Stock Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Nestle India Ltd

Mixed bag quarter; domestic biz sustains double-digit growth

Consumer Goods	Sharekhan code: NESTLEIND	Result Update

Summary

- Nestle India's Q2CY2021 performance was mixed with revenues growing ~14%, while OPM was flat at 24.4% (lagging ours as well as the street's expectation of 25%)
- Domestic business maintained double-digit growth momentum at 13.7%, across all key categories seeing an improvement in sales.
- The company will transfer Rs. 837.4 crore banked in its general reserve to retain earnings with effect from January 1, 2022 that can be utilised for higher payouts to shareholders in CY2022.
- Stock trades at 59.3/50.7x its CY2022/23E earnings. We maintain a Buy with a revised price target of Rs. 20,435.

Nestle's revenues grew by 13.8% to Rs. 3,462.4 crore in Q2CY2021, largely inline with our expectation of Rs. 3,419.5 crore. The domestic business grew by 13.7% driven by volume and mix-led growth. Export sales grew by 17.7% due to timing of exports to affiliates. Sales of the Maggi range of noodles and sauces, Kit Kat and Nestle Munch grew in double digits. Gross margins improved by 67 bps yoy to 57.0%. However, the same was lower by 152 bps on q-o-q basis due to increase in the coffee prices, oils and dairy prices. The OPM stood almost flat 24.4%, lower than our as well street expectation of ~25%. Despite challenges of the second wave the company made sure that the much needed food and beverages products are available to the customer. Implementation of telecaller model, frontline sales team making efforts to overcome supply obstacles helped Nestle enable smooth supply of products in the market. E-commerce channel continued to perform well for the company and grew by 105% during the quarter (contribution of e-Commerce channel stood at 6.4%). The management is banking on 3-4 key growth drivers to achieve double-digit growth in the medium term 1) Increase in the presence in the rural markets, which contributes 25% of domestic revenues (Nestle currently covers 89,288 villages and aims is to reach 1,20,000 villages by 2024), 2) New products contributed 4.9% of revenues (~40 new innovations in pipeline) and 3) accelerated footprints through new channels (e-Commerce contributes ~6%). We expect prepared foods category to maintain double-digit volume growth while confectionary and liquid beverages segments will see sequential improvement in the sales on back of expected improvement in domestic mobility with a reduction in COVID-19 cases. Key input prices and packaging material have started going up and the impact of same on gross margins have to be keenly monitored. We expect Nestle to take prudent price hikes and focus on efficiencies to mitigate the impact of input cost inflation in the quarters ahead. The company has invested Rs. 1000 crore of the planned investment of Rs. 2600 crore (including the capital expenditure) for improving growth prospects. Also, the company has decided to transfer Rs. 837.4 crore parked in general reserve to retained earnings considering the strong cash generation ability and strong financial position of the company in CY2022. The same can be utilised for higher dividend payouts to shareholders.

Key positives

- Domestic business grew by 13.7%; the domestic business achieved double digit growth for last nine quarters (except for Q2CY2020, disrupted by first wave of COVID-19).
- E-commerce sales contribution improved to 6.4% from 3.8% in Q1CY21 (hyper-local channels grew fast by 147% in H1CY2021).

Key negatives

- Gross margins declined by 152 bps sequentially mainly on account of spike in input prices.

Our Call

Valuation -Retain Buy with a revised PT of Rs. 20,435: We have broadly maintained our earnings estimates for CY2021 and CY2022 and introduced CY2023 earnings in this note. Nestle is the largest food company with a strong portfolio of brands in the packaged food & beverages space, which will help it achieve good growth at a time when consumers are shifting to trusted brands, rural aspirations are improving, thereby boosting overall penetration. We expect the company's revenues and PAT to clock a CAGR of 13.1% and 18% over CY2020-23. With transfer of funds of Rs. 837 crore in the retain earnings we should expect higher dividend payouts in CY2022. The stock is currently trading at 59.3x its CY2022E EPS and 50.7x its CY2023E EPS. We maintain a Buy recommendation on the stock with a revised price target of Rs. 20,435 (rolling it over average of CY2022-23 earnings).

