

20th October 2016

Food & Beverages

Nestlé

Price CHF74.65

Further proof that prospects in the food industry have deteriorated

Fair Value CHF83 (+11%)

BUY

The 30bps slowdown in Q3 organic sales growth vs H1 was disappointing given a comparator that was 80bps easier. But the revision in guidance did not really come as a surprise given the weakness seen at peers (Danone/Nestlé). The global food market is now stable in volumes, with a strong deceleration in China. Our estimates are broadly unchanged. We now expect 3.5% organic sales growth vs +3.7% previously. Nestlé remains our favourite stock in a challenging food industry due to its balanced growth drivers coupled with potential self-help (with the arrival of the new CEO).

Bloomberg	NESN.VX
Reuters	NESZn.VX
12-month High / Low (CHF)	79.9 / 69.4
Market Cap (CHFm)	232,323
Ev (BG Estimates) (CHFm)	245,705
Avg. 6m daily volume (000)	4 959
3y EPS CAGR	7.8%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-3.2%	-4.0%	0.9%	0.1%
Food & Bev.	-0.6%	-1.8%	-1.3%	-1.6%
DJ Stoxx 600	0.7%	1.9%	-1.6%	-6.1%

YEnd Dec. (CHFm)	2015	2016e	2017e	2018e
Sales	88,785	89,699	92,903	98,141
% change		1.0%	3.6%	5.6%
EBITDA	17,210	17,738	18,835	20,444
EBIT	13,382	13,748	14,768	16,097
% change		2.7%	7.4%	9.0%
Net income	10,353	10,824	11,637	12,780
% change		4.5%	7.5%	9.8%

	2015	2016e	2017e	2018e
Operating margin	15.1	15.3	15.9	16.4
Net margin	11.7	12.1	12.5	13.0
ROE	16.6	17.3	18.7	20.0
ROCE	12.5	12.7	14.1	15.7
Gearing	0.9	0.8	0.6	0.4

(CHF)	2015	2016e	2017e	2018e
EPS	3.30	3.50	3.76	4.13
% change	-	6.0%	7.5%	9.8%
P/E	22.6x	21.3x	19.8x	18.1x
FCF yield (%)	4.3%	4.3%	5.0%	5.5%
Dividends (CHF)	2.25	2.30	2.35	3.35
Div yield (%)	3.0%	3.1%	3.1%	4.5%
EV/Sales	2.8x	2.7x	2.6x	2.4x
EV/EBITDA	14.4x	13.9x	12.9x	11.7x
EV/EBIT	18.5x	17.9x	16.5x	14.9x

ANALYSIS

- Pricing remained soft but accelerated.** In Q3 prices rose 1.4%, which was still well below 2015 (+1.9%) but slightly better than H1 2016 (+0.7%). The improvement in the last quarter reflected 1/ some price increases in Brazil, Russia and 2/ easy comps (price of Other Businesses dropped 2.4% in Q3 2015). Commodities prices have started to increase in the past few quarters but this is not reflected in pricing because of inventories and some hedging in place. Management refused to commit itself to an acceleration in the pricing effect going forward.
- Volumes weakened over the quarter.** Volumes rose 1.9% in Q3, decelerating vs H1 (+2.8%). This was due to 1/ price increases, especially in Brazil and 2/ a tough consumer environment, with the global food market roughly flat in volumes. The situation in China has deteriorated sharply because of growth in ecommerce, some reverse migration of workers going back to rural areas and competition from local players. The Chinese food market has now stabilised. Excluding Nestlé Nutrition, sales in China are in negative territory since the beginning of 2016 and the trend is worsening. Yinlu is penalising but Nescafé and confectionary are solid.
- Outlook.** The group revised downwards its organic sales growth guidance for 2016 from 4.2% to 3.5%. This did not really come as a surprise given the weakness seen at peers (Danone/Nestlé). The impact on our estimates was very limited as we were forecasting 3.7% organic sales growth (consensus: +3.8%). The new guidance implies an acceleration in Q4, which should be driven by Brazil and Nestlé Nutrition. Brazil should recover next quarter as most of the volumes impact has now been felt. The group mentioned that it started to return to volume growth at the end of Q3 in the country. Q3 sales in the Nestlé Nutrition division were impacted by negative pricing and inventory adjustments ahead of the change in regulations in China. In Q4 this should be partly offset by the launch of a new SKU on the Illuma brand. The end of supply chain constraints related to the packaging transition in the US should also help. We understand that the group is progressing faster than it thought in its cost savings programme. This should cause higher restructuring costs in H2, limiting the margin progression.

VALUATION

- Our DCF still points to a Fair Value of CHF83.

NEXT CATALYSTS

- Nestlé: 2016 results on 16th February

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