

### Nestle Nigeria Plc: *Interim Results – Q3, September 2010*



October 27, 2010

HOLD

Fair Value: ~~NGN~~ 413.92

Current Price: ~~NGN~~ 400.00

#### Valuation/Analyst Recommendation

The Q3 performance of Nestle is in line with our forecast; hence we maintain our earlier forecast and valuation. We used the Discounted Free Cash Flow Method (DCF) and Discounted Future Earnings Method (DFE) to arrive at a fair value. We project Turnover, Earnings Before Interest and Tax (EBIT) and Profit After Tax (PAT) for the periods ending December 2010, 2011, 2012, 2013 and 2014. We estimate the Turnover of **N85.40bn, N106.75bn, N134.50bn, N164.09bn and N196.91bn** for 2010, 2011, 2012, 2013 and 2014 respectively. We estimate EBIT of **N19.66bn, N24.58bn, N30.97bn, N37.79bn and N41.35bn** for same period respectively, based on EBIT Margin of 23.03%. We arrived at Free Cash Flow (FCF) of **N7.27bn, N10.68bn, N17.79bn, N23.02bn and N20.35bn** and PAT of **N12.46bn, N15.58bn, N19.63bn, N23.94bn and N28.73bn**. We applied a terminal growth rate of **7.23%**. We used a beta value of **0.50**. The beta value of our forecast is based on the 5-year historical returns on the company share price and the Nigerian Stock Exchange All Share Index (NSE ASI) is **0.32**. We considered the cost of equity resulting from the beta value very low and decided for **0.50**. We used the marginal rate of **8.85%** as our **risk free rate** and a **market risk premium of 13.28%**. Applying foregoing parameters on the Capital Asset Pricing Model (CAPM), the cost of equity generates **13.87%**. We used a weighted cost of debt of **3.89%** and a tax rate of **32%**, leading to a WACC of **10.27%**. We used **660.55mn** shares in issue. The DFE Model generates **N492.78** per share and the DCF Model generates **N349.40** per share. Applying a weight of 45% to the DFE and 55% to the DCF, we arrive at a value of **N413.99** per share, which is our fair value. The 2010 forward earnings yield based on our fair value generates **4.56%**, while the 2010 forward Dividend Yield based on **N15.99** Dividend Per Share (dividend payout of **84.74%**), at our fair value generates **3.90%**. We therefore place a **HOLD** on shares of Nestle at the current market price.

#### Business Description

*Nestlé's principal activities are the manufacturing, marketing and distribution of food products including purified water and the manufacture of hydrolyzed plant protein mix of Maggi cube.*

| Ticker                     | NESTLE             |
|----------------------------|--------------------|
| Sector                     | Food and Beverages |
| Date of Incorporation      | September 25, 1961 |
| Date of Listing            | April 20, 1979     |
| Year End                   | December           |
| No of Ordinary Shares      | 660,546,875        |
| Capitalisation (₦)         | 264,218,750,000    |
| % of Market Capitalisation | 3.32               |
| 52-Week High(₦)            | 400.00             |
| 52-Week Low (₦)            | 214.00             |
| YTD Return (%)             | 71.44              |
| 52-Week Avg. Trade         | 197,622            |
| Beta Value                 | 0.32               |
| Current EPS (₦)            | 17.66              |
| Current PE(x)              | 22.65              |

#### Expanding Production Capacity:

The unaudited Q3, 2010 result of **Nestle Nigeria Plc (Nestle)** for the period ended September 30, 2010 showed that its Turnover (TO) grew by **18.31%** to **N59.04bn**, compared with N49.90bn in the corresponding period of 2009. The Profit Before Tax (PBT) increased by **32.31%** between 2009 and 2010 to **N13.28bn** from N10.04bn in the corresponding period of 2009. The tax provision also increased by 48.31% from N2.82bn in 2009 to N4.18bn in 2010. Profit After Tax (PAT) increased to **N9.11bn** in Q3 2010 from N7.22bn in 2009, representing an increase of **26.09%**.

