20 September 2018

Nigerian Consumer Goods.

Earnings preview

Event: In a couple of weeks, Nigerian equities market will be busy with earnings releases. From our consumer goods universe, CADBURY, DANGSUGAR, NB, NESTLE, and UNILEVER are expected to publish Q3 and 9M-18 results for the period ending September. FLOURMILL will publish for Q2 and H1-19 ending September, while PZ and GUINNESS are to publish for Q1-19 ending August and September respectively.

Macro backdrop: Nigeria's economy remained on an expansionary, but sluggish path since exiting recession. At 1.7% average in H1-18, the annualized growth of 1.8% is short of even the "typically conservative" IMF projection (+2.1% for 2018E), and highlights – amidst high oil prices – unresolved structural shortcomings. Elsewhere, the moderating headline inflation has largely been driven by base effect, hence the resumed uptrend is no surprise. The monetary policy authorities believe that the risk to inflation is now stronger to the upside, with recent commentaries suggesting that cutting interest rates is no longer on the table this year.

Nigerian consumer wallets are still squeezed: Nigerian consumers are yet to recover from the squeeze on purchasing power and spending from the naira devaluation and higher fuel pump price. Meanwhile lending to the private sector remains sluggish. The implication is noteworthy for the corporates we cover from both volume and margin growth perspectives, more so with improved FX liquidity ushering a new wave of competition via increased imports.

Input costs are rising: The input costs of our universe are raw materials intensive, hence it is important to highlight the risk to gross margins from the rising prices of soft commodities, in tandem with other commodity prices. For context, in the quarter ending September, prices of wheat, sorghum, maize, barley, and cocoa were up 13% y/y, 44% y/y, 11% y/y, 2 % y/y, and 17% y/y respectively.

Mixed view of consumer goods earnings: On our estimates, NESTLE (+86% y/y), UNILEVER (+93% y/y), and NB (+843% y/y) are expected to report strong earnings growth in Q3-18E vs. Q3-17. For the same period, we expect CADBURY to report PBT of NGN560 million, from loss in Q2-18. We are less optimistic about DANGSUGAR, with estimate of 19% net profit decline in Q3-18E. For FLOURMILL, Q2-19E is likely to show 17% y/y decline in PAT. PZ's June trading statement suggests that trading conditions were yet to improve as at Q1-19E (June-August), hence, it is unlikely that earnings performance (except net finance cost is significantly lower) will be impressive relative to recent past quarters. On the other hand, GUINNESS' Q1-19E earnings is expected to show strong growth, supported by significantly lower finance expenses relative to Q1-18.

The bears still have legs: The risk to Nigerian equities is more to the downside between now and end of the year. September, October, and November are historically bearish months for Nigerian equities and – when combined – often offset the gains in December. Monthly losses thus far this year have exceeded historical averages and the pattern is likely to continue for the rest of the year.

The bears present opportunities: On the bright side, equities are becoming increasingly attractive with continued selloffs. For example, our recommendation for our consumer goods universe has improved from 63% SELL (BUY: 12%; HOLD: 25%) at the beginning of the year to 25% SELL (BUY: 25%; HOLD: 50%) on today's market prices.

Figure 1: Nigerian consumer goods companies – equity rating and price targets

NSE Ticker	Current price	TP (NGN)	Previous TP (NGN)	Potential upside (%)	Expected total return (%)	Current rating	Previous rating
CADBURY	9.40	10.98	10.00	16.81	17.46	HOLD	HOLD
DANGSUGAR	14.00	20.76	16.27	48.29	56.94	BUY	HOLD
FLOURMILL	19.15	48.45	33.29	152.98	163.95	BUY	BUY
GUINNESS	86.00	70.91	73.75	-17.55	-14.73	SELL	SELL
NB	90.00	101.82	93.14	13.13	17.13	HOLD	HOLD
NESTLE	1,381	1,026	942.23	-25.67	-21.67	SELL	SELL
PZ	13.50	14.60	15.13	8.15	11.15	HOLD	SELL
UNILEVER	43.00	40.94	38.44	-4.78	-0.78	HOLD	SELL

Source: NSE, Bloomberg, Cordros Research estimates

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In a couple of weeks, Nigerian equities market will be busy with earnings releases. From our consumer goods universe, CADBURY, DANGSUGAR, NB, NESTLE, and UNILEVER are expected to publish Q3 and 9M-18 results for the period ending September. FLOURMILL will publish for Q2 and H1-19 ending September, while PZ and GUINNESS are to publish for Q1-19 ending August and September respectively.

