



## Nestle Nigeria Plc

---

**Resilient in Turbulent Times**

May 06, 2016

**Q1 Ended March 31, 2016**

## Executive Summary

- Nestle Nigeria Plc (Nestle) reported an impressive performance in Q1 2016 despite the difficult economic environment
- The diversified product mix of the company and aggressive customer-focused advertising improved its top-line performance
- Nestlé's cost management strategy coupled with the operational efficiency boosted the company's earnings in 2015
- Nestle benefitted from its focus on the core food segment
- The inclusion of Wyeth Nutritional Product in Nestlé's portfolio in 2015 has contributed to the growth in revenue
- Nestle has employed the use of local raw materials for use in its production process
- Innovation and renovation of existing products are ways by which Nestle has remained relevant
- We estimate a dividend per share of N36.36 for the FY 2016
- **Our fair value of the shares of Nestle is N839.76**
- **We place a BUY rating on the shares of Nestle at the current price of N690 per share.**

Table 1	
Rating:	BUY
Current Price	N690
Fair Value	N839.76
Price Target	N839.76
Horizon	One Year

## 1.0 Results Analysis

### 1.1 Q1 2016 Performance Analysis:

**Nestle Nigeria Plc (Nestle) reported an impressive performance in Q1 2016 despite the difficult economic environment.** The diversified product mix of the company and aggressive customer-focused advertising the company adopted improved the top-line performance. We also observed that the company was able to increase the prices of some of its products to compensate for the increase in inputs costs. The unaudited Q1 2016 result for the period ended March 2016 shows that Turnover (T/O) increased by 31.12% to N36.13bn compared with N27.56bn in 2015. The company's cost of sales increased by 19.40% to N18.35bn from N15.37bn in Q1 2015. The cost of sales as a percentage of T/O improved to 50.79% in Q1 2016 from 55.77% as at Q1 2015. The Gross Profit (GP) increased by 45.90% to N17.78bn in Q1 2016 from N12.19bn in Q1 2015. Nestlé's administrative, selling and distribution expenses increased by 33.86% to N8.75bn. These expenses as a percentage of turnover increased to 24.23% in Q1 2016 from 23.73% in Q1 2015. The cost saving measures of the company led to a growth in the operating profit or Earnings Before Interest and Tax (EBIT) by 59.84% to N9.03bn from N5.65bn.

*The turnover in Q1 2016 increased by 31.12% to N36.13bn.*

The company recorded a net financial charge of N300.17mn in Q1 2016, a decrease of 113.90% from N2.16bn in Q1 2015. The Profit Before Tax (PBT) grew to N8.73bn in Q1 2016, an increase of 150.23% from N3.49bn in Q1 2015. The growth was as a result of the drop in the interest expenses. The low interest rate in the market during the period helped to lower the interest expenses. The tax provision also increased by 283.71% to N2.04bn from N532.69mn. The Profit After Tax (PAT) was N6.68bn in Q1 2016, from N2.95bn in 2015, representing an increase of 126.16%. There was a significant increase in the company's profit margins in Q1 2016, compared with Q1 2015.

*The company's PBT & PAT increased in Q1 2016 compared with Q1 2015.*

The GP margin increased to 49.21% in Q1 2016 from 44.23% in Q1 2015 while the EBIT Margin increased to 24.98% from 20.49%. The PBT Margin in Q1 2016 increased over the Q1 2015 figure. The PBT margin significantly increased to 24.15%

in Q1 2016 from 12.65% as at Q1 2015. The PAT margin currently stands at 18.49% in Q1 2016, up from 10.72% in the corresponding period of 2015

**Table 2: Quarterly Result Highlights (N'bn)**

	Q1 2016	Q4 2015	Q3 2015	Q2 2015	Q1 2015
Turnover	36.13	43.29	42.06	38.37	27.56
PBT	8.73	8.51	10.21	7.12	3.49
PAT	6.68	6.50	8.35	5.93	2.95

*Source: Company Financial Statement– 2015 and FSDH Research Analysis*

**Table 3: Financial Performance (N'bn)**

	Q1 2016	Q1 2015	%Δ
T/O	36.13	27.56	31.12%
GP	17.78	12.19	45.90%
EBIT	9.03	5.65	59.84%
PBT	8.73	3.49	150.23%
PAT	6.68	2.95	126.16%
GP* Margin	49.21%	44.23%	4.99%
EBIT Margin	24.98%	20.49%	4.49%
PBT Margin	24.15%	12.65%	11.50%
PAT Margin	18.49%	10.72%	7.77%

*\*GP-Gross Profit. Source: Company Annual Account – 2015 and FSDH Research Analysis*

*Trade debtors decreased in Q1 2016 by 17.05% to N12.11bn, from N14.60bn in FY 2015.*

A cursory look at the balance sheet position as at Q1 2016 compared with FY December 2015 shows a marginal decrease in the company's fixed assets. The total fixed assets decreased by 1.90% to N69.16bn in Q1 2016 from N70.50bn in FY 2015. The inventory increased by 13.37% to N12.26bn in Q1 2016, from N10.81bn in FY 2015. The cash and bank balances increased by 115.40% from N12.93bn in FY 2015 to N27.85bn in Q1 2016. Trade debtors decreased in Q1 2016 by 17.05% to N12.11bn, from N14.60bn in FY 2015. **This may signify that there was at least a net cash inflow of about N2.49bn from payments previously owed by customers for goods sold on credit.** The company's trade payables also decreased by 4.09% in Q1 2016 to N8.86bn from N9.24bn as at FY 2015. The working capital stood at a negative N2.15bn in Q1 2016 from a negative N11.02bn in FY 2015, while net assets

for the period increased by 17.88% to stand at N44.80bn in Q1 2016, from N38.01bn as at FY 2015.

