

Nestle Earnings Review Q1 2020

Stock rating: BUY
Target Price: N1,225.87/s
Closing Price: N1,040.00/s

Company Information	
TTM P/B (x)	14.6x
TTM P/E (x)	18.7x
EV/EBITDA (x)	10.5x
Dividend Yield	6.7%
Free Float	33.8%
Market Cap (N'bn)	824.4

Q1 2020: Negative surprise in Opex pressures operating performance

- Revenue declines marginally by 0.9% y/y
- Gross margin expands 0.7ppts on lower material cost
- Profit before tax declines 8.7% on lower Operating & Finance income
- Earnings per share printed at N14.12/s

Marginal decline in Revenue as Food segment pressured

In its recently released Q1 2020 result, Nestle Nigeria reported a 0.9% y/y decline in Revenue to N70.3bn from N71.0bn in Q1 2019. On a q/q basis, Revenue was also lower by 3.2% from N72.7bn in Q4 2019. Across the company's reporting segments, Beverage business reported sturdy Revenue growth, climbing higher by 13.1% y/y to N28.8bn in Q1 2020 from N25.5bn in Q1 2019. On the other hand, the Food business was pressured, declining 8.7% y/y to N41.5bn in Q1 2020 from N45.5bn in Q1 2019. The Food business struggled in the final weeks of the quarter as the government announced lockdown measures to curb the spread of the coronavirus. The attendant impact of this was that big demand sources like restaurants were shut down while ceremonial activities were banned. However, the lockdown had a positive impact on the Beverage business with consumers stockpiling due to lack of clarity on when the lockdown was going to end.

Margins continue to strengthen on lower commodity cost

The company's margins continued to strengthen in Q1 2020 as international commodities prices continued to remain pressured due to lull in demand. Key inputs like Cocoa (-4.1% as at Q1 2020), Coffee (-5.8% as at Q1 2020), Corn (-2.7% as at Q1 2020) and Sugar (-13.3% as at Q1 2020) have continued to trend lower in the year based on data from the World Bank's monthly commodity price update. As a result, Nestle reported a 2.1% y/y decline in Cost of Sales to N38.7bn in Q1 2020 from N39.5bn in Q1 2019. Due to the faster decline in Cost of Sales, Gross Profit recorded a marginal 0.6% y/y uptick to N31.7bn in Q1 2020 from N31.5bn in Q1 2019. In similar vein, Gross margin expanded by 0.7ppts to 45.0% in Q1 2020.

Negative Opex surprise drags on operating performance

The company recorded a negative surprise in operating expenses which climbed 14.0% y/y to N14.1bn in Q1 2020 from N12.4bn in Q1 2019. The spike in Opex was driven by increase in both Marketing & Distribution expenses (+6.5% y/y to N11.0bn) as well as Administrative expenses (+53.1% y/y to N3.1bn). We note Nestle doesn't provide breakdown of the company's expenses by nature in quarterly results, however, we suspect significant rise in Admin personnel cost drove the increase given it represents the biggest portion of Administrative expenses. Against this backdrop, Operating profit fell 8.1% y/y to N17.5bn in Q1 2020 from N19.1bn in Q1 2019.

Lower cash position and weaker yield environment pressures Interest income

Nestle Nigeria recorded a Net Finance Cost of N82.7m in Q1 2020 compared to a Net Finance Income of N34.0m in Q1 2019. This was due to a faster dip in Interest Income (-33.5% to N335.2m) compared to Interest Expense (-11.1% to N417.9m). We note the company has significantly cut down on its debt balance with total Loans & Borrowings declining 97.6% y/y to N158.5m as at Q1 2020. We think this fed into lower Finance Cost and expect the company's Finance Cost to remain significantly low for the rest of the year. The significant dip in Finance Income was due to both weaker yield environment and lower Cash balance (down 52.6% y/y). Nevertheless, this had little impact on Pre-Tax profits but still declined 8.7% y/y to N17.5bn in Q1 2020 from N19.1bn in Q1 2019.