Bloomberg consensus expect 63% of the companies we cover to report high double-digit net profit growth in 2018E and 2019E alike, and 25% to report low single-digit growth (see figure 2). Only one company is expected to report net profit decline in 2018E. We think these expectations have largely adjusted for the last published earnings (i.e. H1-18, Q1-19, and Q4-18 accordingly). This compares favourably with our banking, oil & gas, and agric universe where consensus expect 50% of the components to report double-digit net profit growth in 2018E. Yet, stocks prices have been beaten significantly since July, with the consumer goods index underperforming the broader market (as well as leading other sectoral indices on losses).

Figure 2: Consensus 2018E/2019E PAT and target estimates vs. actuals

CADBURY	2018E	2017A	% ▲
PAT	0.32	0.30	*8%*
TP vs. MP	10.80	9.40	*15%*

NB	2018E	2018A	% ▲
PAT	34.33	33.05	*4%*
TP vs. MP	111.53	92.50	*21%*

DANGSUGAR	2018E	2017A	% ▲
PAT	31.67	39.69	*-20%*
TP vs. MP	20.27	13.90	*46%*

NESTLE	2018E	2018A	% ▲
PAT	45.40	33.72	*35%*
TP vs. MP	1423.25	1370.00	*4%*

FLOURMILL	2019E	2018A	% ▲
PAT	16.04	12.68	*27%*
TP vs. MP	34.11	19.00	*80%*

PZ	2019E	2018A	% ▲
PAT	5.29	1.85	*187%*
TP vs. MP	18.61	13.50	*38%*

GUINNESS	2019E	2018A	% ▲
PAT	9.89	6.72	*47%*
TP vs. MP	88.62	87.90	*1%*

UNILEVER	2018E	2018A	% ▲
PAT	11.42	7.45	*53%*
TP vs. MP	46.03	43.00	*7%*

Legend:

TP:	Target price
MP:	Market price
High double-digit PAT growth	63%
Low single-digit PAT growth	25%
PAT downside	13%
Double digit share upside	63%
Single-digit share upside	38%

Source: Company accounts, Bloomberg

On today's price, consensus shows that 63% of the companies in our universe have high double-digit upside potential and the remaining of 38% have low single-digit upside, with no downsides. We find this instructive, and it is consistent with consensus view across our banking, cement, oil & gas, and agric universe. While we continue to hold the view that earnings have not been broadly supportive of the market this year compared to 2017FY (see figure 3), we also believe that current stock prices strongly reflect other factors which are beyond investors' view of earnings (reported or expected). Should investors therefore, in the absence of macroeconomic stimulants/appetizers, look to the upcoming earnings as the next catalyst for stocks?

Figure 3: Jan-Jun 2018 PAT

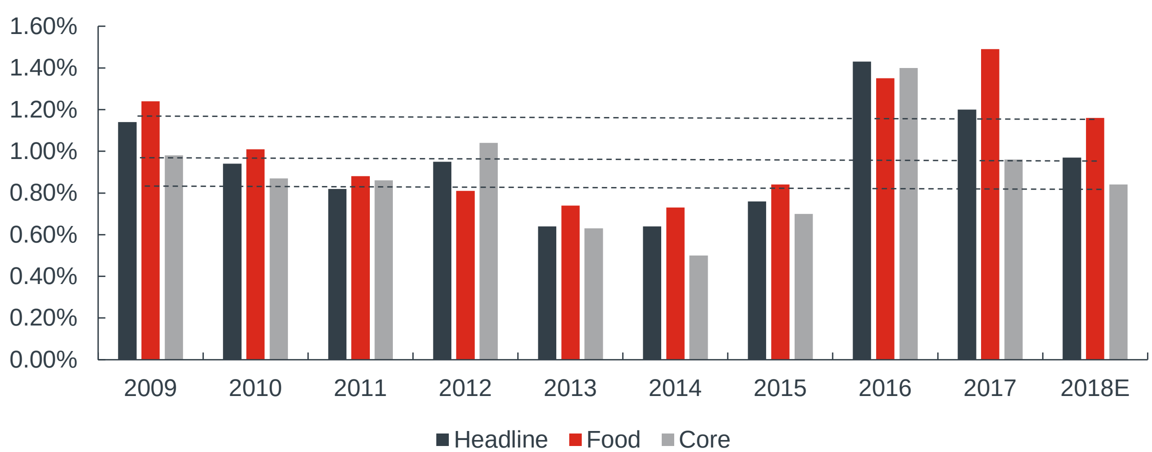
Net profit (NGN'bn)	30-Jun-18	30-Jun-17	% ▲
CADBURY	-0.42	-0.77	*-45%*
DANGSUGAR	12.72	17.1	*-26%*
GUINNESS	4.59	6.59	*-30%*
NB	18.43	23.75	*-22%*
NESTLE	21.46	16.55	*30%*
PZ	1.28	3.68	*-65%*
UNILEVER	5.6	3.51	*60%*