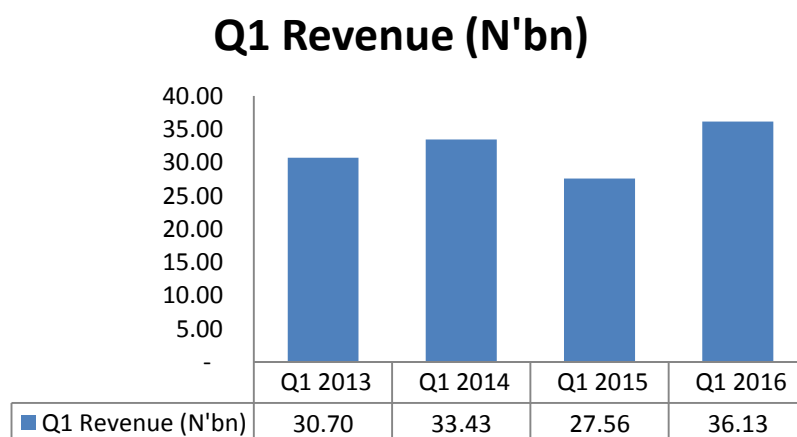
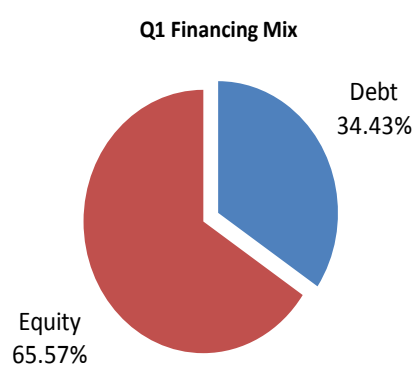
**The total assets of the company which stood at N130.13bn as at Q1 2016 was financed by a mix of equities and liabilities in the ratio of 34.43% and 65.57% respectively.** Our analysis of the liabilities shows that the short-term liabilities stood at N63.12bn, accounting for 73.97% of the total liabilities. The short-term liabilities constituted mainly of trade and other payables and short-term loans and borrowings. Short-term loans and borrowings dropped by 1.54% to stand at N16.84bn in Q1 2016. The company's long-term liabilities stood at N22.21bn accounting for 26.03% of the total liabilities. Long-term liabilities constituted mainly of long term loans and borrowings and deferred tax liabilities, which stood at N12.58bn and N7.22bn respectively in Q1 2016.

Our analysis of the cash flow statement in Q1 2016 shows that Nestle generated a net increase in cash and cash equivalents of N15.23bn. The major contributor to the net cash generated was from the net cash generated from operating activities of N15.64bn. The cash profit generated during the period stood at N10.89bn and it is proportionally higher than the cash profit generated in FY 2015. The ratio of the cash profit to turnover increased to 30.13% in Q1 2016 from 26.94% in FY 2015. This means that more sales translated to higher cash profit in Q1 2016 than in FY 2015.

*The company's assets were financed by a mix of equities and liabilities in the ratio of 34.43% and 65.57% respectively.*

*The short-term liabilities constituted mainly of trade and other payables and short-term loans and borrowings.*

*The cash profit generated during the period stood at N10.89bn and it is proportionally higher than the cash profit generated in FY 2015.*



## 1.2 FY 2015 Performance Analysis:

**Nestle Nigeria Plc (Nestle) reported a positive result in FY 2015 despite the harsh macro-economic environment. Its cost management strategy coupled with its strategic investment in key brands boosted the company's earnings in 2015.** The audited Financial Year (FY) 2015 result for Nestlé Nigeria Plc (Nestlé) shows that its Turnover (T/O) increased by 5.54% to N151.27bn, compared with N143.33bn recorded in the corresponding period of 2014. The cost of sales also increased by 2.23% to N83.93bn from N82.10bn recorded in FY 2014. This led to a fall in the cost of sales as a percentage of turnover to 55.48% in FY 2015 from 57.28% as at FY 2014. The company's administrative, selling and distribution expenses increased by 4.90% to N33.60bn in FY 2015. These expenses as a percentage of turnover decreased marginally to 22.21% in FY 2015 from 22.35% in FY 2014. The company's operating profit (EBIT) appreciated by 15.57% from N29.20bn in FY 2014 to N33.75bn in FY 2015. This improvement revealed the company's efforts to curb costs whilst driving its top line performance.

