

Volume Increase To Buffer Topline Performance

June 14, 2018



INVESTMENT ONE

NIGERIA | EQUITIES | CONSUMER GOODS | NESTLE NIGERIA PLC

Limited Upsides Potential Despite Improving Macro Environment

We maintain a HOLD recommendation on Nestle Nigeria Plc following the release of its Q1 2018 scorecard. Our view is premised on the limited upside represented by our target price of N1,570 against current price levels. We highlight that the upside on the stock is based on the improving macroeconomic environment, expected inflow from election spending and government's expansionary fiscal policy, which could support consumer demand in H2 2018. We forecast Nestle Nigeria Plc FY 2018 P/E multiple at 31.8x, lower than its 2017 P/E multiple of 36.6x, however at a premium compared to Unilever Nigeria Plc with a current P/E ratio of 29.4x. The premium placed on the stock may be due to the potential growth in Nestle Nigeria Plc relative to peers which may have been supported by its larger market share and better gross profit margin performance

Although the stock has shed 3.92% year-to-date, our view of an improvement in Nestle FY 2018 P/E multiple is based on expected improvement in sales volume which could improve topline performance. This combined with stringent opex/sales amidst improving operating environment may drive an increase in PBT supporting a rise in EPS in the FY 2018 period.

In its released Nigeria Q1 2018 results, Nestle Nigeria Plc chalked a 10.3% y/y growth in turnover to N67billion. Although PBT declined by 4% y/y during the same period to N13.6billion due to 89% y/y reduction in net interest income to N281million, the company's bottom line saw support from moderated FX loss following the improvement in FX liquidity, lower interest expense as a result of the deleveraging of its balance sheet and stringent management of its opex/sales

Share data	
Bloomberg	NESTLE NL
Reuters	NESTLE NG
Industry	CONSUMER GOODS
Rating -New	HOLD
Rating - Old	HOLD
Price (13 June 2018)	N1,495
Price Target - New	N1,570
Price Target - Old	N820.10
Upside/Downside	+5.02%
Market Cap. (N'million)	1,185,021.1
Avg. Daily Value Traded (N'million)	292.5
Shares Outstanding (Million)	792.7
Free Float	36.5%

Price Movement Relative to NSE-ASI



Historic Performance against NSE-ASI

Performance Over	1M	3M	6M	12M	YTD
Absolute	-2.29%	8.33%	2.11%	66.11%	-3.92%
Relative to NSE-ASI	2.56%	17.72%	0.82%	48.34%	-5.98%

Source: Bloomberg, Reuters, Investment One Research

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Financials and valuation metrics (YE 31 Dec)	2016A	2017A	2018E	2019E
Sales	181,911	244,151	271,790	331,152
PBT	21,548	46,829	49,751	73,207
PBT margin	11.8%	19.2%	18.3%	22.1%
Basic EPS	10.00	42.55	45.20	66.51
EPS growth (y/y)	-67%	326%	6%	47%
P/E	81.0x	36.6x	34.4x	23.4x
EV/EBIT (x)	16.8x	22.3x	21.2x	15.1x
Dividend yield (%)	1.2%	2.7%	2.6%	3.2%

Source: Company financials, Investment One Research



Topline performance to be volume driven

Going into 2018 through 2019, we forecast topline growth to average 16.6%. We estimate an 11% y/y growth in topline in FY 2018 largely driven by volume growth. This is in contrast with FY 2017 performance which saw support from the price increases taken by the firm in Q4 2016. In our view, the increased competition in the consumer goods space especially in this post FX crisis period, fragile consumer spending as well as the recent price increases may limit the ability of the firm to take significant price increase through 2018. However, we expect election spending, government's expansionary fiscal policy, the potential review of the minimum wage and improving macroeconomic environment to be supportive of volume performance in H2 2018. Although growth in the food segment of the business slowed down in Q1 2018 (+6.9% y/y) which is indicative of intense competition, we are of the view that it may continue to be the major contributor to revenue similar to historical periods

Furthermore, we expect gross profit margin performance to remain relatively stable in the absence of significant price increase. Although the company sources about 80% of its inputs locally, we express concern over the slowdown in the growth of agricultural GDP as revealed in Q1 2018 GDP report to 3% y/y as against the 4.23% y/y growth recorded in Q4 2017 and its potential negative impact on the firm. This coupled with the rising cost of inputs such as sorghum (+50.8% YTD), maize (+8.9% YTD) and cocoa (+26.9% YTD) may put upward pressure on production cost which may pressure gross profit margin performance. Hence, we forecast gross profit margin to shed 30bps y/y to 41.00% in FY 2018.

Effective Operating Cost Management

Similar to past quarters, the company has continued to maintain stringent operating cost measures to support its competitiveness in the space. Evidently, in its Q1 2018 results, the company recorded opex/sales ratio of 16.7%, the lowest since Q2 2010. We expect this trend to continue as part of its cost saving initiative. Hence, we forecast opex/sales ratio at 19.5% in FY 2018.



