

NESTLE and CADBURY.

What makes the difference

I was on a local TV programme yesterday to discuss NESTLE's already published 2017FY results. I also discussed my expectation of the soon-to-be released consumer goods companies' results (DANGSUGAR, UNILEVER, and CADBURY).

The presenter wasn't quite convinced about the performance of consumer goods companies in 2017FY (I guess because he wasn't very familiar with the 9M-17 numbers), but I was quick to point to him, our estimate of 58% and 81% EBITDA and net profit growth respectively for our universe. Expectedly, he thought that was "fantastic" in an economy recovering from recession, with still-depressed consumer purchasing power. But that is not the essence of this piece!

Fig 1: Cordros' consumer goods coverage PAT (NGN'bn)

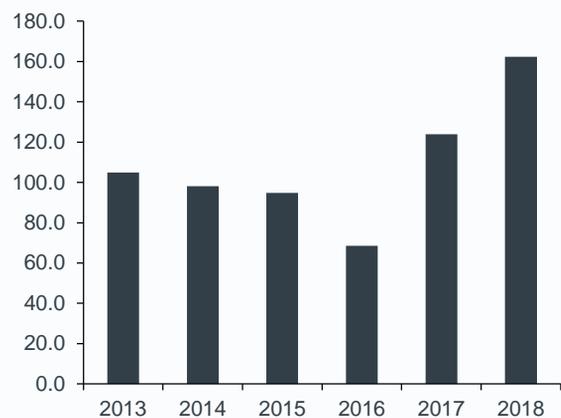
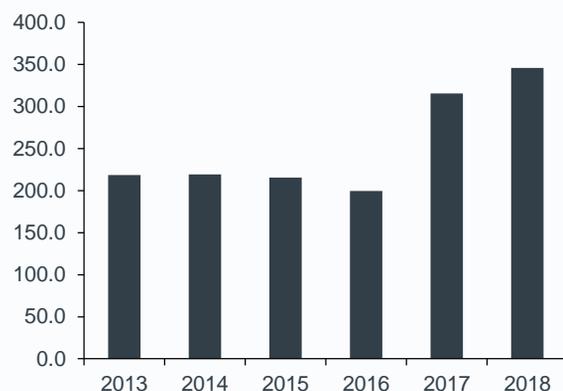


Fig 2: Cordros' consumer goods coverage EBITDA (NGN'bn)



Source: Company accounts, Cordros Research estimates

There was a part of the conversation where we had to compare NESTLE and CADBURY. The presenter caught interest in my assertion that NESTLE's today's revenue is about 8x CADBURY's, and its already reported NGN34bn 2017FY net profit is about 231x the NGN146mn we expect CADBURY to report for the year. In 2004, the revenue and net profit ratios of the two companies were just 1.28x and 1.36x respectively.

Also, at the end of 2004, NESTLE's share price of NGN99.75 was 1.4x CADBURY's. The spread, today, is 82x.

Fig 3: Ratio of NESTLE to CADBURY revenue

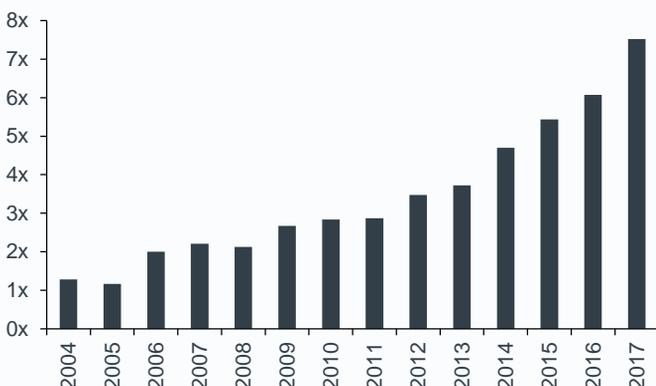
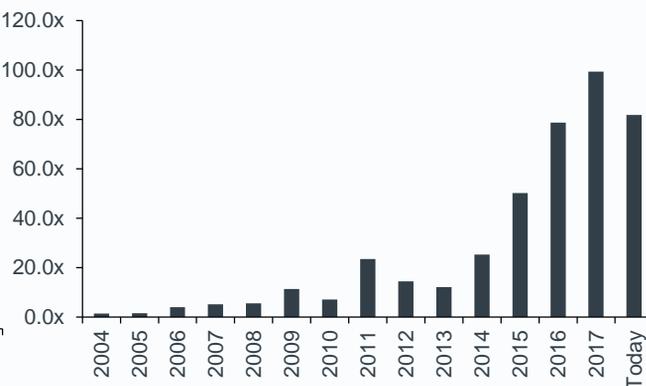