*FY 2015 T/O increased by 5.54% to N151.27bn, compared with N143.33bn.*

The investment income stood at N443.81mn as at FY 2014, representing a decrease of 19.54%, compared with N551.59mn recorded in the corresponding period. The company recorded a decrease of 8.24% in its finance cost to N4.87bn in FY 2015 from N5.31bn in FY 2014. This decrease was largely due to a substantial reduction in the net foreign exchange loss, which stood at N1.76bn in FY 2015 from N3.04bn in FY 2014.

The Profit Before Tax (PBT) grew to N29.32bn in FY 2015, an increase of 19.95% from N24.45bn recorded in the corresponding period of 2014. This significant growth was due to the company's effective management of its cost and finance costs, which allowed revenue to trickle-down to PBT. The tax provision increased by 152.71% to N5.59bn from N2.21bn. The increase in the tax provision was due to the unrecognised tax credits and reversals of temporary differences earlier accounted for in the year 2014. Profit After Tax (PAT) stood at N23.74bn in FY 2015 from N22.24bn in the corresponding period of 2014, representing an increase of 6.75%.

**In our view, Nestle Nigerian has managed to stay afloat of the current macro-economic challenges in the country. The company is managing cost effectively and has increased its market share by the introduction of new products into the market.**

*The company surpassed its previous year's PBT and PAT performance in FY 2015.*

Gross profit margin improved from 42.72% in 2014 to 44.52% in 2015. This showed that the company was able to manage its cost of sales more effectively. Also the company's EBIT margin grew from 20.37% in FY 2014 to 22.31% in FY 2015. This also means it was able to manage its operating expenses better than the previous year. The gain in finance cost translated to a better PBT margin during the year. Nestlé's PBT Margin in FY 2015 increased over its FY 2014 figure. The PBT margin increased to 19.38% in FY 2015 from 17.06% as at FY 2014. Also, the PAT margin increased to 15.69% in FY 2015 from 15.51% in the corresponding period of 2014.

*The company's profit margins increased in FY 2015 compared to FY 2014.*

**Table 4: Profitability Analysis (N'bn)**

	FY 2015	FY 2014	FY 2013	FY 2012
T/O	151.27	143.33	133.08	116.71
EBIT	33.75	29.20	27.83	25.99
PBT	29.32	24.45	26.05	25.05
PAT	23.74	22.24	22.26	21.14
GP* Margin	44.52%	42.72%	42.67%	42.99%
EBIT Margin	22.31%	20.37%	20.91%	22.27%
PBT Margin	19.38%	17.06%	19.57%	21.46%
PAT Margin	15.69%	15.51%	16.72%	18.11%

**Source: Company Annual Account – 2015 and FSDH Research Analysis**

*The gain in finance cost translated to a better PBT margin during the year.*

**The company has benefited significantly from its focus on the food segment within the Nigerian economy.** An analysis of Nestlé's revenues shows that its food segment contributed 59.75% to the company's revenue in 2015. The beverage segment contributed 40.25% to the revenue. Its growth in the food segment is supported by the growing food processing sector of the economy. This is evident by the 7.82% increase in the sales of its food products. In the beverage segment there was a slight improvement in the sale of its products by 2.34% despite the difficult macroeconomic environment and the weak purchasing power of the consumers.

Going forward we expect the company to continue with its strategy of focusing on its food products (especially its baby food and Wyeth Nutrition brands). This is because it produces a higher profit margin of 25.27% as against 18.41% profit margin recorded in the beverage segment of the company.

**Table 5: Revenue Analysis (N'bn)**

Segment	FY 2015	Proportion FY 2015	FY 2014	Proportion FY 2014	Change (YoY)
Food	90.38	59.75%	83.83	58.49%	7.82%
Beverages	60.89	40.25%	59.50	41.51%	2.34%
Total	151.27	100.00%	143.33	100.00%	5.54%

*Source: Company Annual Account – 2015 and FSDH Research Analysis*

**Table 6: Segment Profitability Analysis (N'bn)**

Segment	FY 2015	Proportion FY 2015	FY 2014	Proportion FY 2014	Change (YoY)
Food	22.84	77.89%	16.68	68.23%	36.92%
Beverages	11.21	38.24%	8.02	32.79%	39.87%
Unallocated	-4.73	-16.12%	-0.25	-1.02%	1792.87%
Total	29.32	100.00%	24.45	100.00%	19.95%

*Source: Company Annual Account – 2015 and FSDH Research Analysis*

*Food produced a profit margin of 25.27% as against the 18.41% profit margin of beverages.*

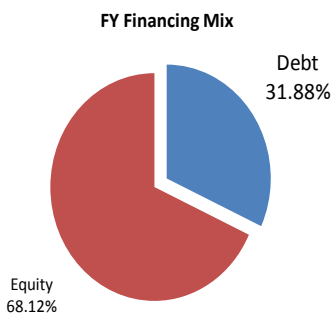
A cursory look at the balance sheet position as at FY 2015 compared with the position as at FY 2014 shows an increase in the company's fixed assets. The total fixed assets increased by 2.66% to N70.50bn in FY 2015 from N68.67bn in FY 2014. The inventory decreased by 1.30% to N10.81bn from N10.96bn in FY 2014. The cash and bank balances recorded an increase of 249.02% from N3.70bn in FY 2014 to N12.93bn in FY 2015. The trade debtors decreased in FY 2015 by 13.17% to N14.60bn from N16.82bn in the FY 2014 period.

