Sharekhan by BNP PARIBAS

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Stock Update

# Nestle India Limited

## Good Quarter; Maintain double-digit growth in domestic biz

| Consumer Goods | Sharekhan code: NESTLEIND | Result Update |
|---|---|---|


**Summary**

- Nestle India's Q1CY2021 performance was largely in-line with expectation with revenue growth of 9% to Rs. 3,610 crore and OPM expansion of 189 bps to 25.8%; PAT grew by 14.6% y-o-y to Rs. 602.6 crore.
- Domestic business maintained its double-digit growth momentum with 10.2% growth (driven by volume and mix growth of 10.7%). All key categories registered double-digit growth with improvement in out-of-home categories.
- We need to keenly monitor the impact of localised lockdown on sales in the coming months. Medium-term thrust remains on achieving double-digit revenue growth by penetrating deep into rural markets (covered 89,288 villages), innovation (that contributes 4.3% to sales), and accelerating footprint through new channels.
- We have broadly maintained our earnings estimates for CY2021 and CY2022. The stock has corrected by 10% from its high and is currently trading at 55.7x its CY2023E EPS. We maintain our Buy recommendation with an unchanged PT of Rs. 19,055.


**Nestle's revenue grew by 9.0% to Rs. 3,610.8 crore in Q1CY2021, in line with our expectation of Rs. 3,639.7 crore. The domestic business grew by 10.2%, driven by 10.7% volume and mix led growth. Key products boosted by home consumption registered double-digit growth. Sales of the Maggi range of noodles and sauces, Kit Kat, Munch, and Nescafe Classic and Nescafe Sunrise grew in double digits. Exports fell by 12.9% due to lower exports to affiliates. Gross margin increased by 223 bps to 58.5%, while OPM increased by 189 bps to 25.8% (better than our expectation of 25.2% and street expectation of 24.9%). Though April started on a good note, the disruption in sales (if any) caused by localised lockdown in key states has to be keenly monitored in the coming months. Management is banking on 3-4 key growth drivers to achieve double-digit growth in the medium term; 1) Increased presence in rural markets, which contributes 25% of domestic revenue (Nestle currently covers 89,288 villages and aims is to reach 1,20,000 villages by 2024), 2) New products contribute 4.3% to revenue (40 new innovation projects in the pipeline); and 3) Accelerated footprints through new channels (e-Commerce stands at 3.8%; grew by 66% in Q1CY2021). The company launched 3-4 new products in Q1CY2021 (including Munch Fruit O Nuts), which are gaining good traction in domestic markets. However, considering the current rise in cases and the overall demand environment, the company might delay some of its new launches, which were planned in the coming months. On the category front, we expect the prepared foods category to continue to maintain double-digit volume growth, while confectionary and liquid beverages will continue to grow in single digits. Once COVID-19 cases reduce substantially, we expect out-of-home categories to post strong recovery in the domestic market. Input prices and packaging material have started going up and impact of the same on gross margins has to be keenly monitored. Management has maintained its thrust on achieving profitability growth in the medium term. We expect OPM to remain at 24%-25% over the next two years. The company declared first interim dividend of Rs. 25 per equity share.**

### Key positives

- Domestic business grew by 10.2%; barring Q2CY2020, the domestic business achieved double-digit growth in the past eight quarters.
- E-commerce channel grew by 66% and currently contributes 3.8% to sales.
- Gross margin improved by 223 bps to 58.5% and OPM improved by 189 bps to 25.8%.

### Key negatives

- Export sales down by 12.9%; the second consecutive quarter of drop in export revenue.

### Our Call

**Valuation - Retain Buy with an unchanged PT of Rs. 19,055:** We have broadly maintained our earnings estimates for CY2021 and CY2022 and would keenly monitor the performance in the coming months. Nestle is the largest food company with a strong brand portfolio in the packaged food and beverages space, which will help it achieve good growth at a time when consumers are shifting to trusted brands and rural aspirations are improving, thereby boosting overall penetration. We expect the company's revenue and PAT to report a CAGR of 13.6% and 19.2%, respectively, over CY2020-CY2022. The stock is currently trading at 55.7x its CY2022E earnings. Strong return profile, future growth prospects, and good dividend payout make it a better pick in the FMCG space. We maintain our Buy recommendation on the stock with an unchanged price target (PT) of Rs. 19,055.

