

Earnings Weakened by Increase in OPEX

Topline Contracts for the First Time in Fifteen Quarters

In its Q1:2020 financial scorecard, NESTLE recorded a marginal contraction in revenue (-0.90%) to NGN70.33bn from NGN70.97bn in the corresponding quarter of 2019. This is the first time the food producer would record a slow-down in sales in its Q1 top-line performance since Q1:2015. Despite a 1.81% growth in export sales, overall revenue suffered a decline on the back of a drop in domestic sales (-1.29%) to NGN69.05bn from NGN69.95bn in Q1:2019. The muted performance recorded during the period mirrors the trend witnessed in the first three quarters of the previous year, as weak consumer purchasing power weighed considerably on top-line. **While there are no indications of a potential improvement in disposable income in the near term, we anticipate a turnaround in top-line performance hinged on increased demand for food and essential commodities in the face of the COVID-19 pandemic. Against this premise, we project a 7.28% growth in 2020FY revenue to NGN304.71bn from NGN284.04bn in 2019FY.**

Slight Moderation in Direct Costs Support Gross Margin

The decline in cost of sales (-2.09%) outpaced the fall-off in revenue (-0.90%), giving rise to a slight moderation in cost to sales to 54.99% from 55.66% in Q1:2019. As a result, gross margin pegged higher at 45.01%, up from 44.34% in the corresponding period. Operating expenses, however, turned a corner, climbing by +14.03% to NGN14.12bn (vs. NGN12.38bn in Q1:2019). The expansion in OPEX stemmed from increased spending on both marketing & distribution expenses (+6.47% YoY to NGN11.04bn) and administrative expenses (+53.07% YoY to NGN3.08bn) during the period. The increase in OPEX, consequently, wiped out the gains recorded on direct costs, resulting in an 8.12% decline in operating profit to NGN17.54bn. Operating margin, thus, moderated to 24.94% from 26.90% in Q1:2019.

Finance costs pegged lower at NGN417.93mn (vs. NGN469.35mn in Q1:2019) as interest bearing liabilities fell from NGN13.21bn as at 2019FY to NGN1.05bn in Q1:2019. Finance income also declined by 50.34% to NGN335.24mn. PBT, thus came in at NGN17.45bn, an 8.71% decline from Q1:2019 levels. An increase in effective tax rate to 35.86% (vs. 32.82% in Q1:2019) pressured bottom-line further, resulting in a 12.85% decline to NGN11.20bn (vs. NGN12.85bn in Q1:2019). This implies a net margin of 15.92%, down from 18.10% in Q1:2019. **While we anticipate a continued uptrend in OPEX in the near term, our expectation of an improvement in topline fuels our earnings projections. Hence, we forecast a 5.18% growth in bottom-line to NGN48.05bn from NGN45.68bn in 2019FY.**

Improvement in Earnings Quality

Earnings quality improved during the period as net cashflow from operating activities exceeded net income by 88.83%, resulting in a negative net operating accrual of NGN9.94bn. During the period, the firm's current ratio also expanded slightly to 0.90x (vs. 0.85x as at 2019FY), indicating an improvement in the company's ability to meet its short-term obligations.

Outlook and Recommendation

Premised on the above-mentioned, we maintain our expected EPS of NGN60.00 and a target P/E of 20.00x, implying a 2020FY target price of NGN1,200. This represents an upside potential of 20.00% on its closing price of NGN1,000 on May 12th, 2020. Hence, we rate **NESTLE** a **BUY**.

Company	NESTLE
Valuation	
Trailing EPS	55.55
BVPS	71.50
P/E	18.00x
P/BV	13.99x
Target PE	20.00x
Dec-2020 Exp. EPS	60.00
Dec 2020 Target price	1,200.00
Current Price	1,000
Up/Downside Potential	+20.00%
Ratings	BUY
Key metrics	
RoAE	86.61%
RoAA	23.30%
Net margin	15.92%
Asset Turnover	1.54
Leverage	3.26
Yr Hi	1469.90
Yr Lo	764.90
YTD return	-47.96%
Beta	0.99
Adjusted Beta	0.99
Shares outstanding	0.79bn
Market cap [NGN]	792.66bn
Financial year end	December
Most Recent Period (MRP)	Q1:2020

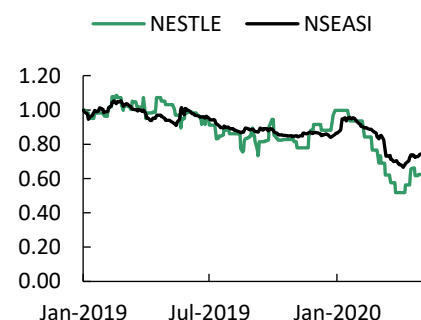


Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	1,082.77
EPS						Max	1,325.26
Target PE		55.53	57.72	60.00	62.28	64.65	
	19.5x	1,082.77	1,125.54	1,170.00	1,214.46	1,260.61	
	19.8x	1,096.65	1,139.97	1,185.00	1,230.03	1,276.77	
	20.0x	1,110.53	1,154.40	1,200.00	1,245.60	1,292.93	
	20.3x	1,124.41	1,168.83	1,215.00	1,261.17	1,309.09	
	20.5x	1,138.30	1,183.26	1,230.00	1,276.74	1,325.26	

Financial Highlights (NGN billion) NESTLE PLC Q1:2020 Unaudited Results				
Profit & Loss Account	Q1:2020	Q1:2019	y/y Growth	
Revenue	70.33	70.97	-0.90%	
Cost of Sales	38.67	39.50	-2.09%	
Gross Profit	31.66	31.47	0.60%	
OPEX	14.12	12.38	14.03%	
Operating Profit	17.54	19.09	-8.12%	
Net Finance Costs	-0.08	0.03	-338.63%	
PBT	17.45	19.12	-8.71%	
PAT	11.20	12.85	-12.85%	
Balance Sheet	Q1:2020	FY: 2019		
PPE	78.24	79.39	-1.45%	
Inventories	36.84	33.28	10.70%	
Trade and other Receivables	44.26	65.82	-32.76%	
Cash and bank	13.99	6.98	100.53%	
Other Assets	11.20	7.90	41.71%	
Total Assets	184.53	193.37	-4.57%	
Shareholders' fund	56.67	45.01	25.92%	
Trade and Other Payables	64.63	78.40	-17.57%	
Total Borrowings	0.33	13.21	-97.50%	
Total Liabilities	127.86	147.82	-13.50%	

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Movements in Price Target

Company Name: NESTLE Plc.

Date	Price (N)	Previous Target Price(N)	New Target Price (N)	Previous Recommendation	New Recommendation
12-May-2020	NGN1000	NGN1200	NGN1200	BUY	BUY

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Company	Disclosure
NESTLE Plc.	

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