

Subdued outlook on weak market growth and cost pressures

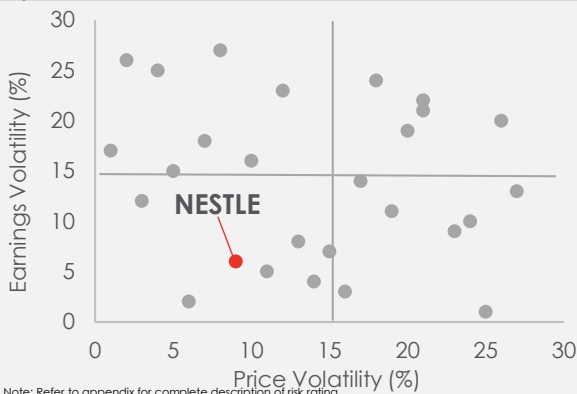
11th March, 2021

Research Analyst:

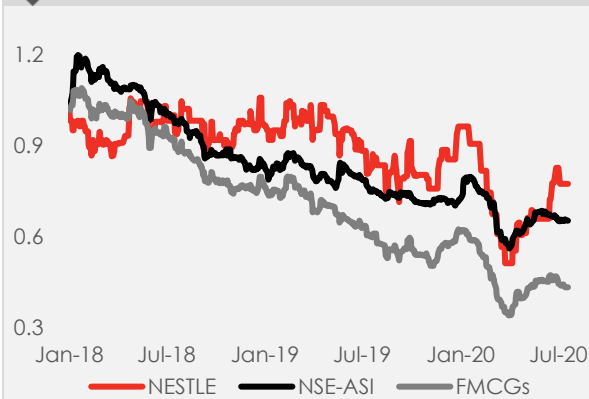
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Risk Rating: Low**Key Data**

Last Price (₦)	1,375.0
Last Price (\$)	3.3
52 week High/Low (₦)	1,505.0/ 750.0
1M Price Change (%)	-5.2
3M Price Change (%)	-1.8
6M Price Change (%)	+17.0
YTD Change (%)	-8.6%
Beta	0.81
Market Capitalization (₦'bn)	1,089.9
Market Capitalization (\$'mn)	2,658.3
Shares Outstanding. (Units'm)	792.7
Float (%)	33.8
Dividend Yield (%)	5.1

Price Performance Chart
Stock Rating
HOLD
Target Price
Old: N1,363.3
New: N1,322.9
Expected Return
-3.8%

Last week, Nestle Nigeria Plc (NESTLE) submitted its financial result for FY-2020. According to the report, Revenue grew marginally by 1.1% y/y to N287.1bn in FY-2020 from N284.0bn in FY-2019. However, the company faced some cost pressures during the year and saw Cost of Sales grow by 7.7% y/y. Overall, the pressure from input cost and higher Interest expense weighed on profitability as Profit before Tax (PBT) and Profit after Tax (PAT) declined 14.7% and 14.2% respectively. Following the new numbers, we update our forecasts and valuation with details in the report.

Beverage segment sustains expansion amidst weakness in Food:

In Nestle's FY-2020 scorecard, the company reported a 1.1% uptick in Revenue to N287.1bn from N284.0bn in FY-2019. The growth in Revenue was supported by sustained growth in Beverage products (up 6.9% y/y to N115.4bn), compensating for decline in the Food business revenue (down 2.5% y/y to N171.7bn). The Beverage business continues to be supported by growth in popular brands like Milo, Nescafe and its Premium water brand, Nestle Pure Life. Our market survey pointed out that despite recent price increases, the company's brands remain favoured among consumers. Although, we note other competitors also raised prices in line with the broad market, thus limiting the downtrading impact. However, the Food business remains a very competitive segment particularly in the bouillon cubes and Infant food business.

Supply chain disruptions pressure raw material cost:

In FY-2020, Cost of Sales grew faster than Revenue, up 7.7% y/y to N167.9bn from N155.9bn in FY-2019. The growth in Cost of Sales was driven by a surge in raw material costs (up 12.7% y/y), due to supply chain disruptions in the local market where Nestle sources most of its raw materials from. Thus, prices of key inputs like Maize, Wheat, Cassava and Sugar rose during the year. As a result, gross margin shrunk 359bps y/y to 41.5% in FY-2020 from 45.1% in FY-2019. Gross profit fell 7.0% y/y to N119.2bn in FY-2020 from N128.1bn in FY-2019.

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Operating expenses kept under control: Operating expenses declined 2.3% y/y to N54.8bn in FY-2020 from N56.1bn in FY-2019, reflecting attempts by the company to curtail costs amidst inflationary and Covid-19 induced pressures. The decline in Operating expenses was driven by lower Marketing & Distribution (down 4.8% y/y) expenses due to curtailed spending on Advertising as well as Sales Promotion. Despite the decline in Operating expenses, Operating profit fell 10.6% y/y to N64.4bn in FY-2020.

