

Nestle Nigeria Plc.

Strong revenue and a welcome recovery of gross margin in Q2-18

Update: NESTLE reported 56.9% y/y EPS growth in Q2-18, driven by strong revenue and margin growth, marginal increase in opex, and a net finance income (vs. loss the previous year). Compared to our estimate, the achieved Q2 EPS was ahead by 8%. Annualized, the H1-18 EPS of NGN27.07 is c.3% ahead of consensus estimate for 2018E.

In-line Q2-18 revenue; 2018E growth estimate unchanged: The reported Q2-18 revenue was ahead of Q2-17 by 11.6% and beat our estimate by a marginal 1%. At current run-rate, we believe NESTLE's revenue growth (10.97% in H1-8) is in line with our 10% forecast for the year, hence we make no changes. Compared to both Q2-17 and Q1-18, we estimate volume grew at low single-digit during the reference period, supported by both Ramadan-related consumption as well as the recent introduction of new SKUs – **Maggi Naija Pot, Golden Morn Puff, and Milo-Ready-to-Drink** – for which adverts and promotions have been aggressive thus far this year. Food revenue grew 11% y/y while Beverages grew by 13% y/y in Q2. We are aware of rising competition in the FMCG space with new entrants, but should also note that NESTLE's RTM is aggressive, hence we expect revenue will maintain the H1 trajectory in the remaining half of the year.

A welcome recovery of margins: From the decline to 38.2% in Q1-18, NESTLE's gross margin recovered strongly to 43.96% in the review period, exceeding both Q2-17's 40.9% and our estimate of 41.6%. We revise our gross margin estimate for 2018E slightly higher to 42.5%, and while noting downside risk relating to the rising price of cocoa (+20% YtD), elsewhere, we believe NESTLE's margin will be supported more by the stable exchange rate, soft sugar (-26%YtD) and dairy prices (-8% YtD), continued sourcing of cheaper local inputs, and importantly, stable selling prices. Our revised forecast brings gross margin closer to the average of 43% achieved between 2012-2014FY (average gross margin was 40% prior), but still below the peak of c.45% achieved in 2015FY.

EBITDA and EBIT grew 28% y/y and 30.7% y/y respectively in Q2-18, with respective 28.4% and 26% margins. Our revised estimates for 2018E produced EBITDA and EBIT growth of 17% and 18% over 2017FY, equating to record-high 27.1% and 24.5% margins respectively.

FX gain offsets interest expense: Net finance income of NGN300 million was recorded in Q2-18. FX gain of NGN590 million more than offset interest expense of NGN550 million, as the balance of borrowings reduced by a further NGN630 million to NGN17.5 billion (vs. NGN24.2 billion in 2017FY and NGN42.99 billion in H1-17). Following the result, and with the risk of FX fluctuation muted, we now model finance cost will be much lower at NGN2.6 billion in 2018E, from NGN4.6 billion previously (vs. NGN15.1 billion in 2017FY).

High effective tax rate: Recognized effective tax rate was 29.5% in Q2, averaging 32.7% over H1-18. We have consequently adjusted our tax rate assumption higher from 25% to 30%, hence the little impact of the upwardly revised gross margin and reduced finance costs estimates on 2018E EPS estimate.

Estimate and valuation: The net impact of the changes to our model is an increase to our 2018E EPS estimate to NGN60.14 (from NGN58.30 previously) and TP to NGN942.23 (previously NGN851.48), while maintaining SELL rating. NESTLE's stock has lost 6% since we updated on Q1-18 result, with a SELL rating. On our estimates, the stock is trading at forward (2018E) P/E and EV/EBITDA multiples of 25x and 16.2x, a significant discount to its five-year historical averages of 45x and 21.1x respectively.

