Nestle Nigeria Plc

Growing Through Continuous Product Innovation

16 November 2018

Q3 Ended 30 September , 2018

Executive Summary

- Nestlé Nigeria Plc (Nestlé) reported a strong performance in Q3 2018 despite the difficult operating environment
- The company is benefiting from investments in expansion in the route to market and market leadership
- It managed its cost of sales better in Q3 2018 than in the corresponding period of last year
- The finance cost dropped significantly and compensated for the increase in the operating expenses
- Consequently, the profit margins increased in Q3 2018 over Q3 2017
- The cash profit from core activities that Nestlé generated in 2017 improved over 2016. This is an indication that more revenue translated to more cash profit in 2017
- Nestlé Nigeria plans to achieve its growth objective through continuous innovation to meet consumer needs and preferences
- As at December 2017, 80% of the agricultural inputs of Nestle are sourced from local farmers due to investments made in 2011
- We estimate a total dividend per share of N55.71 for the FY 2018
- **Our fair value of the shares of Nestle is N1,147.41**
- **Our target price is N1,250**

Table 1	
Rating:	**SELL**
Current Price	N1,500
Fair Value	N1,147.41
Price Target	N1,250
Horizon	One Year

1.0 Results Analysis

1.1 Q3 2018 Performance Analysis:

Nestlé Nigeria Plc (Nestlé) reported a strong performance in Q3 2018 despite the difficult operating environment. The company is benefiting from investments in expansion in the route to market and market leadership. It managed its cost of sales better in Q3 2018 than in the corresponding period of last year. However, the selling and distribution expenses as a proportion of revenue increased in 2018 over the level recorded in Q3 2017. The finance cost dropped significantly and compensated for the increase in the operating expenses. Consequently, the profit margins increased in Q3 2018 over Q3 2017. The unaudited Q3 2018 result for the period ended September 2018 shows that Turnover (T/O) increased by 9.66% to N203.13bn compared with N185.24bn in 2017. The company's cost of sales increased by 6.97% to N116.98bn from N109.36bn in Q3 2017. The increase in the prices of most raw materials and inputs is responsible for increase in cost of sales. Despite the increase in cost of sales, the company was more efficient in 2018 compared with 2017. The cost of sales as a percentage of T/O declined to 57.59% in Q3 2018 from 59.04% as at 2017. Thus, the Gross Profit (GP) increased by 13.53% to N86.15bn in Q3 2018 from N75.88bn in Q3 2017. Nestlé's administrative, selling and distribution expenses increased by 12.18% to N36.79bn. This was as a result of increased investments in marketing and distribution. These expenses as a percentage of turnover increased to 18.11% in Q3 2018 from 17.70% in 2017. The Earnings Before Interest and Tax (EBIT) increased by 14.56% to N49.36bn from N43.09bn.

The turnover in Q3 2018 increased by 9.66% to N203.13bn.

The company recorded a net financial charge of N1.27bn in Q3 2018, a decrease of 114.77% from N8.61bn in 2017. This was because of the significant drop in net foreign exchange loss from N11.15bn in 2017 to N96.07mn in 2018. The Profit Before Tax (PBT) grew to N48.09bn in Q3 2018, an increase of 39.47% from N34.48bn in Q3 2017. The tax provision also increased by 30.19% to N14.97bn from N11.50bn in 2017. The Profit After Tax (PAT) was N33.12bn in Q3 2018, from N22.98bn in 2017, representing an increase of 44.12%.

The drop in the net financial charge was because of the significant drop in net foreign exchange loss from N11.15bn in 2017 to N96.07mn in 2018.

There was an increase in the company's profit margins in Q3 2018, compared with Q3 2017.

The GP margin increased to 42.41% in Q3 2018 from 40.96% in Q3 2017 while the EBIT Margin increased to 24.30% from 23.26%. Similarly, the PBT margin increased to 23.67% in Q3 2018 from 18.61% as at Q3 2017. The PAT margin currently stands at 16.30% in Q3 2018, up from 12.41% in the corresponding period of 2017.

Trade debtors increased in Q3 2018 by 74.78% to N22.19bn, from N12.70bn in FY 2017.

Table 2: Quarterly Result Highlights (N'bn)

	Q3 2018	Q2 2018	Q1 2018	Q4 2017	Q3 2017
Turnover	67.839	67.832	67.46	58.91	63.32
PBT	16.22	18.23	13.64	12.35	10.02
PAT	11.66	12.85	8.61	10.74	6.43

Sources: Company Financial Statement and FSDH Research Analysis

Table 3: Financial Performance (N'bn)

	Q3 2018	Q3 2017	%∆
T/O	203.13	185.24	9.66%
GP	86.15	75.88	13.53%
EBIT	49.36	43.09	14.56%
PBT	48.09	34.48	39.47%
PAT	33.12	22.98	44.12%
GP* Margin	42.41%	40.96%	1.45%
EBIT Margin	24.30%	23.26%	1.04%
PBT Margin	23.67%	18.61%	5.06%
PAT Margin	16.30%	12.41%	3.90%

Sources: Company Annual Account and FSDH Research Analysis *GP-Gross Profit.