The trade creditors decreased by 30.03% to N9.24bn from N13.21bn as at FY 2014. The working capital stood at a negative N11.02bn in FY 2015 from a negative N7.25bn recorded in FY 2014. Its Net assets for the period increased by 5.75% to stand at N38bn in FY 2015 from N35.94bn as at FY 2014.

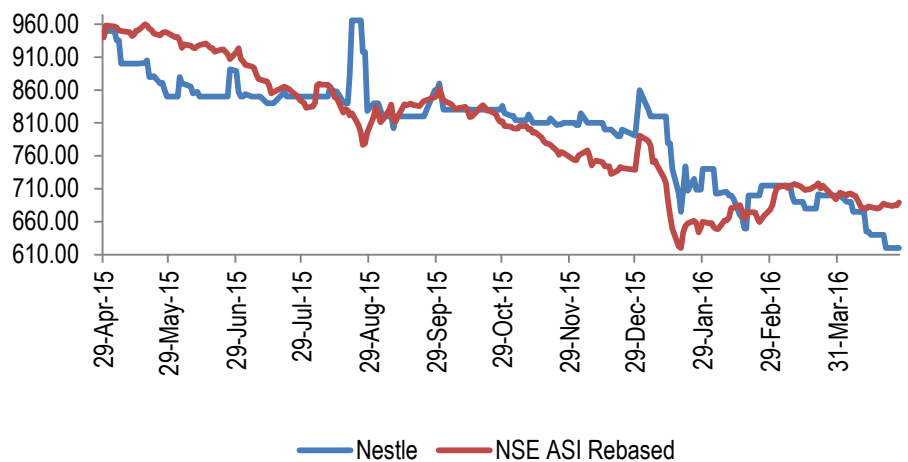


*The total assets of the company which stood at N119.22bn as at FY 2015 were financed by a mix of equities and liabilities in the ratio of 68.12% and 31.88% respectively.*

The total assets of the company which stood at N119.22bn as at FY 2015 were financed by a mix of equities and liabilities in the ratio of 68.12% and 31.88% respectively. Our analysis of the liabilities shows that the short-term liabilities stood at N59.73bn, accounting for 73.55% of the total liabilities, while the long-term liabilities stood at N21.48bn accounting for 26.45% of the total liabilities. The long-term liabilities constituted mainly of long-term debt, which stood at N12.53bn. The short-term liabilities constituted mainly of other creditors and accruals, which stood at N27.42bn in FY 2015.



Nestle VS NSE ASI Rebased (April'15-April'16)



## 2.0 Analysis of the Statement of Cash Flows:

*Nestle Nigeria generated a net increase cash flow of N12.62bn in the year 2015, an improvement over the net increase cash flow of N2.47bn it generated in 2014.*

**Nestle Nigeria generated a net increase cash flow of N12.62bn in the year 2015, an improvement over the net increase cash flow of N2.47bn it generated in 2014.**

The cash profit generated from the core operation increased to N40.75bn in 2015 from N35.59bn in 2014. The ratio of the cash profit generated from core operation to the company's revenue increased to 26.94% in 2015 from 24.83% in 2014. This is positive as more of Nestlé's revenue translated into cash profit in 2015 than in 2014.

The cash generated from operating activities increased from N26.03bn in 2014 to N42.91bn in 2015 while the net cash generated after tax increased from N23.50bn to N39.88bn. The net cash generated from the operating activities was more than sufficient to cover the company's investment need for property, plant and equipment. The net cash generated from investing activities could cover the dividend payment and repayment of loans leaving a shortfall of N499.60mn. The loans proceeds of N13.5bn were more than enough to upset the shortfall.

<b>Table 7: Cash flow Analysis (N'bn)</b>	<b>2015</b>	<b>2014</b>
<b>Cash Profits from Core Activities</b>	40.75	35.59
<b>Changes in Working Capital</b>	2.16	(9.57)
<b>Cash from Operating Activities</b>	42.91	26.03
<b>Income Tax Paid</b>	(2.73)	(2.35)
<b>Net Cash From Operating</b>	39.88	23.50
<b>Net Cash Used In Investing Activities</b>	(7.23)	(7.26)
<b>Net Cash Used in Financing Activities</b>	(22.49)	(27.48)
<b>Cash Generated for the Year</b>	12.62	2.47
<b>Ratio of Cash Profit from Core Operations to Revenue</b>	26.94%	24.83%
<b>Ratio of Net Cash from Operation to PPE Investment</b>	516.12%	300.64%
<b>Source: Company Annual Account – 2015 and FSDH Research Analysis</b>		

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

### 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. Using the DuPont analysis, we attributed the growth in the ROE to the increase in the company's profit margin. Its cost management initiatives and improvement in sales were primarily responsible for the increased margin. The asset turnover however dropped to 1.27% in 2015 compared to 1.35% in 2014.