The company's profit margins increased in Q3, 2010 over Q3, 2009 and over the FY December, 2009 figures. The PBT margin increased to 22.50% in Q3, 2010 from 20.12% as at Q3, 2009, and up from 20.18% as at the end of the financial year in December, 2009, respectively. This shows that the company's total costs as a percentage of TO stand at 77.50%, lower than 79.88% recorded in the corresponding period of 2009. PAT Margin currently stands at 15.42%, up from 14.47% in the corresponding period of 2009, and up from 14.32% as at FY 2009. The result also indicated that the percentage of TO, PBT, and PAT in the Q3, 2010 to the Full Year Audited TO, PBT and PAT for the period ended December, 2009 are: **86.42%, 96.36% and 93.07%**, respectively; indicating that it should surpass the previous year's performance with good margins.

A cursory look at the balance sheet position as at Q3, 2010 compared with the position as at December, 2009 shows that the company's fixed assets increased. Its fixed assets increased by 30.95% to N33.27bn from N25.40bn in FY 2009. We reported earlier that Nestle is currently embarking on production expansion in Sagamu, Ogun State in order to increase its market share. Stocks decreased marginally by 4.26% to N10.24bn in Q3, 2010 from N10.70bn in FY 2009. Cash and bank balances increased from N1.76bn in FY 2009 to N3.91bn in Q3 2010. Nestlé's working capital improved from a negative of N165.21mn in FY 2009 to N3.37bn in Q3 2010. Its management however needs to put in place strategies to reduce the trade debtors which increased significantly by 67.81% to N3.27bn from N1.95bn in order to reduce its cash conversion cycle. The net assets increased by 19.20% to N12.57bn from N10.54bn as at FY 2009.

Our analysis of the operating environment shows that the manufacturing and distribution businesses in which food and beverages firms operate in Nigeria, are faced with infrastructure challenges (transportation and power). In order to meet their power needs, manufacturing companies invest heavily in alternative sources of power. The cost of acquiring and maintaining this equipment add in no small measure to the operating costs. Manufacturing firms sometimes shift some of these costs to their customers in form of increase in the price of goods, while the firms bear a portion of it. In addition to the problem of infrastructure, the current financial crisis and the unwillingness of banks to lend has reduced credits to the real sector, while the available credits command high interest rates, thus increasing financing costs for the manufacturers. These factors have limited the growth of the manufacturing sector in the country, despite the huge market potentials within and in the neighboring countries. In the last one year, the manufacturing sector has not witnessed significant improvement as the capacity utilization fluctuates between 35% and 40%. In addition, the Nigerian manufacturing industry is relatively small in relation to the size of the domestic economy. The sector has not grown remarkably over the years due to the neglect of the sector for crude oil, epileptic power supply, collapsing infrastructure, among others. Manufacturing sector's contribution to the Gross Domestic Product (GDP) as at June 2010 was 3.93%, while the growth rate is 7.69%.

The capital employed by Nestle at December 31, 2009 was such that equity, inter-company loan, deferred taxation and gratuity & other long term employee benefits accounted for 41.78%, 47.23%, 8.33% and 2.66% of the capital structure respectively. Its total assets stood at N44.25bn, while total liabilities stood at N33.71bn. The short term liabilities stood at N19.01bn, accounting for 56.40% of the total liabilities while the long-term liabilities stood at N14.70bn accounting for 43.60% of the total liabilities. The interest bearing liabilities of Nestle as at December 31, 2009 stood at N14.92bn, of which a total of N11.92bn is an inter-company loan. An analysis of the TO of Nestle in 2009 shows that its revenue of N68.32bn was derived from the sale of food, representing 61.88% of the total, while beverages accounted for 38.12%. Nestlé's product line include: **Maggi, Cerelac, Nutrend, Nan, Lactogen and Golden Mom**. Beverages – this includes the production and sale of **Milo, Chocomilo, Nido, Nescafe and Nestle Pure Life Water**. Its outstanding shares stood at about 660.54mn out of which 390.59mn is owned by **Nestle CWA Limited**, representing about 59.13% of the shares while the remaining 40.87% is held by other Nigerians, foreign individuals and institutions. The company has a general license agreement with **Societe Des Produits Nestle SA** and **Nestle SA** for the provision of technical and other support services. Over 75% of its raw materials are sourced locally through farmers and suppliers.