A cursory look at the balance sheet position as at Q3 2018 compared with FY December 2017 shows that the cash position of the company improved greatly in Q3 2018. Although the company tied down more cash in inventory and trade and receivables, it also enjoyed free credits from trading partners. Consequently, its working capital improved. The total fixed assets decreased by 7.78% to N66.75bn in Q3 2018 from N72.38bn in FY 2017. The inventory increased by 27.46% to N30.48bn in Q3 2018, from N23.91bn in FY 2017. The cash and bank balances increased by 119.13% from N15.14bn in FY 2017 to N33.17bn in Q3 2018. Trade debtors increased in Q3 2018 by 74.78% to N22.19bn, from N12.70bn in FY 2017. The company's trade payables also increased by 81.53% in Q3 2018 to N42.22bn from

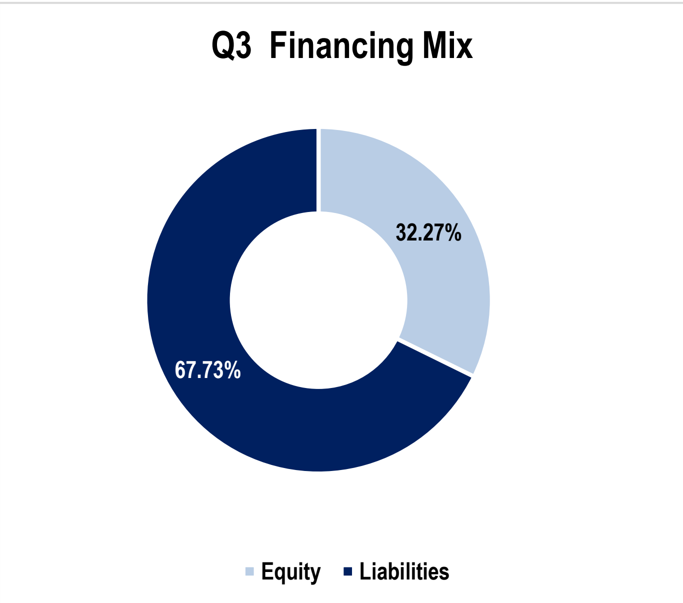
The company's assets were financed by a mix of equities and liabilities in the ratio of 32.27% and 67.73% respectively.

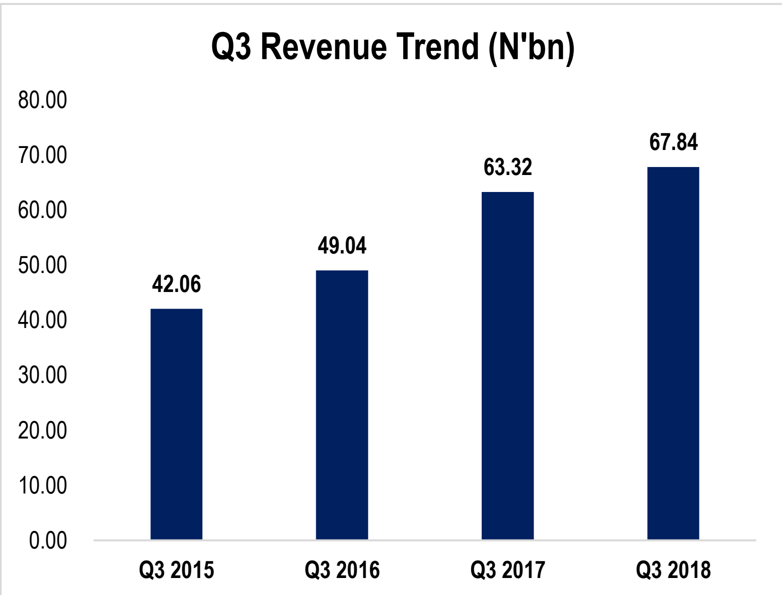
The short-term liabilities constituted mainly of trade and other payables and current tax liabilities.

The ratio of the cash profit to turnover increased to 29.34% in Q3 2018 from 25.72% in FY 2017.

N23.26bn as at FY 2017. The working capital stood at N7.67bn in Q3 2018 from a negative N7.18bn in FY 2017, while net assets for the period increased by 25.37% to stand at N56.26bn in Q3 2018, from N44.88bn as at FY 2017. **The total assets of the company which stood at N174.34bn as at Q3 2018 was financed by a mix of equities and liabilities in the ratio of 32.27% and 67.73% respectively.** Our analysis of the liabilities shows that the short-term liabilities stood at N98.02bn, accounting for 83.01% of the total liabilities. The short-term liabilities constituted mainly of trade and other payables and current tax liabilities. The company's long-term liabilities stood at N20.06bn accounting for 16.99% of the total liabilities. Long-term liabilities constituted mainly of long-term loans and borrowings and deferred tax liabilities, which stood at N7.13bn and N10.28bn respectively in Q3 2018.

Our analysis of the cash flow statement in Q3 2018 shows that Nestle generated a net increase in cash and cash equivalents of N33.17bn. The major contributor to the net cash generated was from the net cash generated from operating activities of N66.67bn. The cash profit from core activities generated during the period stood at N59.60bn but was lower than the cash profit generated in FY 2017 at N62.80bn. The ratio of the cash profit to turnover increased to 29.34% in Q3 2018 from 25.72% in FY 2017.





