Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Nestle India Limited

Margins miss mark; domestic sales continues to grow in double digits

Consumer Goods	Sharekhan code: NESTLEIND	Result Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 17,223**	
Price Target: **Rs. 19,055**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

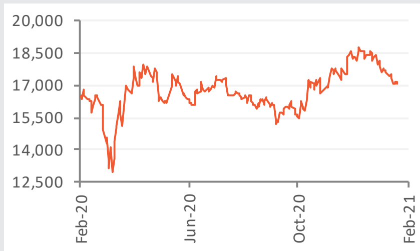
Company details

Market cap:	Rs. 1,66,057 cr
52-week high/low:	Rs. 18,823/12,589
NSE volume: (No of shares)	1.3 lakh
BSE code:	500790
NSE code:	NESTLEIND
Free float: (No of shares)	3.6 cr

Shareholding (%)

Promoters	62.8
FII	13.7
DII	7.8
Others	15.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.3	1.4	4.8	5.0
Relative to Sensex	-9.6	-17.3	-33.0	-21.9

Sharekhan Research, Bloomberg

Summary

- Nestle India's (Nestle's) revenues grew by 9.0% to Rs. 3,432.6 crore in Q4CY2020; domestic sales grew by 10.1% (export sales decreased by 7.7%). OPM expanded by 111bpsto 22.6% (versus ours and street's expectation of 23.6%)
- For CY2020, domestic sales grew by 8.5% with two-thirds of portfolio growing in double digits. OPM stood at 24%.
- Sustained product launches, likely improvement in out-of-home consumption and expansion in distribution network remain key growth drivers in the near to medium term.
- We have trimmed our earnings estimates for CY2021/22 by 2-3%. In view of long term growth prospects and cheery dividend payout (of 112% for CY2020), we maintain a Buy rating with an unchanged PT of Rs. 19,055.

Nestle's revenues grew by 9.0% to Rs. 3,432.6crore in Q4CY2020, inline with our expectation of Rs. 3,415.8crore.Domestic business grew by 10.1%, inline with a 10.2% growth achieved in Q3. We expect volume growth to sustain at ~8%. Exports fell by 7.7% due to lower demand for exports. Sales of the Maggi range of noodles and sauces, Kit Kat, Munch, and Nescafe Classic & Nescafe Sunrise grew in double digits. For CY2020, domestic revenues grew by 8.5% with two third of portfolio growing in double digits, mainly on account of higher demand for in-house consumption products. Demand for out-of-home category improved q-o-q but is yet to get back to pre-COVID levels. Benign input prices and operating efficiencies helped OPM improving by 111 bps to 22.6%, but this was lower than our expectation of 23.6%. The company plans to invest Rs. 2,600 crore over the next 3-4 years to augment existing manufacturing capacities as well as towards a new under-construction state-of-the-art factory in Sanand, Gujarat. With domestic mobility improving led by a drop in COVID-19 cases would help out-of-home-categories perform better in the coming quarters. Further, sustained innovation under existing brands, entry into categories and expansion of distribution reach remains the key growth drivers in the near to medium term. The company ended CY2020 with an OPM of 24% (improved by 80BPS on y-o-y basis). We expect OPM to sustain at 24-25% in the coming years.

Key positives

- Two-thirds of the portfolio grew in double digits in CY2020.
- Gross margins expanded by 231 bps y-o-y and 91 bps q-o-q to 59.1%
- E-commerce sales grew by 111% (contributes 3.7% of domestic revenues);
- The company paid a final dividend of Rs.65 per share (total dividend of Rs. 200 per share for CY2020).

Key negatives

- Export revenues decreased by 7.7% due to lower coffee exports
- Other income decreased by 32% in Q4 due to lower yields.

Our Call

View: Retained Buy with unchanged target price of Rs. 19,055 - We have trimmed our earnings estimates for CY2021/22 by 2-3% to factor in slightly lower than earlier expected OPM. Nestle is the largest food company with a strong portfolio of brands in the packaged food and beverages space, which will help it to achieve to good growth at a time when consumer habits are changing, with a greater preference for branded products and a gradual recovery in the out-of-home consumption. We expect revenues and PAT to clock a CAGR of 12.4% and 18.4% over CY2020-22E. The stock currently trades at 57x its CY2022E EPS. In view of long-term growth prospects and a cheery dividend payout (3 years average dividend payout of 124%) we maintain our Buy recommendation with an unchanged price target of Rs. 19,055.