The equity multiplier increased to 3.14 from 2.95, indicating that a larger portion of its assets is being financed through debt as opposed to the previous year.

		<b>2015</b>	<b>2014</b>
<b>Profitability</b>	PAT	23.74	22.24
	Turnover	151.27	143.33
	Profit Margin	<b>15.69</b>	<b>15.51</b>
<b>Operating Efficiency</b>	Turnover	151.27	143.33
	Total Assets	119.22	106.06
	Asset Turnover	<b>1.27</b>	<b>1.35</b>
<b>Financial Leverage</b>	Total Assets	119.22	106.06
	Equity	38.01	35.94
	Equity Multiplier	<b>3.14</b>	<b>2.95</b>
<b>Return on Equity (ROE)</b>		<b>62.45%</b>	<b>61.87%</b>

*Source: Company Annual Account – 2015 and FSDH Research Analysis*

#### 4.0 Drivers of Performance:

The following factors affected the earnings of Nestlé's:

##### Positive Factors:

- Diversified product portfolio which are essential for healthy living
- Its backward integration strategy to secure raw materials locally by partnering with farmers to provide quality raw materials
- Investments in plants upgrade to produce products more efficiently
- Cost cutting initiatives and enhanced operational efficiency
- Reliance on expertise of specialists in its numerous global related companies to boost innovation and production
- Introduction of Wyeth Nutrition products into the market.

##### Negative Factors:

- The weak consumer spending power
- Difficult operating environment
- The weak foreign exchange rate
- The security challenges in the country.

#### 4.1 Strategic Focus:

**Nestlé expects to continue its cash management strategy whilst maintaining its focus on its food industry in order to drive sales. The company continues to market its products as nutritiously viable and focus on investing in selected key brands that are popular amongst consumers.** Nestle also focuses on enhancing lives with science-based nutrition and health solutions for all stages of life. It also provides a range of foods and confectionaries for all family members.

Nestlé focuses on effective consumer engagement through targeted research and implements effective innovation and renovation of its products in the market. In order to overcome the prevailing foreign exchange issues plaguing the Nigerian economy the company has adopted the use of local raw materials as substitutes in the manufacture of its goods. This inclusion in its production processes involves the use of locally made soya beans, cocoa, palm oil and sorghum in a number of its products.

*Nestle has adopted local substitution strategy in sourcing some of its raw materials.*

*Nestlé's recently opened a new manufacturing plant in Abaji, Nigeria to supplement its existing water plant in Agbara Ogun State.*

Thus enabling the company to reduce its costs and ultimately remain more operationally efficient going forward. It has also restructured its employee portfolio with a focus on recruiting sales and supply chain specialists, whilst lowering its administrative staff. It also maintained its current production personnel at its previous level to optimize productivity. Nestlé recently opened a new manufacturing plant in Abaji (14.6-hectare site), the Abuja Federal Capital Territory in Nigeria to supplement its existing water plant in Agbara, Ogun State. The plant is a N5.6bn investment and will continue to produce Nestlé Pure Life water. It will be Nestlé Waters' second and most modern water processing facility in Central and West Africa. The aim is to support future demand and growth in the northern and western regions of Nigeria. This facility will also host a Technical Training Centre to develop young engineers' skills.

*In FY 2015, the Nigerian market contributed 97.98% to the turnover of the company, while Niger, Senegal, Togo, Ghana, Guinea and others contributed the remaining 2.02%.*

## 5.0 Business:

Nestlé manufactures and markets a range of high quality brands: Infant Cereals - Nestlé Nutrend, NAN Lactogen and Nestlé Cerelac; Family Cereals-Nestlé, and Golden Morn; Beverage Drink - Nestlé Milo; Confectionary- Nestlé Chocomilo, Chocolim cube; Nestlé Kitkat Bullion- Maggi cube, Maggi Chicken, Maggi Crayfish, Maggi Mix'PY, and Nestlé Pure Life table water. Nestlé also markets Coffee - Nescafe Classic Coffee, Nescafe 3-in-1 Coffee and Nescafe breakfast, as well as Nestlé's Full Cream Milk product- Nestlé Nido and Nido Essentia. Globally, Nestlé companies are organized into regional groupings to leverage expertise and the size of the company. In the case of Nigeria, the company 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 2015, Nigerian market contributed 97.98% to the turnover of the company, while Niger, Senegal, Togo, Ghana, Guinea and others contributed the remaining 2.02%.

*Nearly all of the company's key ingredients for products which are manufactured in Nigeria are sourced locally through farmers and suppliers where available.*

**On a continuing basis, to stimulate industrial growth, the company is committed to long-term sustainable business practices.** Nearly all of the company's key ingredients for products which are manufactured in Nigeria are sourced locally through farmers and suppliers where available.

As part of this policy, it has successfully introduced the use of locally produced items such as soya bean, maize, cocoa, palm oil and sorghum in a number of its products. Also, the company has successfully substituted imported corn starch with locally produced cassava starch.