In this report, we discuss the recent performance of the Nigerian economy and what we expect from our universe for the rest of 2018E and 2019E. We also discuss of our broad view of the equities market for the rest of the year. In summary, we believe market risk remains to the downside, albeit, with a welcome note that valuations for our universe, from our perspective, have improved significantly compared with the beginning of the year.

Weak H1-18 growth. Less optimistic H2 outlook: Nigeria's economy remained on an expansionary, but sluggish path since exiting recession. At 1.7% average in H1-18, the annualized growth of 1.8% is short of even the "typically conservative" IMF projection (+2.1% for 2018E), and highlights – amidst high oil prices – unresolved structural shortcomings. Though non-oil sector growth was notably stronger in Q2 vs. Q1, the record-low agric sector growth, tepid manufacturing output expansion, and trade sliding into recession during the period are concerning. The GDP data on manufacturing and trade in particular contrast sharply with the PMI readings, which have continued to show positive readings. Narrowed down, credit to the private sector is yet to improve and FX (despite improved supply) remains accessible at rates constraining of both real sector growth and the recovery of aggregate consumption. Overall, growth outlook is now more conservative compared to the beginning of the year, although the economy should receive some support from continued strong current account, better government revenues and stimulus from faster implementation of the 2018 budget and some election spending.

Flattering headline inflation now exposed. Monetary policy has turned a corner: The moderating headline inflation has largely been driven by base effect, hence the resumed uptrend is no surprise. The charts in figure 4 shows that the average monthly headline, food, and core inflation thus far this year is not markedly different from previous years' trajectory. The monetary policy authorities believe that the risk to inflation is now stronger to the upside, with recent commentaries suggesting that cutting interest rates is no longer on the table this year.

Figure 4: Monthly inflation rates



Source: NBS, Cordros Research estimates

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Nigerian consumer wallets are still squeezed: Nigerian consumers are yet to recover from the squeeze on purchasing power and spending from the naira devaluation and higher fuel pump price. Meanwhile lending to the private sector remains sluggish. The implication is noteworthy for the corporates we cover from both volume and margin growth perspectives, more so with improved FX liquidity ushering a new wave of competition via increased imports. The impact of pricing has neutered following the Jan-Mar results, hence revenues from April have largely been volume driven. We look for low single-digit revenue growth for our universe in Q3-1E (growth is in mid-single digit, excluding DANGSUGAR). On the positive, the corporates across our universe have largely geared up sales improvement initiatives to help cope with the current challenging environment.

Input costs are rising: The input costs of our universe are raw materials intensive, hence it is important to highlight the risk to gross margins from the rising prices of soft commodities, in tandem with other commodity prices. For context, in the quarter ending September, prices of wheat, sorghum, maize, barley, and cocoa were up 13% y/y, 44% y/y, 11% y/y, 2 % y/y, and 17% y/y respectively. Positive for DANGSUGAR and FLOURMILL, the price of raw sugar was down 22% y/y, but this, in our view, has also increased the risk of more illegal imports via the porous borders.

Mixed view of consumer goods earnings: On our estimates, NESTLE (+86% y/y), UNILEVER (+93% y/y), and NB (+843% y/y) are expected to report strong earnings growth in Q3-18E vs. Q3-17. For the same period, we expect CADBURY to report PBT of NGN560 million, from loss in Q2-18. We are less optimistic about DANGSUGAR, with estimate of 19% net profit decline in Q3-18E. For FLOURMILL, Q2-19E is likely to show 17% y/y decline in PAT.