Key risk

Any slowdown in domestic consumption or regulatory hurdles in key food categories or an increase in the key input prices would act as a key risk to our earnings estimates.

Valuation Rs cr

Particulars	CY18	CY19	CY20	CY21E	CY22E
Revenue	11,292	12,369	13,350	15,087	16,878
OPM (%)	23.6	23.2	24.0	24.5	24.9
Adjusted PAT	1,648	1,970	2,082	2,559	2,921
% YoY growth	*29.3*	*19.5*	*5.7*	*22.9*	*14.1*
Adjusted EPS (Rs.)	171.0	204.3	216.0	265.4	303.0
P/E (x)	100.7	84.3	79.7	64.9	56.8
P/B (x)	45.2	85.9	82.2	73.6	58.1
EV/EBIDTA (x)	61.6	57.5	51.4	44.8	39.2
RoNW (%)	46.5	70.3	105.4	119.7	114.2
RoCE (%)	42.7	50.2	57.8	63.4	65.3

Source: Company; Sharekhan estimates

Revenue up 9% in Q4CY2020; benign drove up margins: Revenue grew by 9% y-o-y to Rs. 3,417.4crore in Q4CY2020, inline with our expectations, driven by healthy volumes and product mix. Domestic revenue also grew by 10.1% y-o-y. Gross margins expanded by 231 bps to 59.1% due to an improved mix and benign input prices. Employee cost rose by 25% mainly on account of higher incentives given in view of COVID-19 and was further impacted by finalisation of long-term compensation arrangements for most factory employees. This resulted in a just 111bps improvement in OPM to 22.6%. Operating profit grew by 14.6% y-o-y to Rs. 777 crore. Lower other income and higher interest and depreciation charges resulted in profit before tax (PBT) to grow by 9% y-o-y to Rs. 670.1 crore. Reported PAT stood flat at Rs. 483.3crore mainly on account of higher tax (grew by 32% during the quarter due lower tax in the base quarter).

CY2020 - revenues grew by 8%; OPM stood at 24%: Revenue grew by 8% y-o-y to Rs. 13,350.2 crore in CY2020 on back of strong recovery in the domestic business in H2CY20after a dismal Q2 that was affected by supply disruptions during the COVID-led lockdowns. Gross margins stood flat at 57.5% due to a significant decline in Q1 and Q2. Operating efficiencies and lower ad-spends helped OPM to expand by 80 bps to 24.0% in CY2020. Operating profit grew by 12% y-o-y to Rs. 3,201.5 crore. Lower other income and higher interest and depreciation charges caused profit before tax (PBT) to grow by just 5.2% y-o-y to Rs. 2,812.8 crore. A lower tax incidence led reported PAT to grow by 5.7% y-o-y to Rs. 2,802.5 crore.

Other key highlights

- Two-thirds of the product portfolio including brands such as *Maggi Noodles, Maggi Sauces, KitKat, Munch, Nescafé Classic & Nescafé Sunrise* clocked double-digit growth as in-home consumption increased.
- Out-of-home consumption products also saw a gradual improvement sequentially, but are yet to recover to Pre-Covid levels.
- E-commerce channels witnessed a 111% growth in CY2020 and now contribute 3.7% to total revenues.
- Nestle plans to invest Rs. 2,600 crore in 3-4 years to augment its existing manufacturing capacities, as well as towards a new under-construction factory in Sanand, Gujarat.
- The company declared a final dividend of Rs. 65 per share (total dividend for CY2020 stood at Rs200 per share).

