Nestle Nigeria Plc.

Q1-18 EPS behind expectation; slight downward revision to 2018E estimate

Update: NESTLE recently published Q1-18 result showing EPS grew by a marginal 3% y/y to NGN10.86, which is behind what the market expects for the period by 15%. Compared to our estimate, the achieved EBIT was short by 1% while EPS missed by 25%, owing to significant variation (-161%) on the net finance cost line.

In-line revenue; 2018E estimate unchanged: Q1-18 revenue grew by 10.3%, consistent with our 10% growth estimate for the period. Annualized, the achieved revenue is behind market expectation by only 2%. A 15% q/q revenue growth suggests volume recovered strongly from the slack in the Oct-Dec period of last year, although we estimate volume may have grown at low single-digit relative to Q1-17. Food revenue grew by 7% y/y while Beverages – benefiting from a low base volume in our view – grew by a bigger 17% y/y. Compared to Q4-17, both segments recorded 16% and 11% top-line growth respectively. Thus far from our routine checks, prices have been stable for most of NESTLE's products compared with end-2017 levels, and although early – but we observed the gradually reducing on-the-shelve prices of consumer products across major outlets – reemphasizes our view on volume-led growth in 2018. Our 10% revenue growth estimate for 2018E is unchanged.

Low Q1 gross margin; forming a trend? Gross margin of 38.2% was achieved in Q1-18, slightly below the 39% we estimated for the period. Gross margin in Q1-17 was equally low (at least compared to Q4-16's 45%) at 38.4%, before recovering to 42% average between Q2-Q4 of 2017. We retain our 42% gross estimate for 2018E (vs. 41% in 2017FY), suggesting we expect recovery in subsequent quarters. Our estimate is in sync with the 41% gross margin the company had achieved historically before the bump to 45% in 2015FY. The major risks to our gross margin estimate are (1) lower selling price and (2) the increase we have observed thus far this year in the price of local maize. Although the risks are tempered by the (1) relatively lesser competition, given the strong loyalty that NESTLE's brands enjoy, (2) stable and even improving currency exchange rate, and (3) softer prices of other raw material inputs such as sorghum, sugar, and dairy.

Q1-18 EBIT margin was lower by 8 bps y/y, driven majorly by the lower gross margin, and also because opex as a ratio of revenue only declined by a marginal 14 bps. We have 23% EBIT margin in our model for 2018E (the same 23% EBIT margin as in 2017FY), while noting that upside risks are almost the same as downsides.

Surprisingly high finance costs risk earnings growing below expectation: The interest expense of NGN521 million (5% y/y and 158% q/q) and FX loss of NGN639 million (-38% y/y and 3118% q/q) reported in Q1-18 are both high in our view, considering NESTLE's much reduced borrowings and the stable FX. We have consequently revised our finance cost estimate for 2018E higher by 105%, given that the amount reported in Q1 alone is more than half our prior estimate for the year. We should note that the expectation of a much lower finance cost carries significant weight both in our view, and the market's of NESTLE's earnings growth in 2018E. Gross loans as at end-march was NGN18.11 billion (vs. NGN48.7 billion in Mar, 2017 and NGN24.2 billion in Dec. 2017), the lowest since 2009FY.

Earnings estimate and valuation: Compared to our previous estimate, we revise 2018E net profit lower by 6% to reflect the changes on the net finance cost line. On 2017FY results, our revised net profit estimate is higher by 37% (previously 46%). On our revised estimates, we have a DCF-based TP of NGN851.48 (previously NGN851.92) for NESTLE and maintain SELL rating. The stock is trading at forward (2018E) P/E and EV/EBITDA multiples of 27.4x and 18.3x respectively, at premium to Middle East and Africa peer averages of 18.7x and 12.4x.

SELL

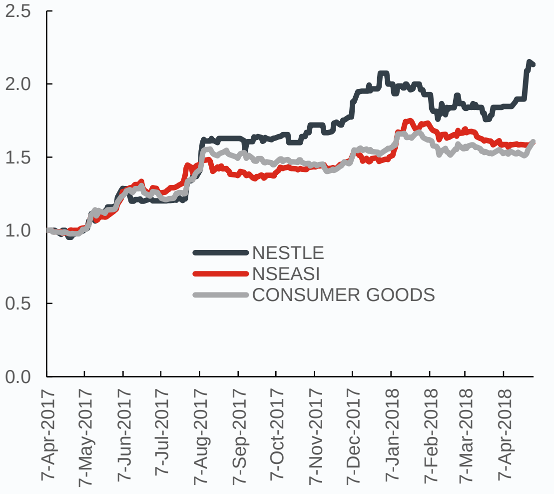
Target Price (NGN)	851.48
Current Price (NGN)	1,599.00
Implied Return (%)	-46.75