Fig 4: Ratio of NESTLE to CADBURY share price



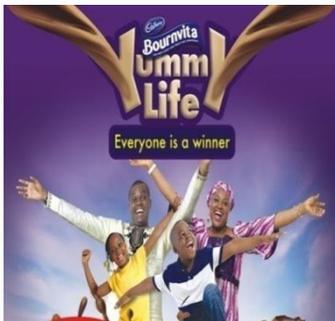
Certainly, anyone seeing or hearing of this data for the first time would also ask “how come”? The presenter did not disappoint! And in my response to him, I touched on the following issues:

Brand quality perception – In my view, the management of NESTLE has established the brand as a mark of quality in the minds of the average Nigerian consumer. I have listened to the various CEOs of NESTLE say that what the company sells is “trust” and that they ensure that is message is always in the public face. For instance, in the recent past, there was a general perception communicated in the Nigerian Yoruba dialect that “*olówó ló n mu Mílo*”. This means that “only the rich consumes *Milo*”.

Brand connection with consumers – Compared to CADBURY, we also think NESTLE has invested more into connecting its products with consumers. For reference, think *Milo*, think children and sports. Think *Maggi*, think of the Nigerian woman. Think *Golden Morn*, think children. Think *Pure Life* water, think of class. Think *Cerelac*, think infants. And think *Nescafe*, think of the Nigerian corporate man or woman. To buttress, feedback from one of the meetings we had with the distributors of the two companies is that the ratio of their *Milo*-to-*Bournvita* sales is 8:2.

I think CADBURY’s effort at connecting *Bournvita* with children is inconsistent, and has been less potent in recent time, compared to two decades ago. While noting the recent effort at reigniting this connection, we think the result is faced with strong pressure from NESTLE’s dominant presence in that space. It is also difficult to point specifically to the consumers that *Butter Mint* and *Tom-Tom* are connecting with.

CADBURY



NESTLE



Product portfolio size – This is a major factor that defines the wide divergence between the two companies’ revenues. NESTLE currently has about 18 products and 36 SKUs. For CADBURY, it is 5 and 18 respectively. NESTLE boasts of leading market share across most of its product categories, including *Milo* which was trailing *Bournvita* as at 2010. On this, the feedback we also received during our meetings with distributors is that a combination of NESTLE’s products is enough to complete (or almost) a “hamper” during festive periods.

Investment – NESTLE clearly stands out here. In the last ten years, the group has invested NGN104bn in capital expenditure. This equates to NGN10bn per annum, 5x CADBURY’s NGN2bn average per annum capex investment. You can think of NESTLE’s investments in terms of capacity expansion, new product launches, product extension, taste reformulation, and the improvement of look and feel.

Fig 5: Annual capex (NGN’bn)

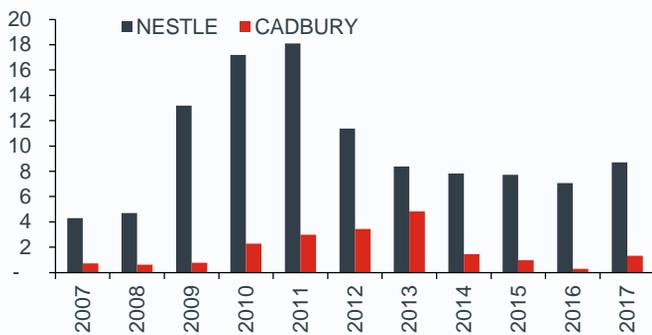
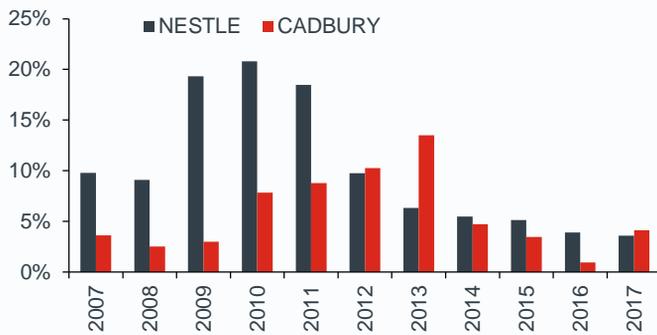


