Nestlé

Price CHF78.95

Bloomberg	NESN VX
Reuters	NESZn.VX
12-month High / Low (CHF)	79.9 / 68.4
Market Cap (CHF)	245,705
Ev (BG Estimates) (CHF)	256,922
Avg. 6m daily volume (000)	5 579
3y EPS CAGR	8.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	1.4%	8.2%	8.1%	5.9%
Food & Bev.	0.4%	4.4%	7.0%	0.8%
DJ Stoxx 600	1.6%	2.6%	7.2%	-6.1%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	88,785	90,267	94,021	99,553
% change		*1.7%*	*4.2%*	*5.9%*
EBITDA	17,210	17,850	19,061	20,736
EBIT	13,382	14,066	15,169	16,547
% change		*5.1%*	*7.8%*	*9.1%*
Net income	10,353	10,890	11,772	12,956
% change		*5.2%*	*8.1%*	*10.1%*

	2015	2016e	2017e	2018e
Operating margin	15.1	15.6	16.1	16.6
Net margin	11.7	12.1	12.5	13.0
ROE	16.6	16.7	17.5	18.2
ROCE	12.5	13.0	14.5	16.0
Gearing	0.9	0.6	0.3	0.0

(CHF)	2015	2016e	2017e	2018e
EPS	3.30	3.52	3.81	4.19
% change	-	*6.7%*	*8.1%*	*10.1%*
P/E	23.9x	22.4x	20.7x	18.8x
FCF yield (%)	4.0%	4.1%	4.9%	5.3%
Dividends (CHF)	2.25	2.30	2.35	3.35
Div yield (%)	2.8%	2.9%	3.0%	4.2%
EV/Sales	2.9x	2.8x	2.7x	2.5x
EV/EBITDA	15.2x	14.4x	13.2x	11.9x
EV/EBIT	19.5x	18.3x	16.6x	14.9x

An attractive profile

Fair Value CHF84 vs. CHF80 (+6%) BUY

In the current environment, we favour Nestlé's defensive profile. The group remains the most diversified in terms of geographies and categories in our coverage universe. The release of the H1 2016 results reinforced our conviction that in the future it will better leverage its size to optimize its cost base and improve its working capital. The arrival of the new CEO at the beginning of 2017 could also trigger a more active acquisitions policy. Fair Value adjusted to CHF84. Buy recommendation maintained.

ANALYSIS

- **Weak pricing penalized organic sales growth but volumes/mix remained solid. RIG was up 2.7% in Q2, decelerating vs Q1 (+3.0%) due to an extra day in the quarter (29 days in February 2016) but in line with the historical trend** (+2.9% over the past five years). **But pricing continued to slow down (+0.4% in Q2 after +0.9% in Q1)**, reflecting the deflationary environment in a number of developed markets, the lack of rebound in commodity prices and the tough comparison base (price increases in Latam and Eastern Europe last year). The company reported to have increased or maintained its markets shares in 57% of its geographies.

- **Nestlé is confident in achieving around 5% organic sales growth in H2.** The group has reiterated its full year guidance of organic sales growth in line with 2015 (+4.2%), which implies +4.6% in H2. **We think this is achievable. The pricing should recover from the historical low reached in Q2** as the group has already started (at the end of June) and will continue to take price increases to offset currency depreciation/inflation in Brazil, Russia, Turkey, Ukraine and the UK… **The comparison base is also very favourable** as H2 2015 was affected by a rebate adjustment on skin health products in the US and the Maggi noodles recall. Of note, the group said that it has regained a 60% market shares of the noodles market in India (80% before the recall). Finally, **the closing of the Froneri transaction** at the end of the summer should generate an acceleration of organic sales growth by the deconsolidation of the poorly performing ice cream business in Europe.

- **China remains a concern.** Organic sales in the country (8% of the group's sales) were down in Q2. The group reported that it continues to gain market shares in 60% of its categories in a food & beverage market which has now stabilized. The trend is negative for Yinlu and is not expected to improve before 2017. Infant nutrition also proves to be challenging in the mainstream and premium ranges due to the low dairy prices, the tough competitive environment and the new regulatory measures. Organic sales of the Nestlé Nutrition division were up only 0.1% in Q2.

- **Raising our estimates. We now have deeper confidence in the group's ability to optimize its cost base.** In H1, it delivered CHF660m of savings as part of its Nestlé Continuous Excellence program. It is also implementing the first initiatives of the new cost savings program it has announced at its investors' Day. In a three-year timeframe from 2019, it will generate CHF2bn per year of structural economies stemming from 1/ procurement (CHF0.5bn), 2/ asset intensity (CHF1bn) and 3/ reduction in SG&A expenses (CHF0.5bn). **We raise our EPS estimate by 2% on average over the next three years. We also factor into our forecasts a stronger improvement in working capital** (in 2016, -100bps as % of group's sales vs -50bps previously). In H1, Nestlé decreased its working capital by 150bps to 4.3%, which contributed to the 41% growth in free cash flow. **We are convinced by its willingness to continue its efforts in this area**.

VALUATION

- Our DCF now points to a Fair Value of CHF84. At yesterday's share price, the stock is trading at 22.4x P/E 2016e and 20.7x P/E 2017e (respectively 22.5x and 20.5x for Danone and 22.1x and 20.2x for Unilever).

NEXT CATALYSTS

- Q3 2016 sales in October: Unilever on 13th, Danone on 18th and Nestlé on 20th

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