Results (Standalone) **Rs cr**

Particulars	Q4CY20	Q4CY19	YoY (%)	Q3CY20	QoQ (%)
Net Sales	3417.5	3130.7	9.2	3525.4	-3.1
Other Operating income	15.1	18.6	-18.8	16.3	-7.6
Total Revenue	3432.6	3149.3	9.0	3541.7	-3.1
Raw Material Cost	1404.5	1361.4	3.2	1484.3	-5.4
Employee Cost	403.3	322.7	25.0	369.7	9.1
Other Expenses	847.8	787.4	7.7	804.2	5.4
Total Operating Cost	2655.6	2471.4	7.5	2658.1	-0.1
Operating Profit	777.0	677.9	14.6	883.6	-12.1
Other Income	30.6	44.7	-31.5	34.5	-11.2
PBIDT	807.6	722.6	11.8	918.1	-12.0
Interest & Other Financial Cost	42.0	28.4	47.9	40.5	3.8
Depreciation	95.5	79.6	20.0	91.1	4.8
Profit Before Tax	670.1	614.6	9.0	786.5	-14.8
Tax Expense	186.9	141.6	32.0	199.4	-6.3
Reported PAT	483.3	473.0	2.2	587.1	-17.7
Adj. EPS (Rs)	50.1	49.1	2.2	60.9	-17.7
			bps		**bps**
GPM (%)	59.1	56.8	231	58.1	99
OPM (%)	22.6	21.5	111	24.9	-231

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Growth momentum improves sequentially; structural growth story intact

The domestic FMCG market growth recovered to 7.3% in Q3FY2021 from 1% in Q2FY2021. We believe that shift in demand for branded products, rural demand staying ahead of urban demand, gradual recovery in out-of-home categories and new product launches remain key catalysts for revenue growth in the near to medium term. Raw material prices have been rising in the recent past and sustenance of this trend will pressurise gross margins in FY2021. Consumer goods companies ability to pass on the input price increase, sustained benefits of cost-saving initiatives and judicious media spends would determine level the profitability growth in the coming quarters. Structural growth story of domestic consumer goods market is intact with lower per capita consumption of products compared with other international countries, lower penetration in the rural markets and opportunities to launch new differentiated products and gaining market share from small players.

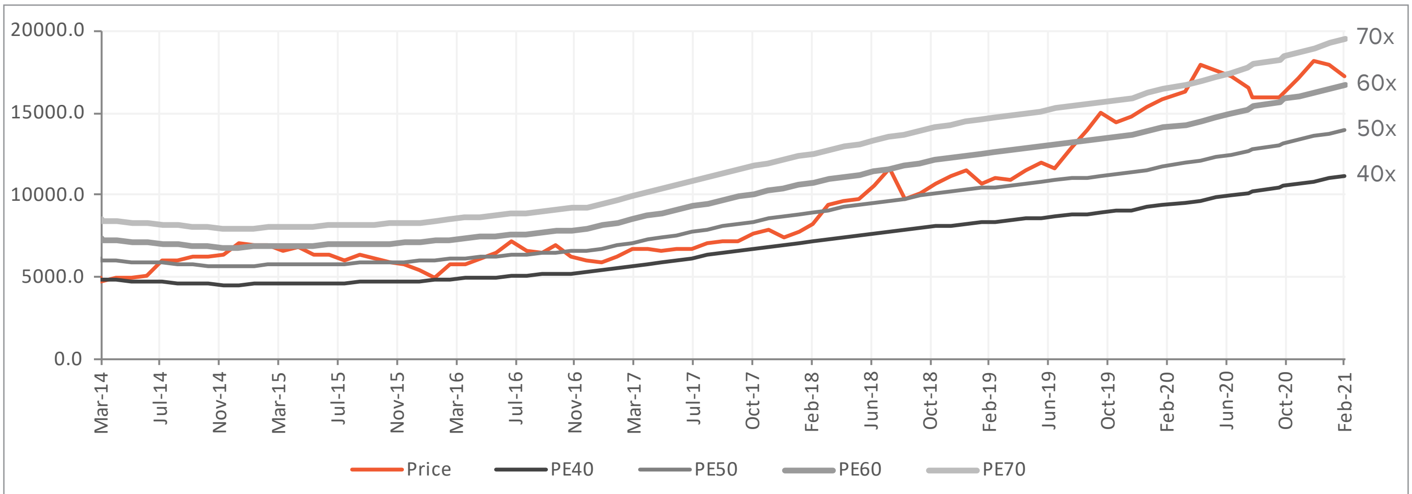
■ Company Outlook – Revenue growth to recover to double digits in CY2021

Nestle's revenues grew by 8% in CY2020 affected by lower exports and COVID-led disruptions in Q2CY2020. H2CY2020 saw strong rebound with double digit growth in revenues. Sustained innovations, going deep into the rural markets and rising trend of eating out would help the company to post good recovery in CY2021 and maintain steady revenue growth momentum in the near to medium term. Relatively benign input prices, improved revenue mix and operating efficiencies would help OPM improve gradually in the near to medium term. We expect OPM to remain at 24-25% in the coming years.