**Table 9: Directors' Shareholding as at December 31, 2015**

Director	Position	Holdings
Mr. David Ifezulike	Chairman	56,255
Mr. Dharnesh Gordhon	MD/CEO	Nil
Mr. Syed Saiful Islam	Executive	1,100
Mrs. Iquo Ukoh*	Executive	37,500
Mr. Giuseppe Bonanno	Non-Executive	Nil
Mr. Kais Marzouki	Non-Executive	Nil
Mr. Gbenga Oyebode	Non-Executive	Nil
Mrs. Ndidi Okonkwo Nwuneli	Non-Executive	Nil

*Source: Company Annual Account – 2015 and FSDH Research Analysis*

*\*Resigned March 15, 2016*

**Table 10: Shareholding Structure as at December 31, 2015**

Name	No. Of Ordinary Shares	% of Shareholding
Nestlé S.A., Switzerland	503,177,098	63.48%
Others	289,479,154	36.52%
<b>Total Number of Shares</b>	<b>792,656,252</b>	<b>100.00%</b>

*Source: Company Annual Account – 2015 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)	546,932,813,880.00
NSE Capitalization (NGN)	8,793,467,152,330.56
% of NSE Capitalization	6.22%
52 Week high NGN	965.98
52 Week low NGN	615.26
YTD Return (%)	-16.57%
52 Weeks Average Volume Traded	6,347,278
Trailing EPS NGN	34.65
Trailing P/E Ratio (X)	19.91

*\*As at 05 May, 2016. Source: Company Annual Account – 2015 and FSDH Research Analysis*

## 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 products segment contributed 59.75% to the company's revenue in FY 2015, compared with the contribution of 40.25% by the beverages range.

### 6.1 Food Products:

The company engages in the production and sale of Maggi, Cerelac, Nutrend, NAN, Lactogen, Golden Morn and Golden Morn Millet. The introduction of Wyeth Nutrition products in Nestle portfolio in 2015 has increased its market share. Products in this category compete with a lot of imported food products in the market. 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: Gerber baby food, Cow&gate baby food, BeechNut baby food, Unilever's Knorr and Royco Cubes.

### 6.2 Beverages:

This includes the production and sale of Milo, Chocomilo, Nido, Nescafe, Nestlé Pure Life (water) and Nestlé Pure Life water fortified with zinc. Some of the other competing products in the market are Bournvita, Ovaltine, Eva Water, Cway water, Swan Water, Peak Milk, Cowbell Milk, RichChocó, etc.

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



## 7.0 SWOT Analysis:

<p><b>7.1 Strengths:</b></p> <ul style="list-style-type: none"> <li>○ Strong brand name</li> <li>○ Quality products in the market</li> <li>○ Technical partnership with parent company</li> <li>○ Securing raw materials via backward integration</li> <li>○ Consistent dividend payment</li> <li>○ Energy efficient production process</li> <li>○ Diversified products.</li> </ul>	<p><b>7.2 Weaknesses:</b></p> <ul style="list-style-type: none"> <li>○ Declining growth in revenue.</li> <li>○ High finance costs.</li> </ul>
<p><b>7.3 Opportunities:</b></p> <ul style="list-style-type: none"> <li>○ Large market size in Nigeria</li> <li>○ Government local substitution strategy</li> <li>○ Improvement in products regulations and enforcements</li> <li>○ Existing taste and preference for products by consumers.</li> </ul>	<p><b>7.4 Threats:</b></p> <ul style="list-style-type: none"> <li>○ Security challenges in the Northern region</li> <li>○ Poor road infrastructure in the country</li> <li>○ Stiff competition in the industry</li> <li>○ Weak foreign exchange market</li> <li>○ Weak purchasing power of consumers.</li> </ul>

*We estimate a total dividend of N36.36 Kobo per share in FY 2016.*

## 8.0 Forecast:

### Our Forecast Drivers

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

#### Positive Factors:

- Focus strategy on food segment of the Nigerian economy
- Cost management initiatives
- Growing demand for food and beverages in Nigeria
- Focus on investment in key brands
- Investment and innovation in plants, which should improve efficiency
- Technical partnership with the parent and related companies
- Large market size in Nigeria and stable growing population
- Strong demand for product at all levels
- Existing taste and preference for products by consumers.

#### Negative Factors:

- The prevailing stiff competition in the industry
- The current weak consumer spending power
- Security challenges in some parts of Nigeria
- Expected further depreciation in the Naira.

*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 N176.64bn, N208.90bn, N253.33bn, N305.18bn and N358.49bn for the periods ending December 2016, 2017, 2018, 2019 and 2020. We estimate EBIT of N44.41bn, N54.82bn, N67.34bn, N81.34bn and N96.01bn, and EBITDA of N51.20bn, N62.64bn, N76.47bn, N92.12bn and N108.93bn for the same period using EBIT margins of 25.14%, 26.24%, 26.58%, 26.65% and 26.78% respectively. Our PBT forecasts for the periods are: N45.58bn, N57.63bn, N71.20bn, N86.43bn and N102.47bn. Adjusting for tax, our PAT forecasts are N31.90bn, N40.34bn, N49.84bn, N60.50bn and N71.73bn. PAT Margin for the period are 18.06%, 19.31%, 19.67%, 19.82% and 20.01%. Our forecast final dividend for the FY 2016 is N36.36 per share.