### Key Risks

Any slowdown in domestic consumption or regulatory hurdles in key food categories or an increase in 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 | 15,116 | 17,243 |
| OPM (%) | 23.6 | 23.2 | 24.0 | 24.4 | 24.7 |
| Adjusted PAT | 1,648 | 1,970 | 2,082 | 2,512 | 2,956 |
| *% YoY growth* | *29.3* | *19.5* | *5.7* | *20.6* | *17.7* |
| Adjusted EPS (Rs.) | 171.0 | 204.3 | 216.0 | 260.5 | 306.6 |
| P/E (x) | 99.9 | 83.6 | 79.1 | 65.6 | 55.7 |
| P/B (x) | 44.8 | 85.3 | 81.6 | 69.7 | 61.8 |
| EV/EBIDTA (x) | 61.1 | 57.1 | 51.0 | 44.5 | 38.5 |
| RoNW (%) | 46.5 | 70.3 | 105.4 | 114.7 | 117.6 |
| RoCE (%) | 69.7 | 94.1 | 136.4 | 139.7 | 142.5 |

*Source: Company; Sharekhan estimates*

**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. 17,086** | |
| Price Target: **Rs. 19,055** | ↔ |

↑ Upgrade ↔ Maintain ↓ Downgrade

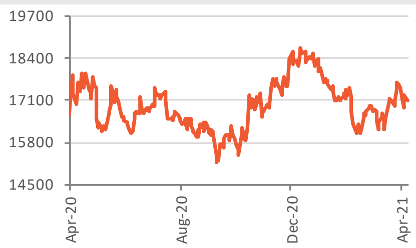
**Company details**

| | |
|---|---|
| Market cap: | Rs. 1,64,736 cr |
| 52-week high/low: | Rs. 18,822 / 15,104 |
| NSE volume: (No of shares) | 1.4 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 | 3.0 | -3.3 | 5.1 | 0.5 |
| Relative to Sensex | 7.1 | 0.8 | -12.6 | -52.8 |

*Sharekhan Research, Bloomberg*

**Revenue up 9% in Q4CY2020; benign input prices drove up margins:** Revenue grew by 9% y-o-y to Rs. 3,600.2 crore in Q1CY2021, in line with our expectations. Domestic revenue also grew by 10.2% y-o-y, driven by volume and mix growth of 10.7%. Gross margin expanded by 223 bps to 58.5% due to a better mix and benign input prices. Other expenses increased by 90 bps mainly on account of higher advertisement spends. OPM improved by 189 bps y-o-y to 25.8%. Operating profit grew by 17.2% y-o-y to Rs. 929.2 crore. Lower other income affected by lower yields led to 14.6% growth in reported PAT to Rs. 602.3 crore.

## Other key highlights

- Two-thirds of the product portfolio, including brands such as Maggi Noodles, Maggi Sauces, KitKat, Munch, Nescafé Classic, and Nescafé Sunrise reported double-digit growth as in-home consumption increased.
- Demand for out-of-home products continued to improve sequentially. However, rising COVID-19 cases will keep a check on demand of out-of-home category products.
- E-Commerce channel (contributes 3.8% to revenue) continued to deliver strong performance and registered 66% growth in Q1CY2021.
- The company launched 3-4 new products during the quarter. There is strong pipeline of new product launches. However, there might be some delay in the launches in the current scenario of rising COVID-19 cases and localised lockdowns in key states.
- The company has paid first interim dividend of Rs. 25 per share in Q1CY2021.