■ Valuation – Retained Buy with unchanged target price of Rs. 19,055

We have trimmed our earnings estimates for CY2021/22 by 2-3% to factor in slightly lower than earlier expected OPM. Nestle is the largest food company with a strong portfolio of brands in the packaged food and beverages space, which will help it to achieve to good growth at a time when consumer habits are changing, with a greater preference for branded products and a gradual recovery in the out-of-home consumption. We expect revenues and PAT to clock a CAGR of 12.4% and 18.4% over CY2020-22E. The stock currently trades at 57x its CY2022E EPS. In view of long-term growth prospects and a cheery dividend payout (3 years average dividend payout of 124%) we maintain our Buy recommendation with an unchanged price target of Rs. 19,055.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
HUL	65.2	49.4	43.2	44.1	35.7	31.0	37.1	28.3	30.7
Britannia Industries	44.8	40.4	34.9	33.0	28.8	25.1	30.6	32.5	33.0
*Nestle India	79.7	64.9	56.8	51.4	44.8	39.2	57.8	63.4	65.3

Source: Company, Sharekhan estimates   ** Nestle India is December year ending company*

About company

Nestle is the largest food company in India with a turnover of over Rs. 12,000 crore. It has presence across India with eight manufacturing facilities, four branch offices, one R&D center and approximately 8,000 employees. It manufactures products under internationally famous brand names such as *Nescafé, Maggi, Milkybar, KitKat, Bar-One, Milkmaid and Nestea* and in recent years the company has also introduced products of daily consumption and use such as Nestle Milk, Nestle Slim Milk and more. Nestle has a diversified portfolio of brands divided into four segments: *Milk Products & Nutrition, Prepared Dishes & Cooking Aids, Confectionery and Powdered & Liquid Beverages*. The brands are broadly segregated on the basis of nutrition, health, comfort, variety, indulgence and taste. It is the market leader in the categories of 'Instant Noodles' and 'Infant Cereals & Infant Formula'.

Investment theme

The FMCG industry is expected to recover in the near term as a result of revival in rural demand, exponential growth in e-Commerce and modern trade channels and efforts undertaken by the companies to boost growth. Nestle has maintained its leadership position across key categories over the years. The company had faced a setback in CY2015 post the Maggi debacle, however, it bounced back within a short span of time by re-launching the product with the help of innovative media campaigns. Sustained innovation, premiumisation, enhancing of distribution reach and adoption of the cluster based distribution approach would be the key growth drivers for the company in the near to medium term.

Key Risks

- Slowdown in demand environment: Any slowdown in demand, especially in international markets, would affect sales of key categories, resulting in moderation of sales volume growth.
- Increased competition in highly-penetrated categories: Increased competition in highly penetrated categories such as instant noodles, instant coffee, infant cereals, etc. would act as a threat to revenue growth.
- Increased input prices: Any significant increase in the prices of some key raw materials such as milk would affect profitability and earnings growth.

Additional Data

Key management personnel

Suresh Narayanan	Chairman & Managing Director
Shobinder Duggal	Chief Financial Officer
B Murli	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	2.0
2	SBI Funds Management Pvt Ltd	1.37
3	Axis Asset Management Co Ltd/India	1.55
4	Arisaig India Fund Limited	1.0
5	BlackRock Inc	0.9
6	Vanguard Group Inc	0.9
7	UTI Asset Management Co Ltd	0.5
8	Standard Life Aberdeen PLC	0.4
9	Mitsubishi UFJ Financial Group Inc	0.3
10	Norges Bank	0.2

Source: Bloomberg (Old data)

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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