We recently updated on GUINNESS and PZ with respective PAT growth forecasts of 35% and 11% in 2019E. That said, PZ's June trading statement suggests that trading conditions were yet to improve as at Q1-19E (June-August), hence, it is unlikely that earnings performance (except net finance cost is significantly lower) will be impressive relative to recent past quarters (but likely better compared to the loss reported in Q1-18). On the other hand, GUINNESS' Q1-19E earnings is expected to show strong growth, supported by significantly lower finance expenses relative to Q1-18.

Figure 5: PAT estimates vs. actuals

Ticker	NGN'bn	NGN'bn	% ▲	Period
*CADBURY	0.56	0.70	*-20%*	Q3-18
DANGSUGAR	7.64	9.42	*-19%*	Q3-18
FLOURMILL	4.02	4.82	*-17%*	Q2-19
NB	2.45	0.26	*843%*	Q3-18
NESTLE	11.99	6.43	*86%*	Q3-18
UNILEVER	2.21	1.15	*93%*	Q3-18

* PBT

Source: Company accounts, Cordros Research estimates

The bears still have legs: The risk to Nigerian equities is more to the downside between now and end of the year. September, October, and November are historically bearish months for Nigerian equities (as shown in figure 6) and – when combined – often offset the gains in December. Monthly losses thus far this year have exceeded historical averages (as shown in figure 7), and the pattern is likely to continue for the rest of the year. Fundamentally, the market is short of stimulants from economic and policy points of view, while the risks of the upcoming elections and continued foreign investor aversion towards emerging and frontier markets risky assets will continue to weigh on market sentiments.

The bears present opportunities: On the bright side, equities are becoming increasingly attractive with continued selloffs. For example, our recommendation for our consumer goods universe has improved from 63% SELL (BUY: 12%; HOLD: 25%) at the beginning of the year to 25% SELL (BUY: 25%; HOLD: 50%) on today's market prices. In the absence of material downward revision to earnings estimates following the soon-to-be released results (and likely so), further rating upgrades are likely, should stocks' prices decline further – upgrades will be stronger where earnings exceed our expectations. Our equity strategy view is that prices are likely to rebound strongly from H2-2019 wherein we expect oil prices to remain at current healthy levels (for Nigeria), and the local elections and external risks induced selloffs must have dissipated. Historically for

Nigeria, market rebound – whenever it happens – is often very strong after a bearish year as depicted by the chart in figure 8.

CADBURY – TP: NGN10.98 (Old: NGN10.00) - HOLD

CADBURY's shares have lost 12% since we last updated in July with HOLD recommendation. We roll forward estimates and valuation to 2019E and maintain HOLD, with 16% upside – and expected total return of 17% after incorporating 2018E dividend yield of c.1%. From NGN460 million loss in H1-18, we expect NGN140 million net profit in 9M-18E on estimated NGN560 million profit in Q3-18E. While we expect lower revenue relative to Q2-18, earnings should gain support from relatively improved gross margin. It would be interesting to see the feedthrough to gross margin from the rising price of cocoa (17% y/y in Q3-18) and the offsetting impact of softer raw sugar prices (-22% y/y in Q3-18).

DANGSUGAR – TP: NGN20.76 (Old: NGN16.27) - BUY

DANGSUGAR's shares have lost 18% since we last updated in July with HOLD recommendation. We roll forward estimates and valuation to 2019E and upgrade rating to BUY with 48% upside – and expected total return of 57% after incorporating 2018E dividend yield of c.9%. We expect Q3-18E net profit will be flat relative to Q2-18, but lower by c.19% vs. Q3-17, largely on lower revenue (owing to weaker sales volume and softer selling prices) and gross margin. It would be interesting to see how softer raw sugar prices (-22% y/y in Q3) have impacted gross margin (via the mix of lower unit input costs and possibly, selling prices) and volume (via increased activities of illegal importers).

FLOURMILL – TP: NGN48.45 (Old: NGN33.29) - BUY

FLOURMILL's shares have lost 29% since we last updated in August with BUY recommendation. We maintain BUY with 153% upside – and expected total return of 164% after incorporating 2019E dividend yield of 11%. FLOURMILL is likely to report lower profit in Q2-19E (-16% y/y on our estimate) relative to Q2-18. The slow start (-11% y/y) at the crucial first quarter (accounting for 26% of yearly sales) is instructive, and we believe conditions – increased competition, softer selling prices, generally weak demand, and Apapa traffic gridlock – have not improved. We are also conservative in gross margin estimate amidst rising wheat prices and softer selling prices. It would be interesting to see the feedthrough to gross margin from the rising price of wheat (13% y/y as at September ending) and the offsetting impact of softer raw sugar prices (-22% y/y in Q3-18).