1.2 FY 2017 Performance Analysis:

FY 2017 T/O increased by 34.21% to N244.15bn, compared with N181.91bn.

Nestle reported a positive result in FY 2017 despite the challenging macro-economic environment. The company's earnings in 2017 was a reflection of the company's sustained market leadership in providing nutritional food for Nigerians of all ages and its focus on driving penetration. The audited Financial Year (FY) 2017 result for Nestle shows that its Turnover (T/O) increased by 34.21% to N244.15bn, compared with N181.91bn recorded in the corresponding period of 2016. The cost of sales also increased by 34.43% to N143.28bn from N106.58bn recorded in FY 2016.The higher increase in cost of sales compared with T/O resulted in a marginal increase in the cost of sales as a percentage of T/O to 58.69% in FY 2017 from 58.59% as at FY 2016. The company's administrative, selling and distribution expenses increased by 21.71% to N45.17bn in FY 2017. This increase in administrative, selling and distribution expenses was as a result of higher investments in marketing and distribution channels to lay the foundation for future strong growth. These expenses as a percentage of turnover decreased marginally to 18.50% in FY 2017 from 20.40% in FY 2016. The company's operating profit (EBIT) appreciated by 45.76% from N38.21bn in FY 2016 to N55.70bn in FY 2017.

Nestle invested in marking and distribution channels to lay the foundation for future strong growth.

The investment income stood at N6.24bn as at FY 2017, representing an increase of 48.58%, compared with N4.20bn recorded in the corresponding period of 2016. The company recorded a decrease of 27.58% in its finance cost to N15.11bn in FY 2017 from N20.86bn in FY 2016. This decrease was largely due to a substantial reduction in the net foreign exchange loss, which stood at N11.17bn in FY 2017 from N16.29bn in FY 2016. Additionally, the company had a significant decrease in loans and borrowings.

The company had a significant decrease in loans and borrowings.

The Profit Before Tax (PBT) grew to N46.83bn in FY 2017, a significant increase of 117.32% from N21.55bn recorded in the corresponding period of 2016.We note that profit in 2016 was impacted by currency devaluation. This significant growth in PBT in 2017 was due to the company's management of its finance costs, which allowed revenue to trickle-down to PBT. The tax provision decreased by 3.81% to N13.10bn from N13.62bn. Profit After Tax (PAT) stood at N33.72bn in FY 2017 from N7.92bn in the corresponding period of 2016, representing an increase of 325.54%.

The gain in finance cost translated to better profit margins during the year.

Gross profit margin decreased marginally from 41.41% in 2016 to 41.31% in 2017. The company's EBIT margin grew from 21.01% in FY 2016 to 22.81% in FY 2017. The gain in finance cost translated to better profit margins during the year. The PBT margin increased to 19.18% in FY 2017 from 11.85% as at FY 2016. Also, the PAT margin increased to 13.81% in FY 2017 from 4.36% in the corresponding period of 2016.

The food segment continues to be the biggest contribution to Nestlé's revenue and profitability.

Table 4: Profitability Analysis (N'bn)

	FY 2017	FY 2016	FY 2015	FY 2014
T/O	244.15	181.91	151.27	143.33
EBIT	55.70	38.21	33.75	29.20
PBT	46.83	21.55	29.32	24.45
PAT	33.72	7.92	23.74	22.24
GP* Margin	41.31%	41.41%	44.52%	42.72%
EBIT Margin	22.81%	21.01%	22.31%	20.37%
PBT Margin	19.18%	11.85%	19.38%	17.06%
PAT Margin	13.81%	4.36%	15.69%	15.51%

Sources: Company Annual Account and FSDH Research Analysis

The food segment continues to be the biggest contribution to Nestlé's revenue and profitability. An analysis of Nestlé's revenues shows that its food segment contributed 63.17% to the company's revenue in 2017 while the beverage segment contributed 36.83%. Both the food and beverage segments recorded an improvement in the sale of products by 36.03% and 31.21% respectively.

Given the higher profit margins in the food segment, we expect the company to invest in innovation within its food products. This is evident in the two new products the company has added to this segment. Profit margins in the food and beverages segment in FY 2017 was 25.03% and 19.02% respectively. We also note that the company has also added a new product (Milo Ready-to-Drink) to the beverages segment.

Table 5: Revenue Analysis (N'bn)

Segment	FY 2017	Proportion FY 2017	FY 2016	Proportion FY 2016	Change (YoY)
Food	154.23	63.17%	113.38	62.33%	36.03%
Beverages	89.93	36.83%	68.53	37.67%	31.21%
Total	**244.15**	**100.00%**	**181.911**	**100.00%**	**34.21%**

Sources: Company Annual Account – 2017 and FSDH Research Analysis

Table 6: Segment Profitability Analysis (N'bn)

Segment	FY 2017	Proportion FY 2017	FY 2016	Proportion FY 2016	Change (YoY)
Food	38.60	82.42%	26.19	121.53%	47.38%
Beverages	17.10	36.52%	12.33	57.21%	38.72%
Unallocated	-8.87	-18.94%	-16.97	-78.74%	47.73%
Total	**46.83**	**100.00%**	**21.55**	**100.00%**	**19.95%**