Higher effective tax rate pressures Net Income

Nestle Nigeria recorded a 3.0ppts y/y increase in Effective Tax Rate to 35.9% in Q1 2020. Thus, Tax expense decline at a slower pace compared to Pre-Tax Profits placing further pressure on Net Income. Against this backdrop, Nestle Nigeria recorded a 12.9% y/y decline in Net Income to N11.2bn in Q1 2020 from N12.8bn in Q1 2019. Nevertheless, on a q/q basis, the company's Q1 2020 Net Income was higher by 26.6% y/y compared to Q4 2019. Earnings per Share for Q1 2020 printed at N14.12/s in Q1 2020.

Outlook: Subdued outlook on weaker consumer pockets

Flattish Revenue forecast as consumers grow weaker

We note Nestle Nigeria retains very unique qualities that has sustained its Revenue growth over the years including i) Broad & Fairly inelastic product portfolio ii) Strong brand loyalty iii) Widespread distribution network. However, we believe the macroeconomic problems which would result from the economic effects of the coronavirus outbreak would significantly depress consumer pockets. We struggle to see any significant improvement in volume growth post-COVID era although we think should another round of lockdown be implemented, the company's Beverage business may benefit from increased stockpiling but would see its bigger Food business face pressures. Against this backdrop, we lower our Revenue forecast to a marginal 0.7% (previously 2.1%) growth in Revenue to N286.0bn in FY 2020e. Our projection is based on sturdy growth in Beverage (FY 2020e – 10.0%) while Food (FY 2020e – -5.0%) business continue to drag.

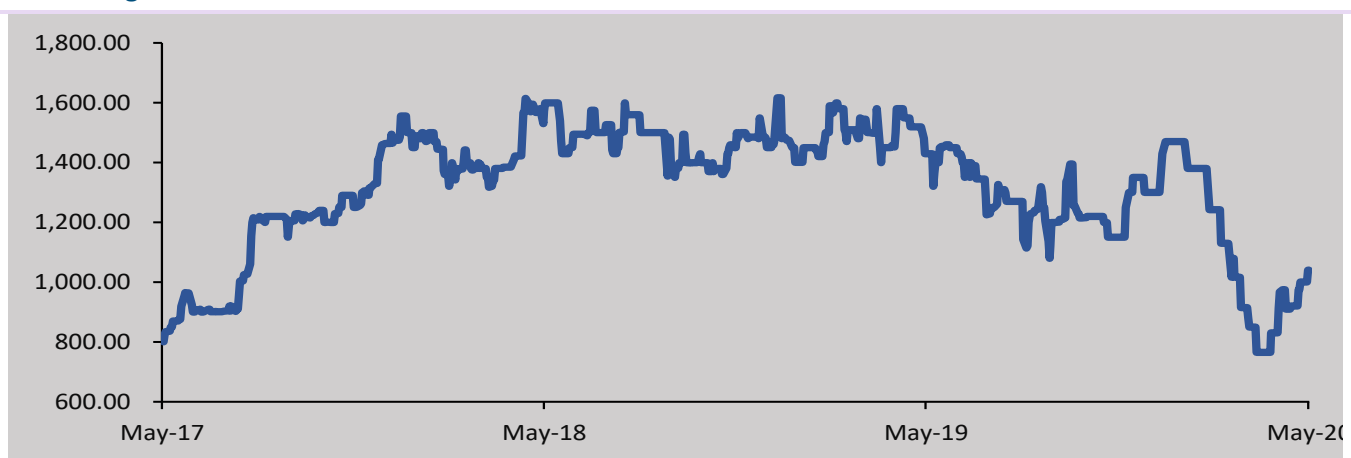
Weaker commodity prices mean lower costs

With commodities prices expected to remain pressured in 2020 as global demand is expected to remain in a lull, we expect this to feed into lower input costs for Nestle. While we note that possible devaluation remains a key risk on the horizon, we expect the CBN to remain strong on keeping the naira at current levels. Furthermore, we note that Nestle has a diversified input sourcing base with about 60% of its inputs sourced in Nigeria. Thus, we expect minimal pressure from Cost of Sales. We lower our modeled Cost margin by 0.9ppts to 55.0% for 2020e while we have a flattish 0.4% y/y forecast growth for Gross Profit. Overall, we forecast a marginal 1.4% y/y growth (previously – 7.0%) in Net Income to N46.3bn (previously N48.9bn) in FY 2020e with Earnings per share printing at N58.47/s. The cut in our Net Income forecast was due to higher modelled Effective Tax Rate of 35.0% relative to prior 30.0%.