NESTLE – TP: NGN1,026.07 (Old: NGN942.23) - SELL

NESTLE's shares have lost 8% since we last updated in July with SELL recommendation. We roll forward estimates and valuation to 2019E and maintain SELL with 26% downside – and expected total return of -21% after incorporating 2018E dividend yield of 4%. On our estimate, NESTLE's net profit grew by 86% y/y in Q3-18E, supported by significantly lower finance charges (-88% y/y), continued double-digit revenue growth (10% y/y), and slightly higher gross margin. It would be interesting to see the feedthrough to gross margin from the rising prices of cocoa (17% y/y in Q3-18) and maize (11% y/y in Q3), and the offsetting impact of softer raw sugar prices (-22% y/y in Q3).

NB – TP: NGN101.82 (Old: NGN93.14) - HOLD

NB's shares have lost 14% since we last updated in August with HOLD recommendation. We roll forward estimates and valuation to 2019E and maintain HOLD with 13% upside – and expected total return of 17% after incorporating 2018E dividend yield of 4%. On our estimate, NB's net profit grew by over 800% y/y in Q3-18E, supported by lower opex and finance charges. We estimate that revenue will likely be flat compared to Q3-17. Compared to the Q1 and Q2 this year, NB's Q3-18 net profit is likely to be much lower (we estimate -70% on average), reflecting the typically lower revenue and gross margin reported during the period. It would be interesting to see the feedthrough to gross margin from the rising prices of sorghum (44% y/y in Q3-18), maize (11% y/y in Q3-18) and barley (2% y/y in Q3-18).

UNILEVER – TP: NGN40.94 (Old: NGN38.44) - HOLD

UNILEVER's shares have lost 18% since we last updated in July with SELL recommendation. We roll forward estimates and valuation to 2019E and upgrade rating to HOLD with 5% downside – and expected total return of -0.5% after incorporating 2018E dividend yield of 4%. On our estimate, UNILEVER's net profit grew by about 90% y/y in Q3-18E, mainly accruing from significantly lower finance charges (94% y/y). Revenue growth slowed in Q2 (7% y/y) compared to Q1 (19% y/y), and we expect to see the trend continue in the third and final quarters, with impact of carryover price having largely waned. In the H1-18 results conference call, management guided to challenging short term trading outlook, citing continued pressured purchasing power and poor credit to the private sector as major risks. It would be interesting to see the feedthrough to gross margin from softer CPO prices (15% y/y in Q3-18) and the possible offsetting impact of higher petroleum products prices.

GUINNESS – TP: NGN70.91 (unchanged) - SELL

We recently updated (07 September) on GUINNESS with SELL recommendation. For 2019E, we forecast revenue growth of 9%, 34% gross margin (unchanged vs. 2018FY), slightly higher EBIT margin, and 35% net profit growth. Net finance cost, which we forecast to more than halve in 2019E on the assumption of nil FX losses, is a major driver of our EPS estimate. The impact of the FX loss on earnings is expected to be very visible in the soon-to-be released Q1-19 result.

PZ – TP: NGN14.60 (unchanged) - HOLD

We recently updated (12 September) on PZ with HOLD recommendation. For 2019E, we are conservative with 5% revenue and 11% net profit growth forecasts. The squeeze on consumer spending and rising costs have been more pronounced on PZ's HPC and white goods portfolio, and outlook is less optimistic in the near term. PZ's June trading statement suggests that trading conditions were yet to improve as at Q1-19E (June-August), hence, it is unlikely that earnings performance (except net finance cost is significantly lower) will be impressive relative to recent past quarters (but likely better compared to the loss reported in Q1-18).

Chart pack.