Sources: Company Annual Account – 2017 and FSDH Research Analysis

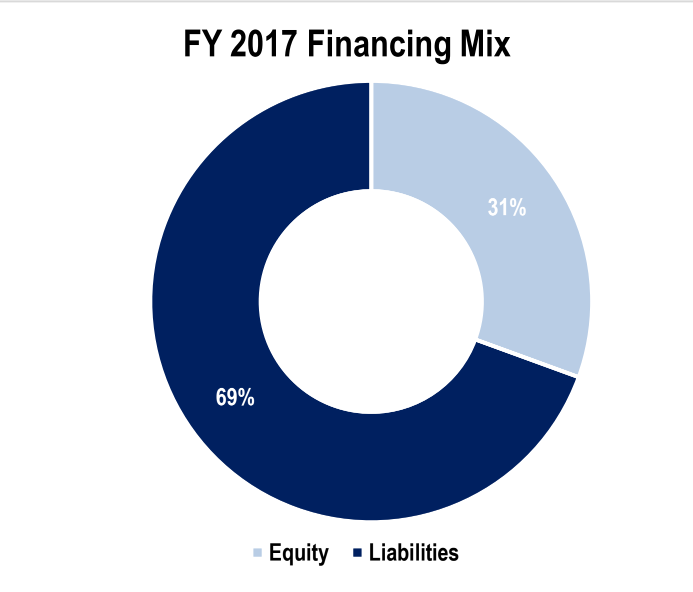
Profit margins in the food and beverages segment in FY 2017 was 25.03% and 19.02% respectively.

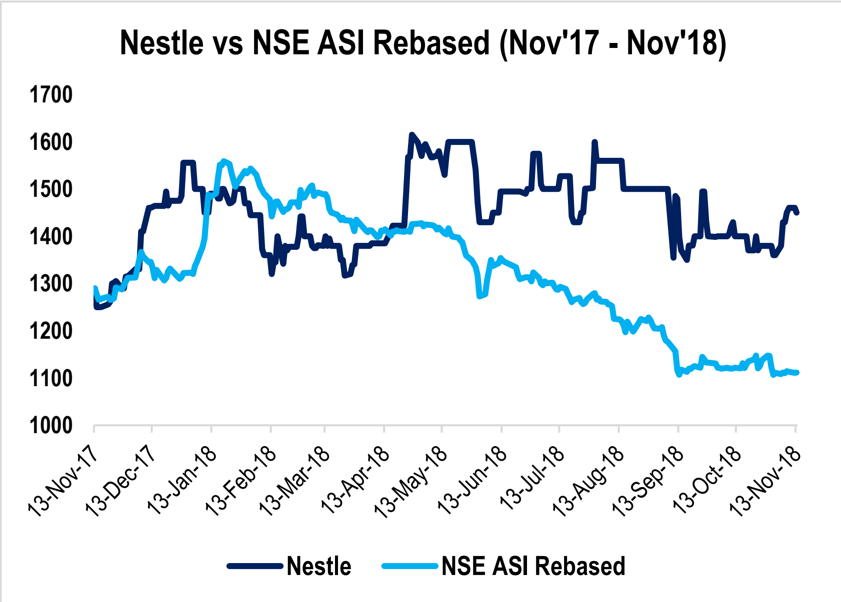
A cursory look at the balance sheet position as at FY 2017 compared with the position as at FY 2016 shows a marginal increase in the company's fixed assets. The total fixed assets increased by 3.14% to N72.38bn in FY 2017 from N70.17bn in FY 2016. The inventory increased by 15.86% to N23.91bn from N20.63bn in FY 2016. The cash and bank balances recorded a significant decrease of 70.52% from N51.35bn in FY 2016 to N15.14bn in FY 2017. The trade debtors increased in FY 2017 by 35.48% to N9.93bn from N7.33bn in FY 2016.

The total assets of the company which stood at N146.80bn as at FY 2017 were financed by a mix of equities and liabilities in the ratio of 30.57% and 69.43% respectively.

The trade creditors increased by 33.56% to N14.21bn from N10.64bn as at FY 2016. The working capital stood at a negative N7.18bn in FY 2017 from a negative N23.30bn recorded in FY 2018. Net assets for the period increased by 45.34% to stand at N44.88bn in FY 2017 from N30.88bn as at FY 2016. The total assets of the company which stood at N146.80bn as at FY 2017 were financed by a mix of equities and liabilities in the ratio of 30.57% and 69.43% respectively. Our analysis of the liabilities shows that the short-term liabilities stood at N79.68bn, accounting for 78.17% of the total liabilities, while the long-term liabilities stood at N22.25bn accounting for 21.83% of the total liabilities. The long-term liabilities constituted mainly of deferred taxation, which stood at N10.40bn.

The short-term liabilities constituted mainly of other creditors and accruals, which stood at N34.85bn in FY 2017.





2.0 Analysis of the Statement of Cash Flows:

Nestle Nigeria generated a net increase cash flow of N11.42bn in the year 2017, an improvement over the net increase cash flow of N51.20bn it generated in 2016.