**Results (standalone)** Rs cr

| Particulars | Q1CY21 | Q1CY20 | YoY (%) | Q4CY20 | QoQ (%) |
|---|---|---|---|---|---|
| Net Sales | 3600.2 | 3305.8 | 8.9 | 3417.5 | 5.3 |
| Other Operating income | 10.6 | 19.5 | -45.5 | 15.1 | -29.5 |
| Total Revenue | 3610.8 | 3325.3 | 8.6 | 3432.6 | 5.2 |
| Raw Material Cost | 1497.6 | 1453.2 | 3.1 | 1404.5 | 6.6 |
| Employee Cost | 368.1 | 358.4 | 2.7 | 403.3 | -8.7 |
| Other Expenses | 815.3 | 720.3 | 13.2 | 847.8 | -3.8 |
| Total Operating Cost | 2681.0 | 2531.9 | 5.9 | 2655.6 | 1.0 |
| Operating Profit | 929.9 | 793.4 | 17.2 | 777.0 | 19.7 |
| Other Income | 29.7 | 42.9 | -30.8 | 30.6 | -3.1 |
| PBIDT | 959.5 | 836.2 | 14.7 | 807.6 | 18.8 |
| Interest & Other Financial Cost | 54.0 | 41.0 | 31.9 | 42.0 | 28.8 |
| Depreciation | 93.6 | 91.4 | 2.5 | 95.5 | -2.0 |
| Profit Before Tax | 811.9 | 703.9 | 15.3 | 670.1 | 21.1 |
| Tax Expense | 209.6 | 178.4 | 17.5 | 186.9 | 12.2 |
| Reported PAT | 602.3 | 525.5 | 14.6 | 483.3 | 24.6 |
| Adj. EPS (Rs) | 62.5 | 54.5 | 14.6 | 50.1 | 24.6 |
| | | | **BPS** | | **BPS** |
| GPM (%) | 58.5 | 56.3 | 223 | 59.1 | -56 |
| OPM (%) | 25.8 | 23.9 | 189 | 22.6 | 312 |

*Source: Company; Sharekhan Research*

## Outlook and Valuation

### ■ Sector outlook - Growth momentum improves sequentially; Structural growth story intact

We believe the 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. In the current environment with rising COVID-19 cases and localised lockdown, demand for packaged food products is expected to increase. Consumer good companies have adequately stocked up products at warehouse levels and with dealers/distributors to avoid any supply disruption. 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 input price increase, sustained benefits of cost-saving initiatives, and judicious media spends would determine the level of profitability growth in the coming quarters. The structural growth story of the domestic consumer goods market is intact with lower per capita consumption of products as compared to other countries, lower penetration in rural markets, opportunities to launch new differentiated products, and gaining market share from smaller players.

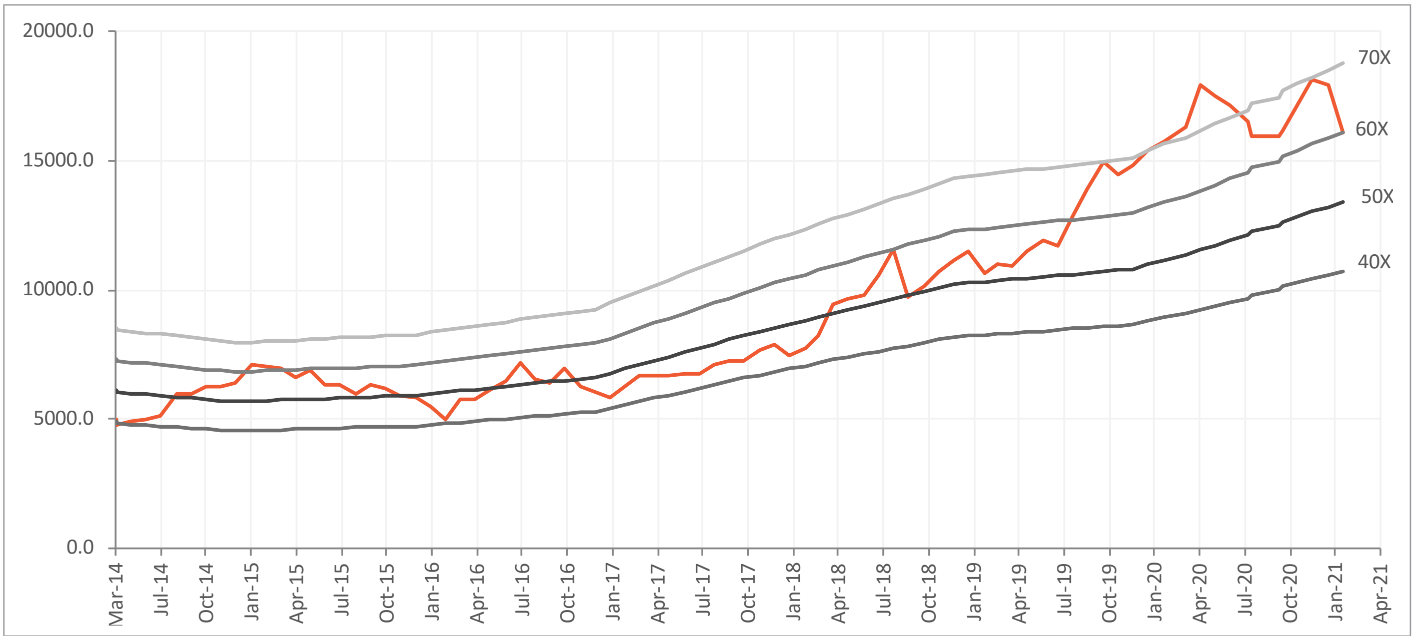
### ■ Company outlook - Revenue growth to recover to double digits in CY2021