Figure 6: Nigeria All Share Index – average monthly returns

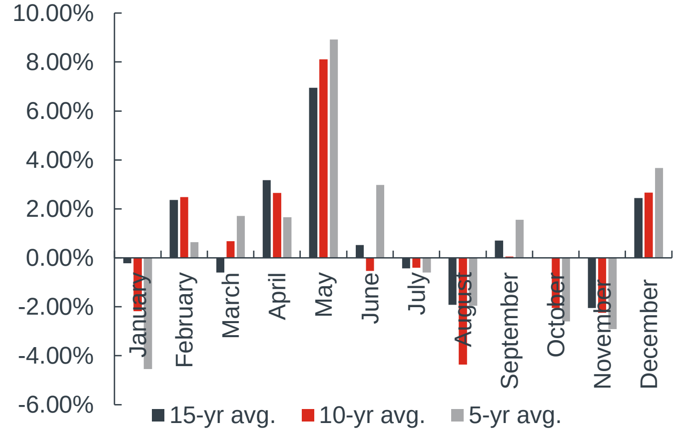


Figure 7: 2018 negative monthly returns are above historical averages

Month	15-yr avg.	10-yr avg.	5-yr avg.	This year
January	-0.22%	-2.18%	-4.54%	15.95%
February	2.37%	2.48%	0.64%	-2.28%
March	-0.60%	0.68%	1.71%	-4.21%
April	3.17%	2.65%	1.67%	-0.57%
May	6.94%	8.11%	8.91%	-7.67%
June	0.53%	-0.54%	2.97%	0.46%
July	-0.43%	-0.40%	-0.60%	-3.29%
August	-1.92%	-4.36%	-1.96%	-5.86%
September	0.71%	0.05%	1.56%	-7.08%
October	-0.01%	-2.05%	-2.59%	
November	-2.05%	-2.24%	-2.91%	
December	2.44%	2.67%	3.67%	

Source: NSE, Bloomberg

Figure 8: Strong NSE ASI rebound (in red) following bearish years

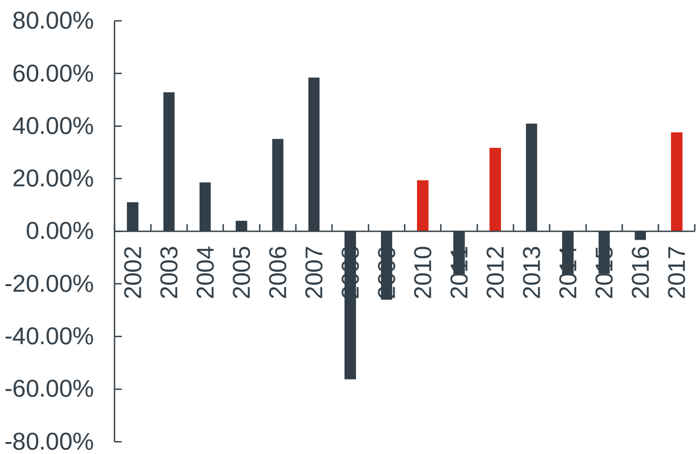


Figure 9: Wheat (USD/bushel)

Source: NSE, Bloomberg

Figure 10: Sorghum (USD/MT)

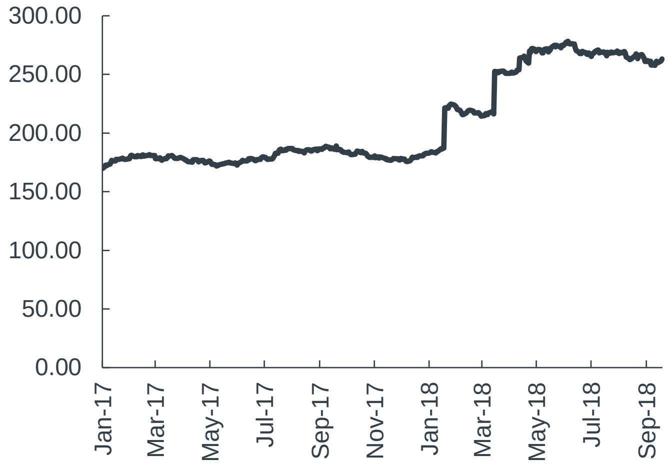
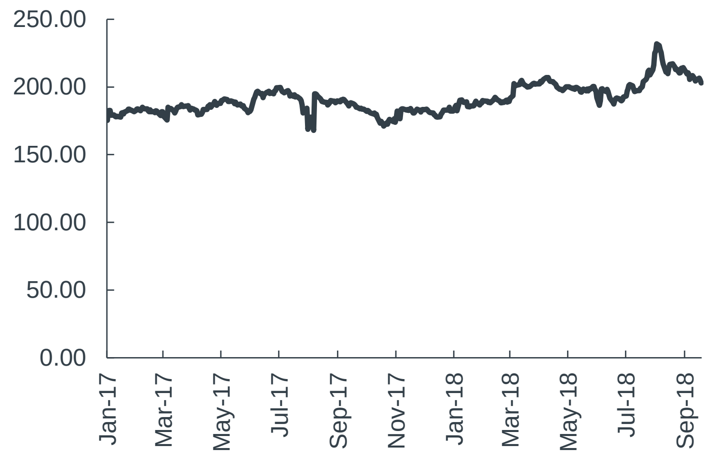