The cash profit from core activities that nestle generated in 2017 improved over 2016. This is an indication that more revenue translated to more cash profit in 2017 in 2016. However, the company tied down a substantial amount of cash in working capital resulting in a drop in cash generated from operating activities. Nestle Nigeria generated a net increase cash flow of N11.42bn in the year 2017, an improvement over the net increase cash flow of N51.20bn it generated in 2016. The cash profit generated from the core operation increased to N62.80bn in 2017 from N44.23bn in 2016. The ratio of the cash profit generated from core operation to the company's revenue increased to 25.72% in 2017 from 24.31% in 2016.

FSDH Research notes that the repayment of the company's foreign loans will help it to reduce the negative impacts of foreign exchange loss going forward.

The cash generated from operating activities decreased from N66.34bn in 2016 to N27.96bn in 2017 while the net cash generated after tax decreased from N61.48bn to N19.24bn. The net cash generated from the operating activities could cover the company's investment needs for property, plant and equipment. However, the net cash generated from operating activities could not cover the financing activities of the company. Leading to a depreciation from the prior year's cash generation. FSDH Research notes that the repayment of the company's foreign loans will help it to reduce the negative impacts of foreign exchange loss going forward.

Table 7: Cash flow Analysis (N'bn)	2017	2016
Cash Profits from Core Activities	62.80	44.23
Changes in Working Capital	(34.84)	22.11
Cash from Operating Activities	27.96	66.34
Income Tax Paid	8.28	4.55
Net Cash From Operating	19.24	61.48
Net Cash Used In Investing Activities	(2.43)	(2.84)
Net Cash Used in Financing Activities	(56.57)	(20.07)
Cash Generated for the Year	11.42	51.20
Ratio of Cash Profit from Core Operations to Revenue	25.72%	24.31%
Ratio of Net Cash from Operation to PPE Investment	220.71%	869.94%
Sources: Company Annual Account – 2017 and FSDH Research Analysis		

3.0 Analysis of Return on Equity

The Return on Equity (ROE) of the company grew from 61.87% in 2014 to 62.45% in 2015.

The Return on Equity (ROE) of the company grew from 25.67% in 2016 to 75.15% in 2017. Using the DuPont analysis, we attributed the growth in the ROE to the increase in the company's profit margin. Improvement in sales and cost management initiatives were primarily responsible for the increased margin. The asset turnover increased to 1.66 in 2017 compared to 1.07 in 2016.

The equity multiplier decreased to 3.27 from 5.49, indicating that a smaller portion of its assets is being financed through debt as opposed to the previous year.

Table 8: Du Pont Analysis (N'bn)

		2017	2016
Profitability	PAT	33.72	7.92
	Turnover	244.15	181.91
	Profit Margin	**13.81**	**4.36**
Operating Efficiency	Turnover	244.15	181.91
	Total Assets	146.80	169.59
	Asset Turnover	**1.66**	**1.07**
Financial Leverage	Total Assets	146.80	169.59
	Equity	44.88	30.88
	Equity Multiplier	**3.27**	**5.49**
Return on Equity (ROE)		**75.15%**	**25.67%**

Sources: Company Annual Account – 2017 and FSDH Research Analysis

4.0 Drivers of Performance:

The following factors affected the earnings of Nestlé's:

Positive Factors:

- Sustained market leadership
- Diversified product portfolio which are essential for everyday living
- Its backward integration strategy to secure raw materials locally by partnering with farmers
- Improvements in the economic environment
- Increased penetration due to the Popularly Positioned Products (PPP) strategy
- Innovative products
- Improved operational efficiency

Negative Factors:

- Difficult operating environment
- The weak consumer spending power
- Stiff competition
- The security challenges in the country.

4.1 Strategic Focus:

PPP offers these consumers high-quality food products that provide nutritional value at an affordable cost.

Nestlé Nigeria plans to achieve its growth objectives by continuing to invest in innovation of new products to meet consumer needs and preferences as well as investment in new facilities. The company's product innovation is based on the understanding of the nutritional needs, local tastes and habits of its customers. Nestle also focuses on food fortification to help micronutrient deficiency challenges. This is reinforced by its PPP strategy, which focuses on the specific needs of lower-income consumers. PPP offers these consumers high-quality food products that provide nutritional value at an affordable cost.

As at December 2017, 80% of the agricultural input in production is sourced from local farmer due to investments made in 2011.

Creating Shared Value (CSV) is embedded in the way Nestle does business. This includes sourcing raw materials for its local production. As at December 2017, 80% of the agricultural input in production is sourced from local farmer due to investments made in 2011. All of the grains and legumes used in Golden Morn are locally sourced.

The company recently inaugurated the Milo Ready-to-Drink plant at the Agbara factory.

5.0 Business:

Nestlé Nigeria is part of the Nestle Group one of the largest food and beverage companies in the world. Globally, Nestlé companies are organized into regional groupings to leverage expertise and the size of the company. Nestle Nigeria is a part of Central and West Africa region. The region is managed through Nestlé Central & West Africa Limited, which is based in Accra. **As at FY 2017; the Nigerian market contributed 98.76% to the turnover of Nestlé Central & West Africa, while Niger, Chad, Senegal, Togo, Ghana, Guinea and others contributed the remaining 1.24%. Thus, the Nigerian market remains an important segment of the Nestle Group.**

Nestle Nigeria spent N51billion on investments in its manufacturing operations from 2012 to 2017.