=N='bn	DecA-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
Turnover (Net Sales)	151.27	176.64	208.90	253.33	305.18	358.49
Cost of Sales	(83.93)	(95.88)	(111.30)	(134.47)	(161.99)	(189.57)
Gross Profit	67.35	80.76	97.60	118.86	143.19	168.92
Admin, Selling & Distribution Expenses	(27.67)	(29.56)	(34.96)	(42.39)	(51.07)	(59.99)
Depreciation	5.93	(6.79)	(7.82)	(9.13)	(10.78)	(12.92)
EBIT	33.75	44.41	54.82	67.34	81.34	96.01
EBITDA	39.68	51.20	62.64	76.47	92.12	108.93
Net Finance Cost	(4.42)	1.16	2.81	3.86	5.09	6.46
PBT	29.32	45.58	57.63	71.20	86.43	102.47
Taxation	(5.59)	(13.67)	(17.29)	(21.36)	(25.93)	(30.74)
PAT	23.74	31.90	40.34	49.84	60.50	71.73

Source: Company Annual Account – 2015 and FSDH Research Analysis

	DecA-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
EBITDA Margin	26.23%	28.99%	29.99%	30.19%	30.19%	30.39%
EBIT Margin	22.31%	25.14%	26.24%	26.58%	26.65%	26.78%
PBT Margin	19.38%	25.80%	27.59%	28.10%	28.32%	28.58%
PAT Margin	15.69%	18.06%	19.31%	19.67%	19.82%	20.01%
EPS(N)	29.95	40.25	50.89	62.88	76.32	90.49
DPS(N)	29.00	36.36	45.98	56.80	68.95	81.75
Dividend Pay-out	96.84%	90.34%	90.34%	90.34%	90.34%	90.34%
Earnings Yield *	3.57%	4.79%	6.06%	7.49%	9.09%	10.78%
Dividend Yield *	3.45%	4.33%	5.48%	6.76%	8.21%	9.74%
P/E Ratio*	28.72	20.86	16.50	13.36	11.00	9.28
Number of Shares ('bn)	0.79	0.79	0.79	0.79	0.79	0.79
ROE	62.45%	67.99%	69.03%	69.38%	69.29%	68.72%
Inventory Turnover	7.76	7.71	7.71	7.71	7.71	7.71

\*At Our Fair Value of N839.76 Source: Company Annual Account – 2015 and FSDH Research Analysis

Table 14: Statement of Financial Position Forecast (2015 - 2020)

N'bn	Dec-A15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20
<b>Fixed Assets</b>	69.15	69.57	70.11	70.70	71.36	72.07
Long Term receivables	1.35	1.35	1.35	1.35	1.35	1.35
<b>Long Term Assets</b>	<b>70.50</b>	<b>70.92</b>	<b>71.46</b>	<b>72.06</b>	<b>72.71</b>	<b>73.43</b>
<b>Stock (inventory)</b>	10.81	12.44	14.44	17.44	21.01	24.59
<b>Trade Debtors</b>	14.60	17.05	20.17	24.46	29.46	34.61
<b>Deposits/Balances &amp; Cash</b>	12.93	26.29	38.01	52.10	68.78	87.27
<b>Other Debtors &amp; Prepayment</b>	9.84	12.11	14.32	17.36	20.92	24.57
<b>Current Assets</b>	<b>48.71</b>	<b>67.88</b>	<b>86.93</b>	<b>111.36</b>	<b>140.17</b>	<b>171.03</b>
<b>Total Assets</b>	<b>119.22</b>	<b>138.80</b>	<b>158.39</b>	<b>183.42</b>	<b>212.88</b>	<b>244.46</b>
<b>Trade Creditors</b>	9.24	10.56	12.26	14.81	17.84	20.87
<b>Bank Overdraft</b>	305.024	-	-	-	-	-
<b>Current tax liabilities</b>	5.04	13.67	17.29	21.36	25.93	30.74
<b>Short Term Loans and Advances</b>	17.11	-	-	-	-	-
<b>Other Creditors &amp; Accruals</b>	28.04	32.74	38.72	46.95	56.56	66.44
<b>Current Liabilities</b>	<b>59.73</b>	<b>80.44</b>	<b>87.59</b>	<b>98.18</b>	<b>110.99</b>	<b>124.27</b>
<b>Working Capital/ Net Current Asset</b>	<b>(11.02)</b>	<b>(12.56)</b>	<b>(0.66)</b>	<b>13.18</b>	<b>29.17</b>	<b>46.76</b>
<b>Capital Employed</b>	<b>59.48</b>	<b>58.36</b>	<b>70.80</b>	<b>85.24</b>	<b>101.88</b>	<b>120.19</b>
<b>Deferred Taxation</b>	6.56	7.94	7.94	7.94	7.94	7.94
<b>Long Term Debt</b>	12.53	-	-	-	-	-
<b>Staff gratuity &amp; long service awards</b>	2.38	3.50	4.42	5.47	6.63	7.87
<b>Long Term Liabilities</b>	<b>21.48</b>	<b>11.44</b>	<b>12.36</b>	<b>13.40</b>	<b>14.57</b>	<b>15.80</b>
<b>Total Liabilities</b>	<b>81.21</b>	<b>91.88</b>	<b>99.95</b>	<b>111.58</b>	<b>125.57</b>	<b>140.07</b>
<b>Total Net Assets</b>	<b>38.01</b>	<b>46.92</b>	<b>58.44</b>	<b>71.84</b>	<b>87.31</b>	<b>104.39</b>
<b>Paid up share capital</b>	0.40	0.40	0.40	0.40	0.40	0.40
<b>Share premium a/c</b>	0.03	0.03	0.03	0.03	0.03	0.03
<b>Share Based Payment Reserves</b>	0.15	0.15	0.15	0.15	0.15	0.15
<b>Retained Earnings</b>	<b>37.43</b>	<b>46.34</b>	<b>57.86</b>	<b>71.26</b>	<b>86.73</b>	<b>103.81</b>
<b>Total Equity</b>	<b>38.01</b>	<b>46.92</b>	<b>58.44</b>	<b>71.84</b>	<b>87.31</b>	<b>104.39</b>
<b>Total Equity &amp; Liability</b>	<b>119.22</b>	<b>138.80</b>	<b>158.39</b>	<b>183.42</b>	<b>212.88</b>	<b>244.46</b>

