

Contraction in Food Giant's Revenue

Topline Pressured by Decline in Domestic Sales

In the first quarter of 2020, **NESTLE** reported a 0.90% YoY contraction in topline – *the first drop since Q1:2015*. The food giant's Q2:2020 financial scorecard reveals a further moderation in topline down by 0.35% YoY to NGN70.70bn. We reiterate that **NESTLE's** topline growth has increasingly slowed since Q1:2019 (+5.19% YoY, +4.59% YoY, and +2.36% YoY in Q1, Q2 and Q3:2019 respectively) - bucking the trend of double-digit growth, although it picked up in Q4:2019 (+15.12% YoY). This, as well as the steady decline (-1.29% and -1.14% in Q1 and Q2:2020 respectively) in domestic sales (*which typically accounts for 98.5% of overall revenue*) leads us to believe that the increasing strain on consumer wallets continues to bite into the company's sales. As a positive, however, we note that export sales continued to grow (+25.81% YoY in Q1, and +48.60% YoY in Q2:2020), providing some respite to sales. For Q2:2020, the pickup in export sales is particularly impressive, when juxtaposed with the sustained land border closure and distribution challenges ushered in by the pandemic. In all, H1:2020 revenue settled at NGN141.03bn, 62bps lower than in the corresponding period in 2019. **Although we consider the waning disposable income of consumers, a key downside risk, we expect the broad uptick in economic activities to bode well for the company's overall performance in H2:2020. Thus, we retain our projection of a 7.28% growth in 2020FY revenue to NGN304.71bn from NGN284.04bn in 2019FY.**

Gross Margin Buckles Under Pressure

Despite the slowdown in revenue, cost of sales was up 14.2% in Q2:2020, overturning the 2.09% drop preceding quarter. As a result, cost of sales climbed to NGN80.19bn in H1:2020, precipitating a decline in gross margin to 43.14% (vs. 46.57% in H1:2019). OPEX also rose by 3.37% to NGN26.51bn, fueled solely by a 50.68% surge in admin expenses, which offset the fall in marketing and distribution costs (-6.34%). This brought operating profit down 15.10% YoY to NGN34.33bn in H1:2020. Although interest bearing liabilities rose to NGN6.62bn during the period, finance costs pegged lower at NGN937.36mn (vs. NGN2.27bn as at 2019FY when interest bearing liabilities stood at NGN13.21bn). PBT, thus, came in at NGN33.86bn, a 16.26% decline from H1:2019 levels. A slight increase in effective tax rate to 35.55% (vs. 35.09% in H1:2019) further weighed on bottom-line, resulting in a 16.84% decline to NGN21.83bn (vs. NGN26.25bn in H1:2019), implying a net margin of 15.48% from 18.50% in H1:2019. **While we expect direct and operating costs to remain elevated for the rest of the year, our earnings outlook rests largely on our topline projection. Ultimately, we forecast a 5.18% growth in 2020FY net income to NGN48.05bn, from NGN45.68bn in 2019FY.**

ROE Remains Attractive

At the end of H1:2020, **NESTLE's** annualized ROE stood at 106.43% - 11.03 percentage points higher than 95.39% in 2019FY. This was propped by the spike in financial leverage to 6.11x (vs. 4.24x as at 2019FY). In contrast however, we observed a decline in annualized ROA to 23.11% vs. 25.69% as at 2019FY, owing to a decline in profitability between both periods.

Outlook and Recommendation

We maintain our 2020FY target price of NGN1200 on the back of an Expected EPS of NGN60.00 and a target P/E of 20.00x. This represents an upside potential of 2.13% to its closing price of NGN1,175 on August 13th, 2020. Hence, we rate **NESTLE** a **HOLD**.

Company	NESTLE
Valuation	
Trailing EPS	52.06
BVPS	39.95
P/E	22.57x
P/BV	29.41x
Target PE	20.00x
Dec-2020 Exp. EPS	60.00
Dec 2020 Target price	1200.00
Current Price	1,175
Up/Downside Potential	+2.13%
Ratings	HOLD
Key metrics	
RoAE	106.86%
RoAA	21.33%
Net margin	15.48%
Asset Turnover	1.46
Leverage	6.11
Yr Hi	1469.90
Yr Lo	764.90
YTD return	-47.96%
Beta	0.89
Adjusted Beta	0.93
Shares outstanding	0.79bn
Market cap [NGN]	931.37bn
Financial year end	December
Most Recent Period (MRP)	H1:2020

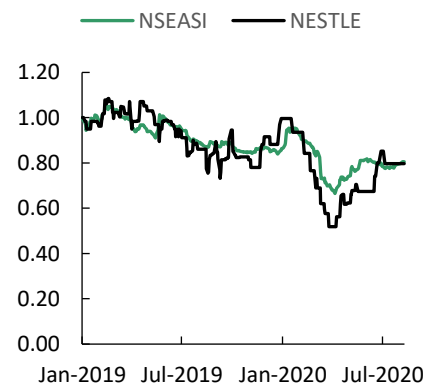


Chart 1: Sensitivity Analysis

Sensitivity Analysis of Dec-2020 Target Price to key model inputs						Min	1,082.77
EPS						Max	1,325.26
		55.53	57.72	60.00	62.28	64.65	
Target PE	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

<i>Profit & Loss Account</i>	H1:2020	H1:2019	y/y Growth
Revenue	141.03	141.91	-0.62%
Cost of Sales	80.19	75.83	5.75%
Gross Profit	60.84	66.08	-7.93%
OPEX	26.51	25.65	3.37%
Operating Profit	34.33	40.43	-15.10%
Net Finance Costs	-0.47	0.00	N/A
PBT	33.86	40.44	-16.26%
PAT	21.83	26.25	-16.84%
<i>Balance Sheet</i>	H1:2020	FY: 2019	
PPE	77.33	79.39	-2.60%
Inventories	42.62	33.28	28.07%
Trade and other Receivables	40.09	65.82	-39.10%
Cash and bank	23.34	6.98	234.48%
Other Assets	10.17	7.90	28.70%
Total Assets	193.55	193.37	0.09%
Shareholders' fund	31.67	45.56	-30.48%
Trade and Other Payables	106.40	78.40	35.71%
Total Borrowings	5.85	13.21	-55.69%
Total Liabilities	161.88	147.82	9.52%

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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
14-August-2020	NGN1175	NGN1200	NGN1200	BUY	HOLD

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NESTLE Plc.	

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