Company Data

NSE Code	NESTLE
Bloomberg Code	NESTLE:NL
Reuters Code	NESTLE.LG
Sector	CONSUMER GOODS
Market Cap. (NGN'bn)	1,267.46
Free Float (%)	36.25

Ratios	Q1-2018	Q1-2017	2017FY
Gross margin	38.18%	38.40%	41.31%
Opex margin	16.66%	16.80%	18.50%
EBITDA margin	29.11%	24.09%	25.47%
EBIT margin	21.52%	21.60%	22.81%
PAT margin	12.76%	13.67%	13.81%
EPS (N)	10.86	10.55	42.55

Price movement (NESTLE vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros research

Summary of Quarterly Results.

Income Statement (NGN'bn)	31-Mar-18	31-Mar-17	y/y % Δ	q/q	Q4-2017	Q3-2017	Q2-2017
Revenue	**67.46**	61.15	*10.3%*	*14.5%*	58.91	63.32	60.77
Cost of Sales	**41.71**	37.67	*10.7%*	*23.0%*	33.92	35.79	35.91
Gross profit	**25.76**	23.48	*9.7%*	*3.1%*	24.99	27.54	24.86
OPEX	**11.24**	10.27	*9.4%*	*-9.2%*	12.38	11.15	11.37
EBIT	**14.52**	13.21	*9.9%*	*15.1%*	12.61	16.39	13.49
Finance income	**0.28**	2.60	*-89.2%*	*-772.9%*	-0.04	1.14	2.54
Financial charges	**1.16**	1.53	*-24.1%*	*423.3%*	0.22	7.50	5.86
Profit before tax	**13.64**	14.28	*-4.5%*	*10.5%*	12.35	10.02	10.18
Taxation	**5.03**	5.92	*-15.0%*	*213.5%*	1.61	3.59	1.99
Profit after tax	**8.61**	8.36	*3.0%*	*-19.9%*	10.74	6.43	8.19

Ratio Analysis	31-Mar-18	31-Mar-17	Q4-2017	Q3-2017	Q2-2017
Gross margin	***38.2%***	*38.4%*	*42.4%*	*43.5%*	*40.9%*
OPEX margin	***16.7%***	*16.8%*	*21.0%*	*17.6%*	*18.7%*
EBIT margin	***21.5%***	*21.6%*	*21.4%*	*25.9%*	*22.2%*
PBT margin	***20.2%***	*23.4%*	*21.0%*	*15.8%*	*16.7%*
PAT margin	***12.8%***	*13.7%*	*18.2%*	*10.2%*	*13.5%*
CoGS	***61.8%***	*61.6%*	*57.6%*	*56.5%*	*59.1%*
Interest cover	***12.5x***	*8.6x*	*56.9x*	*2.2x*	*2.3x*
Tax rate	***36.9%***	*41.5%*	*13.0%*	*35.8%*	*19.5%*
EBITDA margin	***29.1%***	*24.1%*	*24.4%*	*28.5%*	*24.8%*
EPS (NGN)	*10.9*	*10.5*	*13.6*	*8.1*	*10.3*

Source: Company Accounts, Cordros Research estimates

Financial Statement (NGN'million).

Income Statement	2014a	2015a	2016a	2017a	2018e	2019e
Turnover	143,329	151,272	181,911	244,151	268,567	296,766
Cost of sales	-82,099	-83,926	-106,583	-143,280	-155,769	-172,109
Gross profit	61,230	67,346	75,328	100,871	112,798	124,657
Gross opex	-32,030	-33,598	-37,114	-45,173	-51,028	-56,400
EBIT	29,200	33,747	38,213	55,698	61,770	68,256
Interest income	552	444	4,199	6,239	4,416	6,013
Interest exp	-5,306	-4,869	-20,864	-15,109	-4,575	-1,620
PBT	24,446	29,322	21,548	46,829	61,611	72,649
Tax	-2,210	-5,586	-13,623	-13,105	-15,403	-18,162
PAT	**22,236**	**23,737**	**7,925**	**33,724**	**46,208**	**54,487**