Source: Company Annual Account – 2015 and FSDH Research Analysis

## 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: 13.34x (Weighted Average Multiple – Aswath Damodaran)
- Debt: N29.94bn
- Cash: N12.93bn
- Number of shares in issue: 792.66mn

**Applying the EV/EBITDA multiple of 13.34x, we arrived at N839.76 per share as our fair value.**

**The current market value of Nestle share is N690, the highest and the lowest closing prices in the last 52 weeks are N965.98 and N640.01 respectively. The forward earnings yield and dividend yield of the company at our fair value are 4.79% and 4.33% respectively. The capital appreciation for the stock of Nestle Nigeria Plc shows an upward potential of 21.70%. This is higher than our minimum equity return benchmark of 16.65%. We therefore place a BUY rating on the shares of Nestle Nigeria Plc at the price of N690 as of May 05, 2016. Our target price for the shares of Nestle in the next one year is N839.76.**

*Our fair value for Nestle is N839.76.*

## 9.1 Risks to Price Target:

The following risks may affect the attainment of our target price:

- Increase in the yield on fixed income securities
- Drop in market liquidity
- Issuance of new equity
- Reduction in dividend payment

Company	Nestle	Flour Mills**	Honeywell*
Turnover	151.27	308.76	55.08
Gross Profit	67.35	35.37	10.46
EBIT	33.75	10.22	5.44
PBT	29.32	7.72	4.24
PAT	23.74	8.47	3.35
GP Margin	44.52%	11.45%	18.98%
EBIT Margin	22.31%	3.31%	9.87%
PBT Margin	19.38%	2.50%	7.69%
PAT Margin	15.69%	2.74%	6.08%
ROE	62.45%	9.69%	16.27%
Net Assets (N)	38.01	87.41	20.61
Net Assets Per Share (N)	47.95	33.31	2.60

*\*Honeywell's Year End is May \*\*Flour Mill's Year End is March and has an exceptional Item of N14.29bn*  
Source: Company Annual Account – 2015 and FSDH Research Analysis

Rating	Criteria
BUY	Fair value of the stock is $\geq$ 16.65%* compared with the current market price.
HOLD	Fair value of the stock ranges between -10% and 16.65% of the current market price.
SELL	Fair value of the stock is > 10% below the current market price.

*\*16.65% 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.

## For enquiries please contact us at our offices:

**Lagos Office:** 5th-8th floors UAC House, 1/5 Odunlami Street Lagos. Tel: 234-1-2702881-2

**Port Harcourt Office:** Mainstreet Bank Building, 2nd floor, 5 Trans Amadi Road, Port Harcourt. Tel: 234-802 408 1331.

**Abuja Office:** Leadway House (Ground Floor), Plot 1061 Herbert Macaulay Way, Central Business District, Abuja-Nigeria. Tel: 234-9-2918821

**Website:** [www.fsdhgroup.com](http://www.fsdhgroup.com)      **Email:** [research@fsdhgroup.com](mailto:research@fsdhgroup.com)

**Our Reports and Prices are also Available on Bloomberg {FSDH<GO>}**

### **Disclaimer Policy**

*This publication is produced by FSDH Merchant Bank Limited solely for the information of users who are expected to make their own investment decisions without undue reliance on any information or opinions contained herein. The opinions contained in the report should not be interpreted as an offer to sell, or a solicitation of any offer to buy any investment. FSDH Merchant Bank Limited may invest substantially in securities of companies using information contained herein and may also perform or seek to perform investment services for companies mentioned herein. Whilst every care has been taken in preparing this document, no responsibility or liability is accepted by any member of FSDH Merchant Bank Limited for actions taken as a result of Information provided in this publication.*