26th May 2016

Food & Beverages

Nestlé

Price CHF73.60

Bloomberg	NESN VX
Reuters	NESZn.VX
12-month High / Low (CHF)	76.8 / 67.5
Market Cap (CHF)	234,666
Ev (BG Estimates) (CHF)	245,536
Avg. 6m daily volume (000)	5 897
3y EPS CAGR	7.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.7%	6.1%	-1.6%	-1.3%
Food & Bev.	0.4%	4.2%	-4.9%	-2.2%
DJ Stoxx 600	-1.2%	7.5%	-8.4%	-5.9%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	88,785	89,899	93,836	99,476
% change		*1.3%*	*4.4%*	*6.0%*
EBITDA	17,210	17,958	19,023	20,316
EBIT	13,382	13,968	14,902	16,083
% change		*4.4%*	*6.7%*	*7.9%*
Net income	10,351	10,901	11,701	12,631
% change		*5.3%*	*7.3%*	*7.9%*

	2015	2016e	2017e	2018e
Operating margin	15.1	15.5	15.9	16.2
Net margin	11.7	12.1	12.5	12.7
ROE	16.6	16.7	17.5	18.0
ROCE	12.5	12.9	14.1	15.4
Gearing	0.9	0.6	0.4	0.1

(CHF)	2015	2016e	2017e	2018e
EPS	3.30	3.49	3.75	4.05
% change	-	*5.9%*	*7.3%*	*7.9%*
P/E	22.3x	21.1x	19.6x	18.2x
FCF yield (%)	4.3%	4.6%	4.8%	5.1%
Dividends (CHF)	2.25	2.30	2.35	3.35
Div yield (%)	3.1%	3.1%	3.2%	4.6%
EV/Sales	2.8x	2.7x	2.6x	2.4x
EV/EBITDA	14.5x	13.7x	12.7x	11.7x
EV/EBIT	18.7x	17.6x	16.2x	14.7x

More savings to come

Fair Value CHF80 (+9%) **BUY**

Nestlé hosted an Investors seminar at Vevey on 24th and 25th May. This was a great opportunity to review the different divisions overall and get a deep understanding of the products. The group also announced a new savings programme of around CHF2bn per year in a three-year timeframe from 2019. Although it refused to give guidance regarding the improvement in margins, we view this positively as it shows its willingness to fully leverage its scale. We maintain our Buy recommendation.

ANALYSIS

- **The group announced new savings of around CHF2bn per year in a three-year timeframe from 2019.** These are structural economies that **come on top of the operational savings the group is already generating through its Nestlé Continous Excellence programme (around CHF1.5bn per year**) and are set to stem from 1/ procurement (CHF0.5bn), 2/ asset intensity (CHF1bn) and 3/ reduction in SG&A expenses (CHF0.5bn). The savings could be partly generated in 2017 and 2018 but the full impact is likely in 2019. **Management refused to commit itself to the amount to be reinvested (between 2013 and 2015, 15% of savings fuelled to the bottom line) and did not give indications regarding the margin improvement over the coming years**. The company's 2016 guidance ("increase in trading operating margin") is unchanged. We maintain our estimate of 15.5% (+29bps in LFL).
- **The group's CEO stated that it is still aiming for 5-6% organic sales growth (what is called the Nestlé model).** But **Nestlé is currently facing a more challenging environment** as a result of weak pricing (300bps of inflation was lost in Western Europe and China between 2012 and 2015), low commodity prices (Nestlé commodity price index is down 40% since 2011), **an evolving competitive landscape** (the global share of local players increased by 200bp between 2012 and 2015), **changing consumer tastes** (organic, gluten-free..) and the **fast reshaping of retail with e-commerce.** This channel is now close to 4% of total sales and Nestlé reported that its shares in the online segment are higher than in offline in AMS (Americas) and EMENA (Europe, Middle East and North Africa). **The new savings should help boost organic sales growth over coming years through an increase in brand support (marketing and R&D) and competitiveness**. **The group's guidance in 2016 is for sales to grow 4.2% organically, in line with 2015. We previously said that this appears overly cautious given 1/ the favourable comparison base** as Q2/Q3/Q4 2015 were impacted by the Maggi noodles recall in India, the negative media campaign around the Beneful petcare brand and the rebate adjustments related to the Skin Health products sold in the US and **2/ the rebound in commodity prices for two quarters**. The CEO of AOA (Africa, Oceania, Sub-Saharan Africa), **Mme Wang Ling Martello, said that the region should improve throughout the year, partly thanks to better trends at Yinlu (sell-out sales have now stabilised). Our forecast for 4.7% organic sales growth in 2016 is unchanged.**
- **Free cash flow and return on capital are expected to increase**. Free cash flow should benefit from CAPEX discipline and working capital efficiency. The **CFO stated that working capital as a % of sales is expected to decline (no conclusion to be drawn for 2016) but should remain in positive territory** due to the group's category exposure (water, ice cream). **Nestlé applies strict M&A criteria: it wants ROIC to be above WACC (Nestlé: 7%) within five years**. The **CEO said that a buyback is also a means of using excess cash but that this is exceptional. Our view is that the announcement of a programme is likely** as the group's ratio of net debt/EBITDA should be well below 1x at the end of 2016, a level at which the company could see its credit rating upgraded to AAA (which it does not want).

VALUATION/ NEXT CATALYST

- Our Fair Value remains at CHF80. At yesterday's share price, the stock is trading at 21.1x P/E 2016e vs 20.7x for Danone and 21.3x for Unilever. We consider the stock's valuation as justified due to the group's highly defensive profile / H1 2016 results due on 18th August.

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