Key Ratio Performance



Source: Company Financials, Investment One Research

FY 2018 PBT margin to remain relatively flat

Although we forecast interest income to decline by 475bps y/y in FY 2018 on the back of lower interest rate environment, we expect bottom line to continue to see support from the moderating FX loss and lower interest expense following the repayment of parts of its outstanding loans and borrowing. Furthermore, we expect the company's debt-to-equity ratio of 54% in FY 2017 to fall to 36% in FY 2018 due to lower debt as the company pays about N16billion short term debt due to mature in the course of the year. While we forecast a relatively flat PBT margin in FY 2018, we expect the EPS to see support from the improvement in sales volume. Hence, we estimate a 15% increase in EPS to N49.00 in FY 2018.

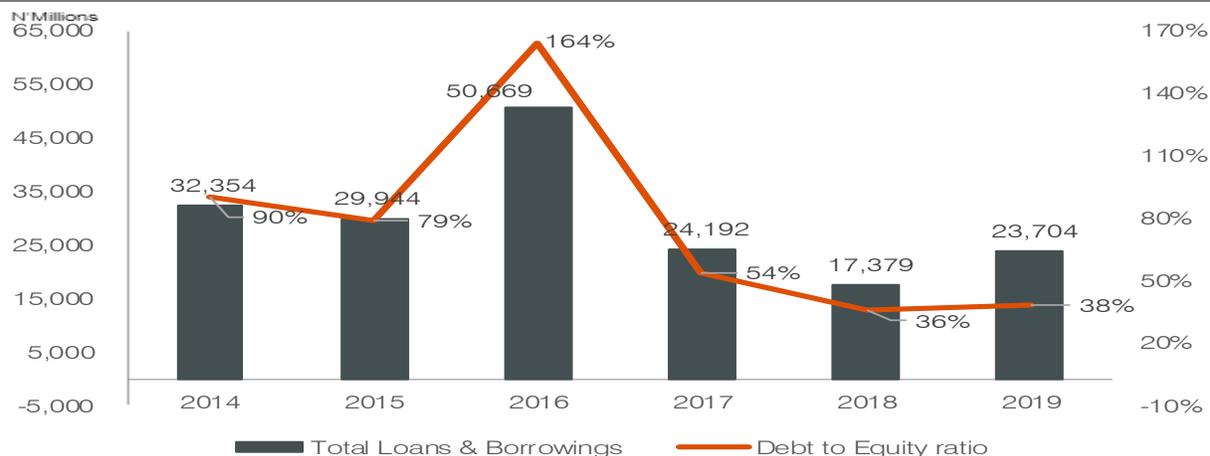
Higher Cash flow from Operations Due to Increased Trade Payables

Through 2018, we expect the company's working capital to increase by N5.9billion to support its FY 2018 operations. Due to the projected rise in the cost of sales, our FY 2018 inventory turnover increased to 6.5x, from 6.4x in FY 2017. Given the implication of a



rising cost of sales on FY 2018 purchases, we forecast our payables turnover at 3.0x in FY 2018, higher than 2.6x recorded in FY 2017. This led to a forecast of a decline in FY 2018 number of trade payables to 122 days, lower than 148 days in FY 2017 on the back of lower average trade payables in FY 2018.

Total Loans & Borrowings and Debt to Equity Ratio Performance



Source: Company Financials, Investment One Research

Risk to our outlook

In summary, we expect topline to grow in FY 2018 supported by volume growth, stability in FX market and continued operating cost management. We believe volume may see support from increased product innovation, election spending, improving macroeconomic environment and government's expansionary fiscal policy.

However, draw back to our estimates remains the delayed implementation of the budget which may negatively impact on capex spending. This may also reduce the likelihood of paying backlog of salaries, which should be positive for consumer spending. Furthermore, tougher than expected competition may weigh negatively on volume and escalation in the cost of inputs may adversely affect gross margin performance. Other risks to our outlook include political risk and over bloated opex/sales performance.



Summary of Financials (N millions). Year End 31 Dec

Income Statement	2016A	2017A	2018E	2019E
Turnover	181,911	244,151	271,790	331,152
Gross profit	75,328	100,871	111,434	145,707
Total opex	-37,114	-45,173	-52,869	-64,416
EBIT	38,213	55,698	58,565	81,291
EBITDA	44,190	62,184	64,996	88,094
Net finance cost	-16,665	-8,870	-8,814	-8,083
PBT	21,548	46,829	49,751	73,207
Taxation	13,624	13,105	13,923	20,487
PAT	7,924	33,724	35,828	52,720

Balance Sheet	2016A	2017A	2018E	2019E
Fixed assets	70,172	72,378	76,078	81,357
Non current assets	71,850	74,299	77,999	83,279
Stocks	20,638	23,910	25,254	29,017
Trade and other receivables	24,035	31,431	32,376	37,630
Cash and bank balances	51,351	15,139	14,111	32,481
Current assets	97,736	72,505	75,343	102,590
Total assets	169,586	146,804	153,342	185,868
Borrowings	10,384	9,565	11,118	13,260
Deferred tax	5,186	10,405	10,405	10,405
Non current Liabilities	17,674	22,245	23,799	25,940
Trade and other trade payables	64,662	49,056	58,824	71,844
Taxation	15,490	15,099	15,099	15,099
Dividend payable	4,239	12,555	12,555	12,555
Bank overdraft	155	3,714	3,714	3,714
Current liabilities	121,033	79,680	81,082	98,286
Shareholders funds	7,924	33,724	35,828	61,641