SELL

Target Price (NGN)	942.23
Current Price (NGN)	1,502.00
Implied Return (%)	-37.27

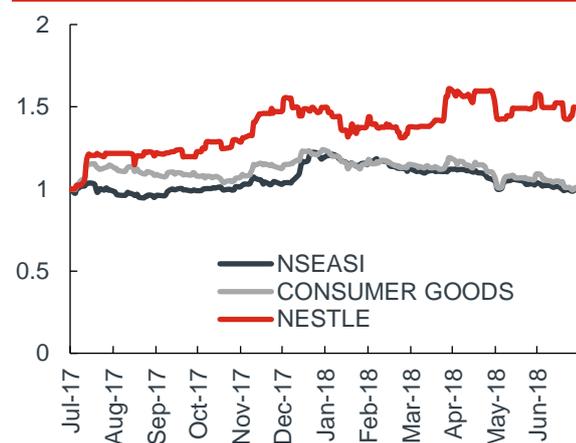
Company Data

NSE Code	NESTLE
Bloomberg Code	NESTLE:NL
Reuters Code	NESTLE.LG
Sector	CONSUMER GOODS
Market Cap. (NGN' bn)	1,190.57
Free Float (%)	36.25

Ratios	Q2-2018	Q2-2017	2017FY
Gross margin	43.96%	40.91%	41.31%
Opex margin	17.96%	18.71%	18.50%
EBITDA margin	28.41%	24.76%	25.47%
EBIT margin	26.00%	22.20%	22.81%
PAT margin	18.95%	13.48%	13.81%
RoAE	91.37%*	59.61%	89.03%
EPS (NGN)	16.21	10.33	42.55

*Trailing 12m

Price movement (NESTLE vs. Benchmark Indices)



Source: NSE, Bloomberg, Cordros Research

Summary of Results.

Income Statement (NGN'bn)	30-Jun-18	30-Jun-17	y/y % Δ	Q2-2018	Q2-18 y/y	Q2-18 q/q	Cordros Q2 est.
Revenue	135.30	121.92	10.97%	67.83	11.62%	0.55%	66.85
Cost of Sales	-79.72	-73.58	8.35%	-38.01	5.86%	-8.86%	-39.04
Gross profit	55.58	48.34	14.97%	29.82	19.95%	15.77%	27.81
OPEX	-23.42	-21.64	8.23%	-12.19	7.17%	8.42%	-12.84
EBIT	32.15	26.70	20.43%	17.63	30.72%	21.46%	14.96
Finance income	0.84	5.15	-83.71%	0.56	-78.11%	97.96%	1.02
Financial charges	-1.12	-7.39	-84.85%	0.04	-100.70%	-103.54%	-1.60
Profit before tax	31.87	24.46	30.31%	18.23	79.15%	33.66%	14.38
Taxation	-10.41	-7.91	31.64%	-5.38	170.67%	6.87%	-2.51
Profit after tax	21.46	16.55	29.67%	12.85	56.94%	49.34%	11.87
EBITDA	35.50	29.78	19.20%	19.27	28.07%	18.77%	

Ratio Analysis	30-Jun-18	30-Jun-17	Q2-2018	Q1-2018	Q4-2017	Q3-2017	Q2-2017	Q1-2017
Gross margin	41.08%	39.65%	43.96%	38.18%	42.42%	43.49%	40.91%	38.4%
OPEX margin	17.31%	17.75%	17.96%	16.66%	21.01%	17.61%	18.71%	16.8%
EBIT margin	23.77%	21.90%	26.00%	21.52%	21.41%	25.88%	22.20%	21.6%
PBT margin	23.56%	20.06%	26.88%	20.22%	20.96%	15.82%	16.75%	23.4%
PAT margin	15.86%	13.57%	18.95%	12.76%	18.24%	10.16%	13.48%	13.7%
Interest cover	28.74x	3.62x	-429.44x	12.52x	56.90x	2.2x	2.3x	8.6x
Tax rate	32.68%	32.35%	29.51%	36.91%	13.00%	35.81%	19.53%	41.5%
EBITDA margin	26.24%	24.43%	28.41%	24.05%	24.40%	28.47%	24.76%	24.09%

Source: Company Accounts, Cordros Research estimates

Financial Statements (NGN'million).