Figure 11: Maize (USD/MT)



Source: Bloomberg

Figure 12: Barley (USD/quintal)

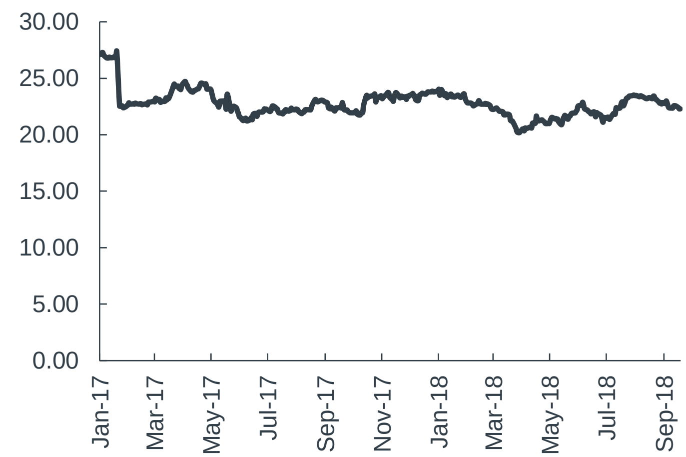


Figure 13: Sugar (USD/lb)

Source: Bloomberg

Figure 14: Cocoa (USD/MT)

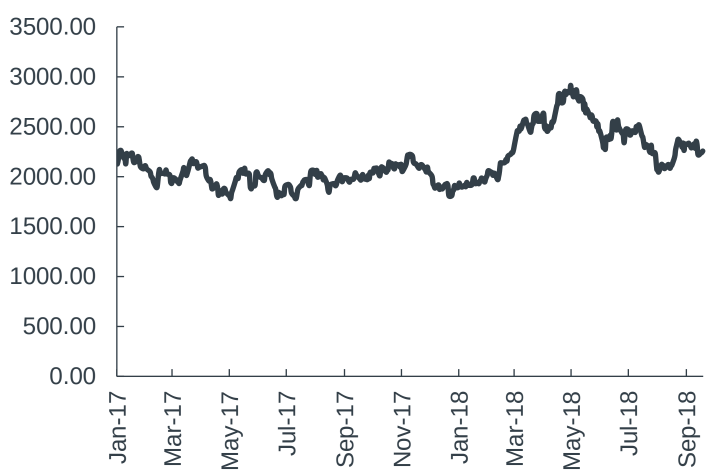
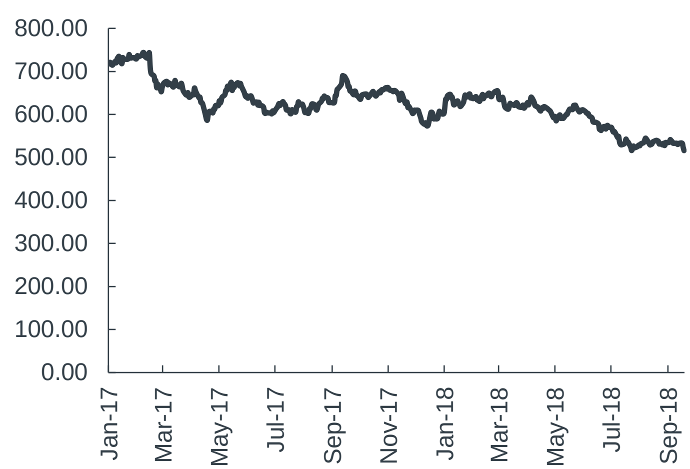


Figure 15: Crude palm oil (USD/MT)



Source: Bloomberg

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Disclosures.

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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.

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