## Industry Analysis (Nmn)

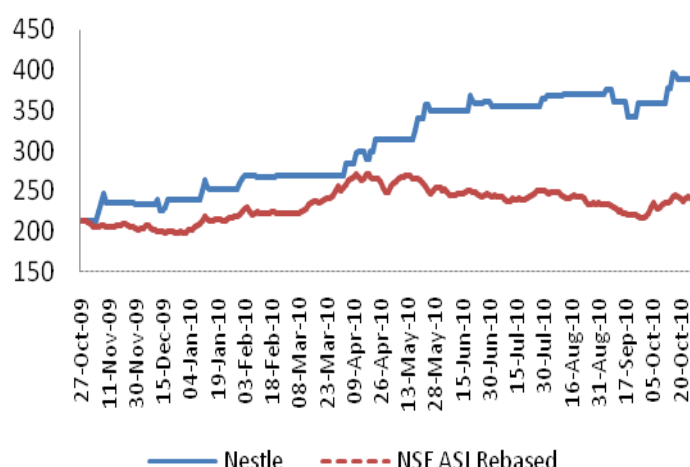
| Company        | TO      | PBT     | PAT    | PAT Margin (%) | ROE (%) | EPS*  | PE*   |
|----------------|---------|---------|--------|----------------|---------|-------|-------|
| Nestle         | 68,317  | 213,783 | 9,783  | 14.32          | 92.79   | 17.66 | 22.65 |
| Dangote Sugar  | 82,396  | 19,587  | 13,186 | 16.00          | 31.69   | 1.08  | 15.60 |
| Flour Mills ** | 206,608 | 24,440  | 16,948 | 8.20           | 34.00   | 9.58  | 7.31  |
| NBC            | 90,196  | 4,328   | 2,888  | 8.79           | 9.70    | 5.50  | 5.64  |

Source: Company Annual Reports as at FY '09, NSE FACTBOOK. \* Current \*\* Flour Mills is as at March, 2010

## Financial Performance (Nmn)

|                | Q3 2010 | Q3 2009 | %Δ    | FY 2009 | FY 2008 | %Δ     | FY 2010F |
|----------------|---------|---------|-------|---------|---------|--------|----------|
| Turnover       | 59,037  | 49,899  | 18.30 | 68,317  | 51,742  | 32.00  | 85,400   |
| PBT            | 13,281  | 10,038  | 32.30 | 13,783  | 11,862  | 16.20  | 18,325   |
| PAT            | 9,106   | 7,222   | 26.10 | 9,783   | 8,331   | 17.40  | 12,460   |
| PBT Margin (%) | 22.50   | 20.12   | 2.38  | 20.18   | 22.93   | (2.75) | 21.46    |
| PAT Margin (%) | 15.42   | 14.47   | 0.95  | 14.32   | 16.10   | (1.78) | 14.59    |

Nestle vs NSE ASI Rebased (Oct., 09 - Oct., 10)



## Directors As At December 31, 2009

| Name              | Position | Shareholding |
|-------------------|----------|--------------|
| Olusegun Osunkeye | Chairman | 300,000      |
| Martin Woolnough  | MD/CEO   | Nil          |
| Martin Kruegel    | Director | Nil          |
| Frederic Dunanton | Director | Nil          |
| David Ifezulike   | Director | Nil          |
| Fiana Mshelia     | Director | 3,125        |
| Etienna Benet     | Director | 63,546       |
| Mrs. Iquoh Ukoh   | Director | 31,250       |

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