Nestlé Nigeria has three manufacturing plants Flowergate, Abaji and Agbara. The Agbara factory has grown into a factory complex housing multiple plants. The company recently inaugurated the Milo Ready-to-Drink plant at the Agbara factory. **Nestle Nigeria spent N51billion on investments in its manufacturing operations from 2012 to 2017.**

The company produces several products including Maggi Star, Maggi Chicken, Maggi Crayfish, Maggi Mix'py, Milo, Milo Energy Cubes, Milo Ready-to-Drink (RTD), Goldern Morn Maize, Golden Morn Puffs, Nestle Pure Life, Nescafe, SMA, NAN Nutrend, Lactogen and Cerelac.

Table 9: Directors' Shareholding as at 31 December 2017

Director	Position	Holdings
Mr. David Ifezulike	Chairman	56,255
Mr. Maurido Alarcon	MD/CEO	Nil
Mr. Syed Saiful Islam*	Executive	Nil
Mr. Jagdish Singla*	Executive	Nil
Mr. Kais Marzouki**	Non-Executive	Nil
Mr. Ricardo Chavez	Non-Executive	Nil
Mr. Gbenga Oyebode	Non-Executive	Nil
Mrs. Ndidi Okonkwo Nwuneli	Non-Executive	Nil

Sources: Company Annual Account – 2017 and FSDH Research Analysis
****Resigned 31 December 2017 ** Appointed 01 January 2018***

Table 10: Shareholding Structure as at 31 December 2017

Name	No. Of Ordinary Shares	% of Shareholding
Nestlé S.A., Switzerland	524,559,457	66.18%
Others	268,096,795	33.82%
Total Number of Shares	**792,656,252**	**100.00%**

Sources: Company Annual Account – 2017 and FSDH Research Analysis

Table 11: Company Summary

Ticker	NESTLE
Sector	Consumer Goods
Sub-sector	Food Products - Diversified
Date of Incorporation	September 25, 1969
Date of Listing	April 20, 1979
Financial Year End	December
Number of Fully Paid Share	792,656,252
Current Capitalization(NGN)	1,173,131,252,960
NSE Capitalization (NGN)	11,703,747,850,069.40
% of NSE Capitalization	10.02%
52 Week high NGN	1,615
52 Week low NGN	1,250
YTD Return (%)	(2.15%)
52 Weeks Average Volume Traded	174,151
Trailing EPS NGN	55.34
Trailing P/E Ratio (X)	26.75

Sources: Company Annual Account – 2017, NSE and FSDH Research Analysis
****As at 16 November 2018.***

The company's food business contributed more to its revenue than its beverage business.

6.0 Product Analysis:

Nestlé has two reportable business segments, which are its strategic business units. The units are Food Products and Beverages. This strategic business units offer different products and are managed separately because they require different technology and marketing strategies. The food and beverages segments contributed 63.17% and 36.83% to the company's revenue in FY 2017 respectively.

6.1 Food Products:

The company engages in the production and sale of Maggi, Cerelac, Nutrend, NAN, Lactogen and Golden Morn under this segment. The company has introduced new products Maggi Naija Pot and Golden Morn puffs. We gathered that the Gold Morn puffs has gained traction in the market. Products in this category have traditionally competed with imported food products in the market. Consumers' gradual shift away from foreign goods to goods with local content because of weak exchange rate should be a positive for Nestle. There are smaller competitors in the food products market in Nigeria but Nestlé maintains the lead in the market. Other competitor's products in this category include, Dan-Q Seasoning Cubes Onga Seasoning Cubes, Unilever's Knorr and Royco Cubes and Kellog's Cereals.

Consumers' gradual shift away from foreign goods to goods with local content because of weak exchange rate should be a positive for Nestle.

6.2 Beverages:

The company engages in the production and sale of Milo, Nido, Nescafe, and Nestlé Pure Life. The company introduced a new product Milo RTD. Competing products in the market are Bournvita, Ovaltine, Horlicks, Eva Water, Cway Water, Swan Water, Peak Milk, Cowbell Milk etc

7.0 SWOT Analysis:

7.1 Strengths:	7.2 Weaknesses:
○ Strong brand name ○ Quality products in the market ○ Technical partnership with parent company ○ Securing raw materials via backward integration ○ Brand Loyalty ○ Improved operational efficiency ○ Consistent dividend payment ○ Diversified products.	○ Increased marketing and distribution expenses
7.3 Opportunities:	**7.4 Threats:**
○ Large market size in Nigeria ○ Government local substitution strategy ○ Existing taste and preference for products by consumers ○ Weak foreign exchange rate	○ Security challenges in the Northern region ○ Poor road infrastructure in the country ○ Stiff competition in the industry ○ Weak purchasing power of consumers ○ Weak foreign exchange rate.

8.0 Forecast:

Our Forecast Drivers

We considered the following factors in arriving at our 5-year forecasts:

We estimate a final dividend for the FY 2018 is N35.71 per share.