Financial Position	2014a	2015a	2016a	2017a	2018e	2019e
PPE	67,515	69,148	70,172	72,378	75,534	77,811
Intangible assets	-	-	-	-	-	-
LT receivables	1,158	1,352	1,678	1,921	2,197	2,368
Non-current assets	**68,673**	**70,500**	**71,850**	**74,299**	**77,731**	**80,179**
Inventories	10,956	10,814	20,638	23,910	27,339	29,473
Trade and other receivables	22,331	24,446	24,035	31,430	35,937	38,742
Prepayments	398	525	1,712	2,025	2,316	2,496
Cash and cash equivalents	3,705	12,930	51,351	15,139	24,531	30,065
Current assets	**37,389**	**48,715**	**97,736**	**72,505**	**90,123**	**100,776**
Total Assets	**106,062**	**119,215**	**169,586**	**146,804**	**167,854**	**180,955**
Trade and other payables	26,657	36,662	64,662	49,056	55,288	59,015
Bank overdraft	1,238	305	155	3,714	424	424
Short term borrowings	12,730	17,109	40,130	10,913	7,190	7,190
Current tax liabilities	3,479	5,040	15,490	15,099	17,017	18,164
Provisions	535	616	597	899	1,013	1,081
Current liabilities	**44,638**	**59,732**	**121,033**	**79,680**	**80,932**	**85,875**
Long term borowings	18,386	12,530	10,384	9,565	10,494	10,494
Deferred tax liabilities	5,271	6,564	5,186	10,405	20,883	23,512
Employee benefits	1,828	2,382	2,104	2,276	2,565	2,738
Non-current liabilities	**25,484**	**21,476**	**17,674**	**22,245**	**33,942**	**36,744**
Total Liabilities	**70,122**	**81,208**	**138,708**	**101,926**	**114,875**	**122,618**
SHF	**35,940**	**38,007**	**30,878**	**44,878**	**52,979**	**58,336**

Profitability Ratios	2014a	2015a	2016a	2017a	2018e	2019e
Gross profit margin	42.7%	44.5%	41.4%	41.3%	42.0%	42.0%
EBITDA margin	24.4%	26.2%	24.3%	25.5%	25.7%	25.7%
Operating profit margin	20.4%	22.3%	21.0%	22.8%	23.0%	23.0%
PBT margin	17.1%	19.4%	11.8%	19.2%	22.9%	24.5%
Net profit margin	15.5%	15.7%	4.4%	13.8%	17.2%	18.4%
RoAE	58.1%	64.2%	23.0%	89.0%	94.4%	97.9%
RoAA	20.8%	21.1%	5.5%	21.3%	29.4%	31.2%
RoACE	32.6%	34.8%	10.6%	44.8%	65.9%	73.9%

Liquidity Ratios	2014a	2015a	2016a	2017a	2018e	2019e
Working capital (NGN'bn)	-7,249	-11,017	-23,297	-7,176	9,191	14,902
Current ratio	0.8x	0.8x	0.8x	0.9x	1.1x	1.2x
Quick ratio	0.6x	0.6x	0.6x	0.6x	0.8x	0.8x
Cash ratio	0.1x	0.2x	0.4x	0.2x	0.3x	0.4x

Efficiency Ratios	2014a	2015a	2016a	2017a	2018e	2019e
Fixed assets turnover	2.1x	2.2x	2.6x	3.4x	3.6x	3.8x
Current assets turnover	3.8x	3.1x	1.9x	3.4x	3.0x	2.9x
Total assets turnover	1.4x	1.3x	1.1x	1.7x	1.6x	1.6x
Inventory turnover	7.9x	7.7x	6.8x	6.4x	6.1x	6.1x
Receivables turnover	7.1x	6.5x	7.5x	8.8x	8.0x	7.9x
Payables turnover	2.9x	2.7x	2.1x	2.5x	3.0x	3.0x
Days inventory outstanding	46	47	54	57	60	60
Days collection outstanding	51	56	49	41	46	46
Days payable outstanding	119	159	221	125	130	125
Cash conversion cycle	-21	-56	-119	-27	-24	-19

Solvency Ratios	2014a	2015a	2016a	2017a	2018e	2019e
Debt-to-capital ratio	0.5x	0.4x	0.6x	0.4x	0.2x	0.2x
Net debt-to-equity ratio	0.8x	0.4x	0.0x	0.2x	-0.1x	-0.2x
Interest coverage	5.5x	6.9x	1.8x	3.7x	13.5x	42.1x

Investment Ratios	2014a	2015a	2016a	2017a	2018e	2019e
Earnings per share (NGN)	28.05	29.95	10.00	42.55	58.30	68.74
Dividend per share (NGN)	27.50	29.00	10.00	42.50	58.30	68.74
Dividend Payout	98%	97%	100%	100%	100%	100%
Dividend yield	2.7%	3.4%	1.2%	2.7%	3.6%	4.3%
PE	36.1x	28.7x	81.0x	36.6x	27.4x	23.3x
EV/EBITDA	23.7x	17.6x	14.5x	20.0x	18.3x	16.5x

Source: Company Accounts, Cordros Research

Disclosures.

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