Increased leverage pressures profitability: In FY-2020, Nestle took on a new debt from its parent company, Nestle S.A. A loan of \$100.0m was approved for Nestle Nigeria of which \$71.2m has been drawn. The new loan will carry an interest rate of LIBOR+11.34% with a tenor of 7 years. As a result, Nestle's Total interest bearing liabilities increased 210.4% y/y to N41.0bn at the end of FY-2020. This fed into higher Finance cost (up 95.3% y/y to N4.4bn) while Finance income (down 51.3% y/y) declined despite stronger cash generation. Consequently, Net Interest expense surged 302.9% y/y to N3.8bn in FY-2020. This pressured profitability as Pre-Tax profit and Net income fell 14.7% y/y and 14.2% y/y to N60.6bn and N39.2bn in FY-2020.

Outlook subdued on tame market growth: Consumer pockets remain pressured as the economy continues the painful recovery from recession. Unemployment levels remain at record highs and food inflation continue to climb amidst pressure from energy costs. All these, amidst tight/shrinking incomes, is expected to continue to impact demand in the FMCG space. That said, we note Nestle's products have strong brand backing with a wide distribution coverage. In addition, most of the company's products are fairly inelastic given the retail appeal to the bottom of the pyramid segment of the market. Thus, we expect Revenue to sustain its uptrend as we forecast a 3.2% y/y growth in Revenue to N296.3bn in FY-2021e.

However, we expect cost to remain a concern in the coming year as raw material cost remain elevated reflected in surging food inflation. Local farmers have had to combat low yield triggered by increased flooding concerns while insecurity issues appear unabating. The option to explore international markets may be considered impossible considering the scarcity of FX as well as devaluation impact on naira cost of importing raw materials. Thus, we expect margins to tighten despite recent price increases. We forecast a 50bps decline in gross margin and consequently project Gross profit will grow slower than Revenue, up 1.9% y/y to N121.5bn. Overall, rebound in Opex growth and renewed Finance cost pressures emanating from financing floating-rate USD denominated loans (amidst rising US yields) are expected to pressure profitability. Thus, we forecast Pre-tax profit would decline 2.7% y/y to N59.0bn in FY-2020.

...Outlook clearly weak on shrinking consumer pockets and elevated cost pressures.

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Fairly priced...HOLD Rating maintained: Following downward revisions to our forecasts, we cut our target price for NESTLE slightly to N1,322.9/s from N1,363.3s previously. Our target price implies a 3.8% downside to current price of N1,375/s, and we consequently retain our HOLD recommendation on the stock.

...we revise our year-end Target Price to N1,322.9/share with a HOLD rating on the stock.

Food segment weakness, higher input cost weigh on earnings

Financial Highlights (N'Mn)

Financial Highlights (N'Mn)			
Headlines	FY - 2020	FY- 2019	Change
Revenue	287,084	284,035	1.1%
Cost of Sales	-167,873	-155,888	7.7%
Gross Income	119,211	128,147	-7.0%
Operating Expense	-54,793	-56,085	-2.3%
Operating Profit	64,419	72,062	-10.6%
Finance Income	647	1,329	-51.3%
Finance Costs	-4,427	-2,267	95.3%
Profit Before Tax	60,638	71,124	-14.7%
Taxation	-21,426	-25,441	-15.8%
Profit After Tax	39,212	45,683	-14.2%
	FY - 2020	FY - 2019	
Cash and Cash Equivalents	58,703	6,978	741.3%
Trade & Other Receivables	39,555	65,820	-39.9%
Trade & Other Payables	116,513	78,400	48.6%
Total Debt	41,014	13,211	210.4%
Total Assets	246,185	193,374	27.3%
Net Assets	29,297	45,558	-35.7%
Gross Margin	41.5%	45.1%	-3.6%
Cost to Sales	58.5%	54.9%	3.6%
Net Margin	13.7%	16.1%	-2.4%
Leverage (Debt/Equity)	140.0%	29.0%	111.0%
Leverage (Net Debt/Equity)	-60.4%	13.7%	-74.1%
Price(N)	1,375.0		
Trailing 12M EPS(N)	49.47		
BVPS(N)	37.0		
Trailing 12M P/E (x)	27.8		
P/BV (x)	37.2		
Trailing 12M ROAE	104.8%		
Proposed Final Dividend (N)	35.50		
Final Dividend Yield	2.6%		
Qualification Date	May 21, 2020		
Closure of Register	May 24-28, 2020 (both dates inclusive)		
Payment Date	June 23, 2020		

Disclosure Appendix

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Buy: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%). We consider this as the minimum return that may deserve our holding of a risk asset, like equity.

Hold: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at 31st December is greater zero but less than the Asymmetric Corridor around the MPR of the Central Bank of Nigeria (which is currently MPR – 500bps; i.e 9%).

Sell: Based on our valuation and subjective view (if any), the expected upside on the stock's close price as at December 31st is less than zero.

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Company	Disclosure
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Fidelity Bank Plc	h
Flour Mills of Nigeria Plc	h
Forte Oil Plc	g
International Breweries Plc	a,h
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