41.4%	41.2%	42.0%	42.0%
EBITDA margin	26.2%	24.3%	26.2%	25.6%	25.6%
Operating profit margin	22.3%	21.0%	22.6%	22.0%	22.0%
PBT margin	19.4%	11.8%	17.7%	22.4%	22.5%
Net profit margin	15.7%	4.4%	12.2%	16.8%	16.8%
RoAE	64.2%	23.0%	83.4%	95.4%	89.5%
RoAA	21.1%	5.5%	17.9%	25.7%	26.4%
RoACE	34.8%	10.6%	40.1%	59.9%	59.5%

Liquidity Ratios	2015a	2016a	2017e	2018e	2019e
Working capital (NGN'm)	-11,017	-23,297	2,897	9,375	11,840
Current ratio	0.8x	0.8x	1.0x	1.1x	1.1x
Quick ratio	0.6x	0.6x	0.7x	0.8x	0.8x
Cash ratio	0.2x	0.4x	0.4x	0.4x	0.4x

Efficiency Ratios	2015a	2016a	2017e	2018e	2019e
Fixed assets turnover	2.2x	2.6x	3.3x	3.4x	3.5x
Current assets turnover	3.1x	1.9x	2.6x	2.6x	2.7x
Total assets turnover	1.3x	1.1x	1.5x	1.5x	1.5x
Inventory turnover	7.7x	6.8x	6.2x	5.7x	5.8x
Receivables turnover	6.5x	7.5x	9.0x	8.3x	8.5x
Payables turnover	2.7x	2.1x	2.3x	2.4x	2.5x
Days inventory outstanding	47	54	59	64	63
Days collection outstanding	56	49	40	44	43
Days payable outstanding	159	221	165	155	149
Cash conversion cycle	-56	-119	-66	-47	-44

Solvency Ratios	2015a	2016a	2017e	2018e	2019e
Debt-to-capital ratio	0.4x	0.6x	0.4x	0.3x	0.3x
Net debt-to-equity ratio	0.4x	0.0x	-0.1x	-0.2x	-0.2x
Interest coverage	6.9x	1.8x	2.9x	31.5x	34.9x

Investment Ratios	2015a	2016a	2017e	2018e	2019e
Earnings per share (NGN)	29.95	10.00	38.94	59.19	65.52
Dividend per share (NGN)	29.35	9.80	38.17	58.01	64.21
Dividend Payout	98%	98%	98%	98%	98%
Dividend yield	3.4%	1.2%	3.1%	4.6%	5.1%

Source: Company Accounts, Cordros Research

Disclosures.

Analyst:

Christian Orajekwe (*christian.orajekwe@cordros.com)*

Analyst's Certification and Disclaimer

The research analyst(s) whose name(s) appear(s) on the cover of this report certifies (y) that:

(1) all of the views expressed in this report accurately reflect his or her personal views about any and all of the subject securities or issuers;

(2) no part of any of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report; and

(3) all analysis made by the analyst(s) were in good faith and the views expressed reflect their opinion, without undue influence or any intervention.

Rating Summary & Definitions

Cordros Capital uses the following rating system:

BUY (OVERWEIGHT) - Over the next twelve months, we expect the stock to return at least 20% above the current market price.

HOLD (NEUTRAL) - Over the next twelve months, we expect the stock to range between <-10% and <+20% from the current market price.

SELL (UNDERWEIGHT) - Over the next twelve months, we expect the stock to be more than 10% below the current market price.

Important Disclosure

This document has been issued and approved by Cordros Capital (Cordros) and is based on information from various sources that we believe are reliable. However, no representation is made that it is accurate or complete. While reasonable care has been taken in preparing this document, no responsibility or liability is accepted for errors or fact or for any opinion expressed herein. This document is for information purposes only. It does not constitute any offer or solicitation to any person to enter into any trading transaction.

Investments discussed in this report may not be suitable for all investors. This report is provided solely for the information of Cordros clients who are then expected to make their own investment decisions. Cordros conducts designated investment business with market counter parties and customers and this document is directed only to such persons. Cordros accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is for private circulation only and may not be reproduced, distributed or published by any recipient for any purpose without prior express consent of Cordros. Users of this report should bear in mind that investments can fluctuate in price and value. Past performance is not necessarily a guide to future performance.

Cordros and/or a connected company may or may not have a relationship with any of the entities mentioned in this document for which it has received or may receive in the future fees or other compensation. Cordros is regulated by the Securities and Exchange Commission to conduct investment business in Nigeria.