Above inflation upside potential...BUY rating retained

Following revisions which has seen our forecasts lower, we cut our target price to N1,225.87/s from N1,325.06/s which implies a 17.9% upside to Friday's closing price of N1,040.0/s. We note Nestle has enjoyed some positive sentiments in recent times rallying significantly thus pricing in some of the company's forward EPS expectation. However, decent upside remains with the stock trading at a 17.8x forward PE multiple which is a steep discount to our peer average of 38.9x. Against this backdrop, we retain our BUY recommendation on the stock with a decent 17.9% upside.

Nestle Nigeria 3-Year Historical Price Movement



Source: Bloomberg, FSDH Research

Nestle Nigeria Plc Earnings Highlight Q1 2020

N'm	Q1 2020	Q1 2019	y/y	Q1 2020	Q4 2019	q/q
Revenue	70,329	70,967	-0.9%	70,329	72,688	-3.2%
Cost of Sales	(38,672)	(39,498)	-2.1%	(38,672)	(40,854)	-5.3%
Gross Profit	31,658	31,469	0.6%	31,658	31,834	-0.6%
Marketing & Distribution Expenses	(11,042)	(10,371)	6.5%	(11,042)	(13,765)	-19.8%
Administrative Expenses	(3,078)	(2,010)	53.1%	(3,078)	(3,057)	0.7%
Other Income/(Expenses)	-	-	n/m	-	-	n/m
Results from Operating Activities	17,538	19,088	-8.1%	17,538	15,012	16.8%
Finance Income	335	504	-33.5%	335	253	32.6%
Finance Cost	(418)	(470)	-11.1%	(418)	(695)	-39.9%
Net Finance Income/(Cost)	(83)	34	-343.2%	(83)	(442)	-81.3%
Profit before Tax	17,455	19,122	-8.7%	17,455	14,570	19.8%
Income (Tax)/Credit	(6,259)	(6,275)	-0.2%	(6,259)	(5,728)	9.3%
Profit for the period	11,195	12,847	-12.9%	11,195	8,842	26.6%

Other Key Inputs	Q1 2020	Q1 2019	y/y	Q1 2020	Q4 2019	q/q
Basic Earnings Per Share (N/s)	14.12	16.21	-12.9%	14.12	11.15	26.6%
EBITDA (N'm)	19,473	20,783	-6.3%	19,473	17,244	12.9%

Margins	Q1 2020	Q1 2019	y/y	Q1 2020	Q4 2019	q/q
Gross Margin	45.0%	44.3%	0.7ppts	45.0%	43.8%	1.2ppts
EBITDA Margin	27.7%	29.3%	-1.6ppts	27.7%	23.7%	4.0ppts
Operating Margin	24.9%	26.9%	-2.0ppts	24.9%	20.7%	4.3ppts
Net Margin	15.9%	18.1%	-2.2ppts	15.9%	12.2%	3.8ppts
Basic Outstanding Share	793	793		793	793	
Depreciation & Amortisation	1,935	1,695		1,935	2,232	

Source: Company Financials, FSDH Research

FSDH Forecast

Nm (unless otherwise stated)								
Income Statement	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Revenues	244,151	266,275	284,035	286,026	290,073	293,580	296,516	299,481
Cost of Sales	(143,280)	(152,354)	(155,888)	(157,314)	(162,441)	(164,405)	(166,049)	(167,709)
Gross Profit	100,871	113,920	128,147	128,712	127,632	129,175	130,467	131,771
Operating Expenses	(45,173)	(53,279)	(56,085)	(57,205)	(58,015)	(58,716)	(59,303)	(59,896)
Operating Profit	55,698	60,641	72,062	71,506	69,618	70,459	71,164	71,875
Other Income/(Loss)	-	-	-	-	-	-	-	-
EBIT	55,698	60,641	72,062	71,506	69,618	70,459	71,164	71,875
Net Finance (cost)/ income	(8,870)	(890)	(938)	(206)	380	507	699	1,204
PBT	46,829	59,751	71,124	71,301	69,998	70,966	71,863	73,079
Taxation	(13,105)	(16,743)	(25,441)	(24,955)	(20,999)	(21,290)	(21,559)	(21,924)
Net Profits	33,724	43,008	45,683	46,345	48,999	49,676	50,304	51,155
EPS, N	42.55	54.26	57.63	58.47	61.82	62.67	63.46	64.54
DPS, N	40.00	58.50	70.00	55.55	58.72	59.54	60.29	61.31
Dividend Sum	31,706	46,370	55,486	44,028	46,549	47,192	47,789	48,598