Source: Company financials, Investment One Research



Summary of Financials (N millions). Year End 31 Dec

Cash Flow Statement	2016A	2017A	2018E	2019E
Profit pre WC. chngs.	66,338	27,956	63,080	85,593
Working capital changes	22,107	-34,844	5,902	4,144
Tax paid	-4,551	-8,277	-13,923	-20,487
Operating cash flow	61,485	19,236	49,157	65,106
Capex	-7,068	-8,716	-10,131	-12,083
Cash flow from investing activities	-2,843	-2,433	-8,706	-11,038
Cash flow from financing activities	-20,070	-56,574	-41,479	-35,697
Free cash flow	38,573	-39,772	-1,028	18,370
Cash balance b/d	12,625	51,197	11,425	10,397
Cash balance c/d	51,197	11,425	10,397	28,767

Profitability Ratios	2016A	2017A	2018E	2019E
Gross margin	41.4%	41.3%	41.0%	44.0%
EBITDA margin	24.3%	25.5%	23.9%	26.6%
EBIT margin	21.0%	22.8%	21.5%	24.5%
PBT margin	11.8%	19.2%	18.3%	22.1%
Net profit margin	4.4%	13.8%	13.2%	15.9%
ROCE av.	9.9%	43.4%	33.1%	46.9%
ROCE/WACC	83.2%	245.2%	182.2%	259.2%
Opex/sales	20.4%	18.5%	19.5%	19.5%

Activity Ratios	2016A	2017A	2018E	2019E
Inventory turnover	6.8x	6.4x	6.5x	6.8x
Days of inventory on hand	53.9	56.7	56.0	53.4
Receivables turnover	7.5x	8.8x	8.5x	9.5x
Days of sales outstanding	48.6	41.5	42.8	38.6
Payables turnover	2.3x	2.6x	3.0x	2.9x
No. of payable days	158.9	141.6	121.8	126.0
Cash conversion cycle	-56.4	-43.4	-23.0	-34.0
Working capital turnover	20.7x	52.7x	8.5x	10.4x
Fixed asset turnover	2.6x	3.3x	3.6x	4.1x
Capital employed turnover	2.3x	3.1x	2.5x	2.9x
Total asset turnover	1.3x	1.5x	1.8x	2.0x

Liquidity & Solvency Ratios	2016A	2017A	2018E	2019E
Current ratio	0.8x	0.9x	0.9x	1.0x
Quick ratio	0.6x	0.6x	0.6x	0.7x
Cash ratio	0.0x	0.2x	0.2x	0.3x
Debt-to-capital ratio	62%	35%	26%	28%
Debt-to-equity ratio	164%	54%	36%	38%
Financial leverage	5.5x	3.3x	3.2x	3.0x



Valuation

Our N1,570 price target is derived using a discounted cash flow (DCF) model over the 2018-2027 period. We assume that sales growth reaches a terminal value of 12.0% in 2027 while EBIT improves to 20% by 2027 from our 2018 estimates. Our WACC is 14.5%, assuming 13.0% risk free rate, 0.73 beta, 8.4% after tax cost of debt and 5.0% equity risk premium.

Our forecast for an improvement in topline growth by 11.3% y/y in FY 2018 to N272billion is expected to be volume driven hinged on improving operating environment, government expansionary fiscal policy and expected election spending which may support an increase in EPS. This may be achieved by the firm's continued operating cost efficiency and improving FX environment which may support gross profit margin as well as lower interest expense on the back of the current lower interest rate environment. Furthermore, given our expectation of higher trade payables in FY 2018 as reflected in their recently Q1 2018 results, we expect the firm's cash conversion ratio to improve to 76% in FY 2018, from 31% in FY 2017.

Research Analyst Certification

Date	Price (N)	Old Price Target (N)	New Price Target (N)	Old Recommendation	New Recommendation
27-Feb-15	820.0	919.7	814.6	HOLD	HOLD
7-April-15	980.0	814.6	604.5	HOLD	HOLD
1-Sep-15	840.0	604.5	511.4	HOLD	SELL
2-Feb-16	740.0	604.5	755.5	SELL	HOLD
16-Jun-16	757.03	784.40	784.40	HOLD	HOLD
1-Feb-17	727.00	836.20	720.40	HOLD	HOLD
9-Jun-17	964.00	719.98	820.10	HOLD	HOLD
13-Jun-18	1,495.00	820.10	1570.00	HOLD	HOLD

Investment One Equity Research Recommendation Definitions

BUY

The stock is considered to be fundamentally strong with the potential to deliver returns in excess of 15% above the current price based on the analyst's target price.

HOLD

The stock is considered to be fairly priced, with potential to deliver returns between 5% and 15% above the current price based on the analyst's target price.

SELL

The stock is considered to be overvalued with weakening fundamentals, with returns expected to be below 5% based on the current price and the analyst's target price.



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