Revenue grew by 8% in CY2020, affected by lower exports and COVID-led disruptions in Q2CY2020. The company started CY2021 on a good note, with revenue and PAT growing by 9% and 15%, respectively, in Q1CY2021. We will keenly monitor the performance in the coming months in the backdrop of rising COVID-19 cases and localised lockdown. However, with a strong product portfolio of brands and established distribution reach, the recovery would be faster for Nestle compared to other small consumer goods companies. Medium-term thrust remains on achieving double-digit revenue growth by penetrating deep in rural markets (covered 89,288 villages), innovation (that contributes 4.3% to sales), and accelerating footprint through new channels. We expect OPM to remain at 24%-25% in the coming years.

### ■ Valuation - Retain Buy with an unchanged PT of Rs. 19,055

We have broadly maintained our earnings estimates for CY2021 and CY2022 and would keenly monitor the performance in the coming months. Nestle is the largest food company with a strong brand portfolio in the packaged foods and beverages space, which will help it achieve good growth at a time when consumers are shifting to trusted brands and rural aspirations are improving, thereby boosting overall penetration. We expect the company's revenue and PAT to post a CAGR of 13.6% and 19.2%, respectively, over CY2020-CY2022. The stock is currently trading at 55.7x its CY2022E earnings. Strong return profile, future growth prospects, and good dividend payout make it a better pick in the FMCG space. We maintain our Buy recommendation on the stock with an unchanged PT 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 | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| HUL | 70.1 | 53.2 | 46.4 | 47.6 | 38.6 | 33.5 | 37.1 | 28.3 | 30.7 |
| Britannia Industries | 49.3 | 44.5 | 38.3 | 36.3 | 31.7 | 27.6 | 30.6 | 32.5 | 33.0 |
| *Nestle India | 79.1 | 65.6 | 55.7 | 51.0 | 44.5 | 38.5 | 136.4 | 139.7 | 142.5 |

*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. 13,000 crore. The company is present across India with eight manufacturing facilities, four branch offices, one R&D centre, and approximately 8,000 employees. The company manufactures products under internationally famous brand names such as Nescafé, Maggi, Milkybar, KitKat, Bar-One, Milkmaid, and Nestea. 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 brand portfolio divided into four segments: Milk Products and Nutrition, Prepared Dishes and Cooking Aids, Confectionery, and Powdered and Liquid Beverages. The brands are broadly segregated on the basis of nutrition, health, comfort, variety, indulgence, and taste. The company is the market leader in the categories of 'Instant Noodles' and 'Infant Cereals and Infant Formula.'

## Investment theme

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 key growth drivers for the company in the near to medium term. Strong return profile, future growth prospects, and good dividend payout make the company a better pick in the FMCG space.

## Key Risks

- **Slowdown in the 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, and infant cereals 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 |
| David McDaniel | Executive Director - Finance and CFO |
| B Murli | Company Secretary |

*Source: Company Website*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Life Insurance Corp of India | 1.5 |
| 2 | SBI Funds Management Pvt Ltd | 1.2 |
| 3 | Axis Asset Management Co Ltd/India | 1.4 |
| 4 | BlackRock Inc | 1.2 |
| 5 | Vanguard Group Inc | 1.0 |
| 6 | UTI Asset Management Co Ltd | 0.5 |
| 7 | ICICI prudential Life Insurance Co. | 0.5 |
| 8 | StJames'sPlace PLC | 0.4 |
| 9 | Standard Life Aberdeen PLC | 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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