Positive Factors:

- Strong revenue growth prospect with strong profit margins
- Market leadership and large market size in Nigeria
- Focus on investment in innovative products
- Improved operational efficiency
- Backward integration to lower imported inputs
- Technical partnership with the parent and related companies
- Customers' brand loyalty

Negative Factors:

- Current weak consumers' spending power
- Difficult operating environment
- Possible currency depreciation

We expect Nestle to grow its turnover from N151.27bn in 2015 to N358.49bn in 2020.

Looking at the medium to long-term outlook of the company and the impact of the aforementioned factors, we are of the opinion that the impact of the positive factors would be higher on both the revenue and the profitability of the company than the negative factors. We therefore estimate a Turnover of N298.45bn, N364.79bn, N440.43bn, N525.15bn and N620.91bn for the periods ending December 2018, 2019, 2020, 2021 and 2022. We estimate EBIT of N64.41bn, N75.66bn, N91.75bn, N109.54bn and N129.05bn, respectively and EBITDA of N72.42bn, N84.87bn, N102.47bn, N122.18bn and N144.15bn for the same period using EBIT margins of 21.58%, 20.74%, 20.83%, 20.86% and 20.78% respectively. Our PBT forecasts for the periods are: N68.13bn, N75.66bn, N90.12bn, N106.14bn and N123.73bn. Adjusting for tax, our PAT forecasts are N49.06bn, N54.49bn, N64.90bn, N76.44bn and N89.10bn. PAT Margin for the period are 16.44%, 14.94%, 14.74%, 14.56% and 14.35%. Our forecast final dividend for the FY 2018 is N35.71 per share.

Table 12:Statement of Profit or Loss (2017 - 2022)						
N'bn	Dec-17A	Dec-18F	Dec-19F	Dec-20F	Dec-21F	Dec-22F
Turnover (Net Sales)	244.15	298.44	364.79	440.43	525.15	620.91
Cost of Sales	(143.28)	(176.49)	(215.73)	(260.46)	(310.56)	(367.19)
Gross Profit	100.87	121.95	149.06	179.97	214.59	253.72
Admin, Selling & Distribution Expenses	(38.69)	(49.53)	(64.19)	(77.50)	(92.40)	(109.56)
Depreciation	(6.49)	(8.01)	(9.21)	(10.73)	(12.64)	(15.11)
EBIT	55.70	64.41	75.66	91.75	109.54	129.05
EBITDA	62.18	72.42	84.87	102.47	122.18	144.15
Net Finance Cost	(8.87)	(3.72)	(0.00)	1.63	3.40	5.32
PBT	46.83	68.13	75.66	90.12	106.14	123.73
Taxation	(13.10)	(19.07)	(21.17)	(25.22)	(29.70)	(34.62)
PAT	33.72	49.06	54.49	64.90	76.44	89.10

*Sources: Company Annual Account – 2017 and FSDH Research Analysis *A-Actual, F-Forecast*

Table 13: Ratio Analysis (2017 - 2022)						
	Dec-17A	Dec-18F	Dec-19F	Dec-20F	Dec-21F	Dec-22F
EBITDA Margin	25.47%	24.27%	23.27%	23.27%	23.27%	23.22%
EBIT Margin	22.81%	21.58%	20.74%	20.83%	20.86%	20.78%
PBT Margin	19.18%	22.83%	20.74%	20.46%	20.21%	19.93%
PAT Margin	13.81%	16.44%	14.94%	14.74%	14.56%	14.35%
EPS(N)	42.55	61.90	68.74	81.87	96.43	112.41
DPS(N)	42.50	55.71	61.87	73.69	86.79	101.17
Dividend Payout	99.89%	90.00%	90.00%	90.00%	90.00%	90.00%
Earnings Yield *	2.87%	5.39%	5.99%	7.14%	8.40%	9.80%
Dividend Yield *	2.87%	4.86%	5.39%	6.42%	7.56%	8.82%
P/E Ratio*	34.79	18.54	16.69	14.01	11.90	10.21
Number of Shares ('bn)	0.79	0.79	0.79	0.79	0.79	0.79
ROE	75.15%	81.43%	77.20%	75.08%	73.16%	71.41%
Inventory Turnover	5.99	7.30	7.30	7.30	7.30	7.30

Sources: Company Annual Account – 2017 and FSDH Research Analysis ****At Our Fair Value of N1,147.41*** ***A-Actual, F-Forecast***