Fig 6: Ratio of capex to revenue



Source: Company accounts, Cordros Research estimates

Distribution network – As at 2016, NESTLE had 107 distributors of its products compared to CADBURY’s 62. We consider this a strong competitive advantage in terms of products’ reach to consumers. Acknowledged, both companies have been quite aggressive in terms of route-to-market (RTM) in recent years, and I like the initiatives (such as the use of tricycles, tablets, e.t.c) they have brought to bear thus far. But overall, we consider NESTLE the winner in this category, given the relative ease with which the group is able to attract distributors, and the support of its balance sheet in funding RTM.

Management/Leadership – Some staff of both CADBURY and NESTLE that I have engaged on why the former has been left so much behind, had a thing or two to say about management and leadership. Firstly, CADBURY has lost several key staff since the company was found wanting on governance issues about a decade ago. I understand that most of these top management staff joined competitor firms. Secondly, the people I spoke with were of the view that CADBURY’s acquisition by KRAFT, and the subsequent transfer of ownership to MONDELEZ, brought about a strategy mismatch that contributes to the challenges the company faces today. In their opinion, MONDELEZ is a candy and confectionery-focused company, and lacks the appropriate strategy to successfully run a food/beverage business, especially in Nigeria. Along the line of the strength of the new owners, gums (*Trident* and *Cloret*) were added to the Nigerian products portfolio about two years ago, the impact of which is yet to impact the numbers.

The numbers reflect in the stocks prices – In the last 13 years, NESTLE's 18% revenue and 33% net profit growth per annum, and unbroken dividend record (average ratio of 87%) compare favourably with CADBURY's 4% revenue and 2% PAT growth during the period. CADBURY resumed dividend payment in 2012 after 6 years (2006-2011) of no payment.

NESTLE is a more efficient producer with average 10-year gross, EBITDA, and EBIT margins of 42%, 25%, and 22% respectively. The group's average 10-year RoAE of 76% is captivating. For CADBURY, the ratios are 29% gross margin, 10% EBITDA margin, 6% EBIT margin, and 27% RoAE.

Fig 7: CADBURY

RATIOS	2013	2014	2015	2016	2017
Profitability					
Gross margin	36.6%	27.5%	32.1%	22.9%	24.4%
EBIT margin	16.0%	6.7%	5.1%	-2.4%	1.5%
EBITDA margin	20.4%	13.0%	11.5%	2.5%	7.1%
ROaE	27.4%	17.6%	9.2%	-2.5%	1.3%
Investment					
EPS	1.9	1.1	0.6	-0.2	0.1
DPS	0.8	0.6	0.6	0.0	0.0
DPR	40.5%	57.1%	105.9%	0.0%	0.0%
Multiples					
P/E	30.7x	65.2x	27.9x	-65.2x	201.6x
EV/EBITDA	22.9x	34.1x	8.4x	21.8x	12.7x

Fig 8: NESTLE

RATIOS	2013	2014	2015	2016	2017
Profitability					
Gross margin	42.7%	42.7%	44.5%	41.4%	41.3%
EBIT margin	24.4%	24.4%	26.2%	24.3%	25.5%
EBITDA margin	20.9%	20.4%	22.3%	21.0%	22.8%
ROaE	59.5%	58.1%	64.2%	23.0%	89.0%
Investment					
EPS	28.1	28.1	29.9	10.0	42.5
DPS	25.5	27.5	29.0	10.0	42.5
DPR	90.8%	98.0%	96.8%	100.0%	99.9%
Multiples					
P/E	42.7x	36.1x	28.7x	81.0x	32.9x
EV/EBITDA	29.7x	23.7x	17.6x	14.5x	18.0x

Source: Company accounts, Cordros Research estimates

Disclosures.

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