Balance Sheet	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Property, Plant & Equipment	72,378	73,366	79,394	83,031	86,197	90,288	93,782	96,671
Right of Use Assets	-	-	4,386	4,359	4,317	4,260	4,187	4,097
Long Term Receivables	1,921	2,237	2,557	2,574	2,611	2,642	2,669	2,695
Intangible Assets	-	-	-	-	-	-	-	-
Long Term Prepayments	234	3,997	-	-	-	-	-	-
Non-Current Assets	74,533	79,600	86,337	89,965	93,125	97,191	100,637	103,463
Inventories	23,910	23,124	33,279	36,182	32,488	32,881	29,889	26,833
Right of Return Assets	-	352	59	59	59	59	59	59
Trade Receivables	31,430	42,175	65,820	45,764	47,862	52,844	50,408	47,917
Contract Assets	-	93	-	-	-	-	-	-
Prepayments	1,791	1,228	902	3,432	2,901	2,936	2,372	2,096
Cash and Cash Equivalents	15,139	15,762	6,978	4,144	4,742	10,733	10,546	12,438
Current Assets	72,271	82,734	107,037	89,582	88,052	99,453	93,274	89,343
Total Assets	146,804	162,334	193,374	179,546	181,177	196,644	193,911	192,807

LIABILITIES								
Deferred Tax Liabilities	10,405	11,374	12,457	12,457	12,457	12,457	12,457	12,457
Employee Benefits	2,276	2,701	4,308	4,308	4,308	4,308	4,308	4,308
LT Loans and borrowings	9,565	5,921	5,516	1,158	1,158	3,862	3,089	2,317
Total Non-Current Liabilities	22,245	19,996	22,281	17,923	17,923	20,627	19,854	19,082
Trade & Other Payables	45,668	60,384	78,400	73,938	73,098	82,202	78,043	75,469
Contract Liabilities	3,387	3,859	5,974	5,974	5,974	5,974	5,974	5,974
Refund Liabilities	-	615	107	107	107	107	107	107
ST Loans & Borrowings	10,913	1,026	4,959	165	165	552	441	331
Current Tax Liabilities	15,099	23,630	31,801	31,801	31,801	31,801	31,801	31,801
Bank Overdraft	3,714	1,394	2,736	331	331	1,103	883	662
Provisions	899	1,209	1,558	1,430	1,450	1,468	1,483	1,497
Total Current Liabilities	79,680	92,118	125,535	113,747	112,928	123,208	118,732	115,842
Share Capital	396	396	396	396	396	396	396	396
Share Premium	32	32	32	32	32	32	32	32
Share Based Reserve	147	155	123	123	123	123	123	123
Retained Earnings	44,302	49,637	45,006	47,323	49,773	52,257	54,772	57,330
Shareholders' Funds	44,878	50,220	45,558	47,875	50,325	52,809	55,324	57,882
Total equity and liabilities	146,804	162,334	193,374	179,545	181,176	196,643	193,910	192,806

Cash Flow	2017	2018	2019	2020E	2021E	2022E	2023E	2024E
Operating Cash Flow	19,236	74,619	49,946	64,683	58,659	62,320	61,646	64,165
Investing Cash Flow	(2,433)	(10,984)	(12,329)	(11,105)	(11,182)	(11,895)	(12,058)	(11,910)
Financing Cash Flow	(56,574)	(60,691)	(47,743)	(56,412)	(46,880)	(44,434)	(49,775)	(50,363)
Free Cash Flow	68,816	24,259	46,173	33,527	45,088	42,996	45,951	45,856

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