Table 14: Statement of Financial Position (2017 - 2022)						
N'bn	**Dec-17A**	**Dec-18F**	**Dec-19F**	**Dec-20F**	**Dec-21F**	**Dec-22F**
Fixed Assets	72.38	72.22	72.86	73.57	74.35	75.20
Long Term Receivables	1.92	1.92	1.92	1.92	1.92	1.92
Long Term Assets	**74.30**	**74.14**	**74.79**	**75.49**	**76.27**	**77.12**
Stock (Inventory)	23.91	24.18	29.56	35.68	42.55	50.31
Trade Debtors	9.93	12.08	14.77	17.83	21.26	25.13
Deposits/Balances & Cash	15.14	30.53	37.50	51.73	68.34	87.41
Other Debtors, Prepayment and Other Assets	23.53	29.49	36.04	43.52	54.93	68.51
Current Assets	**72.50**	**96.28**	**117.87**	**148.76**	**187.08**	**231.36**
Total Assets	**146.80**	**170.41**	**192.65**	**224.25**	**263.35**	**308.49**
Trade Creditors	14.21	18.18	22.23	26.84	32.00	37.83
Bank Overdraft	3.71	-	-	-	-	-
Current Tax Liabilities	15.10	19.07	21.17	25.22	29.70	34.62
Short Term Loans and Other Liabilities	10.91	7.33	4.13	0.72	-	-
Other Creditors & Accruals	35.75	42.59	52.07	62.86	74.95	88.62
Current Liabilities	**79.68**	**87.17**	**99.60**	**115.64**	**136.65**	**161.08**
Working Capital/ Net Current Asset	**(7.18)**	**9.10**	**18.27**	**33.12**	**50.43**	**70.29**
Capital Employed	**67.12**	**83.24**	**93.06**	**108.61**	**126.69**	**147.41**
Deferred Taxation	10.40	11.90	11.90	11.90	11.90	11.90
Long Term Debt	9.56	7.65	6.12	4.90	3.92	3.13
Staff gratuity & long service awards	2.28	3.43	4.45	5.37	6.41	7.60
Long Term Liabilities	**22.25**	**22.98**	**22.47**	**22.17**	**22.22**	**22.63**
Total Liabilities	**101.93**	**110.16**	**122.07**	**137.81**	**158.88**	**183.71**
Total Net Assets	**44.88**	**60.26**	**70.58**	**86.44**	**104.47**	**124.78**
Paid Up Share Capital	0.40	0.40	0.40	0.40	0.40	0.40
Share Premium a/c	0.03	0.03	0.03	0.03	0.03	0.03
Share Based Payment Reserves	0.15	0.15	0.15	0.15	0.15	0.15
Retained Earnings	**44.30**	**59.68**	**70.01**	**85.87**	**103.90**	**124.20**
Total Equity	**44.88**	**60.26**	**70.58**	**86.44**	**104.47**	**124.78**
Total Equity and Liabilities	**146.80**	**170.41**	**192.65**	**224.25**	**263.35**	**308.49**

Sources: Company Annual Account – 2017 and FSDH Research Analysis **A-Actual, F-Forecast*

9.0 Valuation:

We employed a relative valuation method using Enterprise Value (EV) to Earnings Before Interest Tax Depreciation and Amortization (EBITDA) multiple. The assumptions and results of the valuation are:

Assumptions:

- EV/EBITDA Multiple: 12.97x (Food Processing Multiple – Aswath Damodaran)
- Debt: N24.19bn
- Cash: N15.14bn
- Number of shares in issue: 792.66mn
- Cost of Capital : 20%

Applying the EV/EBITDA multiple of 12.97x, we arrived at N1,147.41 per share as our fair value.

Our fair value for Nestle is N1,147.41.

The current market value of Nestle share is N1,480, the highest and the lowest closing prices in the last 52 weeks are N1,615 and N1,250 respectively. The forward earnings yield and dividend yield of the company at our fair value are 5.39% and 4.86% respectively. The fair value of the stock is 22.47% lower than the current market price. We therefore place a **SELL** rating on the shares of Nestle Nigeria Plc at the price of N1,480 as of 16 November 2018. Our target price for the shares of Nestle in the next one year is N1,250.

9.1 Risks to Price Target:

The following risks may affect the target price:

- Increase in the yield on fixed income securities leading to portfolio reallocation from the equity market
- Drop in market liquidity

Table 15 : Comparable Analysis (N'bn)		
Company	**Nestle**	**Cadbury Nigeria**
Turnover	244.15	33.08
Gross Profit	100.87	7.44
EBIT	55.70	0.71
PBT	46.83	0.35
PAT	33.72	0.30
GP Margin	41.31%	22.48%
EBIT Margin	22.81%	2.15%
PBT Margin	19.18%	1.06%
PAT Margin	13.81%	0.91%
ROE	75.15%	2.55%
Net Assets (N)	44.88	11.74
Net Assets Per Share (N)	56.62	6.25
Trailing PE Ratio	26.75	42.635
Trailing Earnings Yield	3.74%	2.35%
Sources: Company Annual Account – 2017 and FSDH Research Analysis		

Table 16 : Analyst Rating	
Rating	**Criteria**
BUY	Fair value of the stock is ≥ 18.88%* compared with the current market price.
HOLD	Fair value of the stock ranges between -10% and 18.88% of the current market price.
SELL	Fair value of the stock is > 10% below the current market price.
18.88% is our estimated minimum equity return. It is the combination of our risk free rate and risk premium. Our risk free rate is the average yield on a five-year FGN Bond. We adopted a 5% risk premium and set the risk free rate every quarter.	

Fair Value: This is the value of the ordinary shares of the company using the valuation method appropriate for the company. It is the intrinsic or true value of the stock based on the fundamentals of the company. The market price may either trade at a premium or discount to the intrinsic value.

Price Target: This is the price that we believe the shares of the company will trade within our time horizon. Other risk factors may affect the attainment of this price. This price may or not be different from the intrinsic value.

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