

Nestlé

Price CHF76.80

Deteriorating trends in China and Brazil

Fair Value CHF83 vs. CHF84 (+8%)

BUY

We revise downwards our Q3 estimate for Nestlé's organic sales growth from +5.5% to +3.5%. China is suffering from a deceleration in the food & beverage market and regulations in the infant nutrition sector, while Brazil has been penalised by a drop in volumes as a result of the group's increase in prices. Over the year, we now expect 3.7% organic sales growth, which compares to the consensus forecast for 4.2%. Our Fair Value is adjusted to CH83.

ANALYSIS

- **Weakness in Q3.** We expect 3.5% organic sales growth, in line with the H1 trend, but well below our previous estimate (+5.5%). This performance is likely to disappoint. At its H1 results publication, Nestlé indicated that organic sales growth should accelerate over the rest of the year, supposedly driven by a 1/ favourable comparison base as H2 2015 was affected by a rebate adjustment on skin health products in the US and the Maggi noodles recall, and 2/ a recovery in the pricing effect due to price increases made to offset currency depreciation. Over the year, we now expect 3.7% organic sales growth vs 4.2% previously. The group's 2016 guidance is for organic sales growth in line with 2015 (+4.2%).
- **Deteriorating trends in China (8% of sales) and Brazil (4% of sales).** The slowdown in the food & beverage market in China is significant and is a result of economic slowdown, reverse migration, the change in channel dynamics and very tough competition from local players. The stabilisation of Yinlu is an objective for the end of 2017. The Chinese infant nutrition market has been disrupted by new regulations, which are inducing tough price competition, mainly in the mainstream and premium segments. In Brazil, price increases in a tough economic background have caused a significant drop in volumes that was not well anticipated by the group.
- **A challenged food industry.** On 16th September, we trimmed our estimates for Danone due to China. Its total sales are expected to rise only 1.4% in Q3, after +4.1% in Q2, primarily due to 1/ the Water division, impacted by the deceleration in the non-alcoholic beverages market, which is now growing 0-3% vs 5-10% previously and 2/ Early Life Nutrition, with destocking of traders operating in cross border ecommerce ahead of regulatory changes.

VALUATION/RECOMMENDATION

- **Our DCF now points to a Fair Value of CHF83 (CHF84 previously) as we cut our EPS estimates by 1% on average over the next three years.** At yesterday's share price, the stock is trading at 21.9x P/E 2016e and 20.4x P/E 2017e, in line with the peer average.
- **Nestlé was the best performing stock in our food coverage universe over the past six months.** It outperformed the DJ Stoxx by 6% vs +3% for Danone and +2% for Unilever. We expect some weakness in the coming days because of consensus adjustments.
- **The group's diversified profile is an asset in a challenging environment.** We estimate that Chinese baby food only accounts for 3% of the group's EBIT vs 12% at Danone. In addition, the arrival of Mr Schneider should trigger a more active acquisitions policy. We maintain our Buy recommendation.

NEXT CATALYSTS

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

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Bloomberg	NESN.VX
Reuters	NESZn.VX
12-month High / Low (CHF)	79.9 / 69.4
Market Cap (CHF)	239,014
Ev (BG Estimates) (CHF)	250,264
Avg. 6m daily volume (000)	5 141
3y EPS CAGR	7.9%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-1.5%	6.2%	7.3%	3.0%
Food & Bev.	0.1%	2.3%	3.4%	0.4%
DJ Stoxx 600	0.5%	-0.3%	1.5%	-5.6%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	88,785	89,833	93,168	98,419
% change		1.2%	3.7%	5.6%
EBITDA	17,210	17,765	18,889	20,501
EBIT	13,382	13,916	14,958	16,302
% change		4.0%	7.5%	9.0%
Net income	10,353	10,839	11,669	12,815
% change		4.7%	7.7%	9.8%

	2015	2016e	2017e	2018e
Operating margin	15.1	15.5	16.1	16.6
Net margin	11.7	12.1	12.5	13.0
ROE	16.6	16.7	17.4	18.1
ROCE	12.5	12.9	14.3	15.8
Gearing	0.9	0.6	0.3	0.0

(CHF)	2015	2016e	2017e	2018e
EPS	3.30	3.51	3.77	4.14
% change	-	6.2%	7.7%	9.8%
P/E	23.3x	21.9x	20.4x	18.5x
FCF yield (%)	4.2%	4.2%	5.0%	5.4%
Dividends (CHF)	2.25	2.30	2.35	3.35
Div yield (%)	2.9%	3.0%	3.1%	4.4%
EV/Sales	2.9x	2.8x	2.6x	2.4x
EV/EBITDA	14.8x	14.1x	13.0x	11.7x
EV/EBIT	19.0x	18.0x	16.4x	14.7x



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