Income Statement	2015a	2016a	2017a	2018e	2019e
Turnover	151,272	181,911	244,151	268,567	296,766
Cost of sales	-83,926	-106,583	-143,280	-154,426	-170,626
Gross profit	67,346	75,328	100,871	114,141	126,140
Gross opex	-33,598	-37,114	-45,173	-48,342	-53,433
EBIT	33,747	38,213	55,698	65,799	72,708
Interest income	444	4,199	6,239	4,941	5,635
Interest exp	-4,869	-20,864	-15,109	-2,637	-1,541
PBT	29,322	21,548	46,829	68,103	76,802
Tax	-5,586	-13,623	-13,105	-20,431	-23,041
PAT	23,737	7,925	33,724	47,672	53,761

Profitability Ratios	2015a	2016a	2017a	2018e	2019e
Gross profit margin	44.5%	41.4%	41.3%	42.5%	42.5%
EBITDA margin	26.2%	24.3%	25.5%	27.1%	27.1%
Operating profit margin	22.3%	21.0%	22.8%	24.5%	24.5%
PBT margin	19.4%	11.8%	19.2%	25.4%	25.9%
Net profit margin	15.7%	4.4%	13.8%	17.8%	18.1%
RoAE	64.2%	23.0%	89.0%	96.5%	96.2%
RoAA	21.1%	5.5%	21.3%	30.3%	30.8%
RoACE	34.8%	10.6%	44.8%	67.9%	73.3%

Liquidity Ratios	2015a	2016a	2017a	2018e	2019e
Working capital (NGN'mn)	-11,017	-23,297	-7,176	4,974	4,257
Current ratio	0.8x	0.8x	0.9x	1.1x	1.0x
Quick ratio	0.6x	0.6x	0.6x	0.8x	0.7x
Cash ratio	0.2x	0.4x	0.2x	0.3x	0.3x

Efficiency Ratios	2015a	2016a	2017a	2018e	2019e
Fixed assets turnover	2.2x	2.6x	3.4x	3.8x	3.8x
Current assets turnover	3.1x	1.9x	3.4x	2.8x	2.9x
Total assets turnover	1.3x	1.1x	1.7x	1.6x	1.6x
Inventory turnover	7.7x	6.8x	6.4x	6.1x	6.1x
Receivables turnover	6.5x	7.5x	8.8x	7.7x	7.5x
Payables turnover	2.7x	2.1x	2.5x	2.8x	2.7x
Days inventory outstanding	47	54	57	60	60
Days collection outstanding	56	49	41	47	48
Days payable outstanding	159	221	125	142	139
Cash conversion cycle	-56	-119	-27	-35	-31

Solvency Ratios	2015a	2016a	2017a	2018e	2019e
Debt-to-capital ratio	0.4x	0.6x	0.4x	0.2x	0.2x
Net debt-to-equity ratio	0.4x	0.0x	0.2x	-0.2x	-0.2x
Interest coverage	6.9x	1.8x	3.7x	25.0x	47.2x

Investment Ratios	2015a	2016a	2017a	2018e	2019e
Earnings per share (NGN)	29.95	10.00	42.55	60.14	67.82
Dividend per share (NGN)	29.00	10.00	42.50	60.14	67.82
Dividend Payout	97%	100%	100%	100%	100%
Dividend yield	3.4%	1.2%	2.7%	4.0%	4.5%

Financial Position	2015a	2016a	2017a	2018e	2019e
PPE	69,148	70,172	72,378	70,862	77,811
Intangible assets	-	-	-	-	-
LT receivables	1,352	1,678	1,921	2,050	2,210
Non-current assets	70,500	71,850	74,299	72,913	80,021
Inventories	10,814	20,638	23,910	26,995	29,102
Trade and other receivables	24,446	24,035	31,430	37,924	40,884
Prepayments	525	1,712	2,025	2,573	2,774
Cash and cash equivalents	12,930	51,351	15,139	27,450	28,174
Current assets	48,715	97,736	72,505	94,942	100,934
Total Assets	119,215	169,586	146,804	167,854	180,955
Trade and other payables	36,662	64,662	49,056	60,184	65,022
Bank overdraft	305	155	3,714	0	0
Short term borrowings	17,109	40,130	10,913	6,500	6,500
Current tax liabilities	5,040	15,490	15,099	22,387	24,186
Provisions	616	597	899	896	968
Current liabilities	59,732	121,033	79,680	89,967	96,677
Long term borrowings	12,530	10,384	9,565	10,982	10,982
Deferred tax liabilities	6,564	5,186	10,405	10,429	12,673
Employee benefits	2,382	2,104	2,276	2,581	2,788
Non-current liabilities	21,476	17,674	22,245	23,992	26,443
Total Liabilities	81,208	138,708	101,926	113,960	123,120
SHF	38,007	30,878	44,878	53,895	57,835

Source: Company Accounts, Cordros Research estimates

Disclosures.

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