Key Risks

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 (standalone) Rs cr

Particulars	CY19	CY20	CY21E	CY22E	CY23E
Revenue	12,369	13,350	15,116	17,243	19,630
OPM (%)	23.2	24.0	24.6	25.0	25.6
Adjusted PAT	1,970	2,082	2,513	2,929	3,427
% YoY growth	19.5	5.7	20.7	16.6	17.0
Adjusted EPS (Rs.)	204.3	216.0	260.6	303.8	355.5
P/E (x)	88.2	83.4	69.1	59.3	50.7
P/B (x)	89.9	86.0	73.5	65.8	50.8
EV/EBIDTA (x)	60.2	53.7	46.6	40.1	34.5
RoNW (%)	70.3	105.4	114.7	117.1	113.2
RoCE (%)	94.1	136.4	139.7	141.9	137.7

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. 18,013**	
Price Target: **Rs. 20,435**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 173,674 cr
52-week high/low:	Rs. 18822/15104
NSE volume: (No of shares)	0.9 lakh
BSE code:	500790
NSE code:	NESTLEIND
Free float: (No of shares)	3.6 cr

Shareholding (%)

Promoters	62.8
FII	12.4
DII	7.9
Others	16.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	2.9	8.1	3.7	5.3
Relative to Sensex	3.4	2.7	-8.2	-30.9

Sharekhan Research, Bloomberg

Revenues grew ~14%; OPM remained flat: Revenue grew by 13.8% y-o-y to Rs. 3,462.4 crore in Q2CY2021. Domestic revenue also grew by 13.7% y-o-y driven by volume and mix-led growth. Gross margins expanded by 67 bps to 57%. However, the same fell by 152 bps q-o-q due to a spike in the raw material cost. The other expenses grew by 25.6% mainly on account of higher advertising spends. The OPM stood flat 24.4%. Operating profit grew by 13.4% y-o-y to Rs. 848 crore. Lower other income led to just 10.7% growth in the reported PAT to Rs. 538.6 crore.

Other key highlights

- Despite challenges of the second wave of COVID-19, the company focused on making available the key products to the consumer by implementation of a 'telecaller model' to take orders across trade channels and frontline sales colleagues made efforts to overcome serious logistical obstacles and ensure availability of the products at the right time.
- More than two-thirds of the product portfolio including brands such as Maggi Noodles, Maggi Sauces, KitKat, Nestle Munch registered double-digit growth.
- Demand for out of home products continued to improve sequentially. However, rising COVID cases will keep a check on the demand of out-of-home category products.
- E-Commerce channel (contributes 6.4% of revenues) continued to deliver strong performance and registered a growth of 105% in Q2CY2021; hyperlocal (quick commerce) channel grew by 147% in H1CY2021.
- Contribution of innovation to domestic sales has improved to 4.9%.
- The company has decided to transfer Rs. 837.4 crore parked in the general reserve to retained earnings considering the strong cash generation ability and strong financial position of the company in CY2022. The same can be utilised for higher dividend payouts to shareholders.

Results (standalone) Rs cr

Particulars	Q2CY21	Q2CY20	YoY (%)	Q1CY21	q-o-q (%)
Net Sales	3462.4	3041.5	13.8	3600.2	-3.8
Other Operating income	14.4	9.0	58.9	10.6	35.1
Total Revenue	3476.7	3050.5	14.0	3610.8	-3.7
Raw Material Cost	1494.8	1331.9	12.2	1497.6	-0.2
Employee Cost	378.3	369.6	2.4	368.1	2.8
Other Expenses	755.6	601.4	25.6	815.3	-7.3
Total Operating Cost	2628.7	2302.9	14.1	2681.0	-1.9
Operating Profit	848.0	747.6	13.4	929.9	-8.8
Other Income	29.5	37.9	-22.3	29.7	-0.6
PBIDT	877.5	785.5	11.7	959.5	-8.6
Interest & Other Financial Cost	51.7	40.8	26.7	54.0	-4.3
Depreciation	95.3	92.4	3.1	93.6	1.8
Profit Before Tax	730.5	652.3	12.0	811.9	-10.0
Tax Expense	191.9	165.7	15.8	209.6	-8.4
Reported PAT	538.6	486.6	10.7	602.3	-10.6
Adj. EPS (Rs.)	55.9	50.5	10.7	62.5	-10.6
			bps		**Bps**
GPM (%)	57.0	56.3	67	58.5	-152
OPM (%)	24.4	24.5	-12	25.8	-136

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Demand remains resilient; Margins to improve sequentially

The pre-quarter commentary of most consumer goods companies indicated strong a sales recovery from June 2021 with easing of lockdown restrictions in most parts of India. Demand, which started recovering from Q3FY2021, remained resilient in Q1FY2022. With a normal monsoon expected for the third consecutive year, agricultural production is predicted to be better in Kharif season in 2021. This will further boost rural demand in the coming quarters. We believe that the shift in demand for branded products, rural demand outpacing urban demand, a gradual recovery in out-of-home categories and product launches remain key catalysts for revenue growth in the near to medium term. On the other hand, prices of key raw materials (including palm oil, copra and raw tea) have started correcting from their high. The substance of same along with calibrated price hikes would enable consumer goods companies to post better OPM sequentially. Profitability is likely to be better off in H2FY2022. Improving revenue mix and better operational efficiencies remain key margin drivers in the medium term.

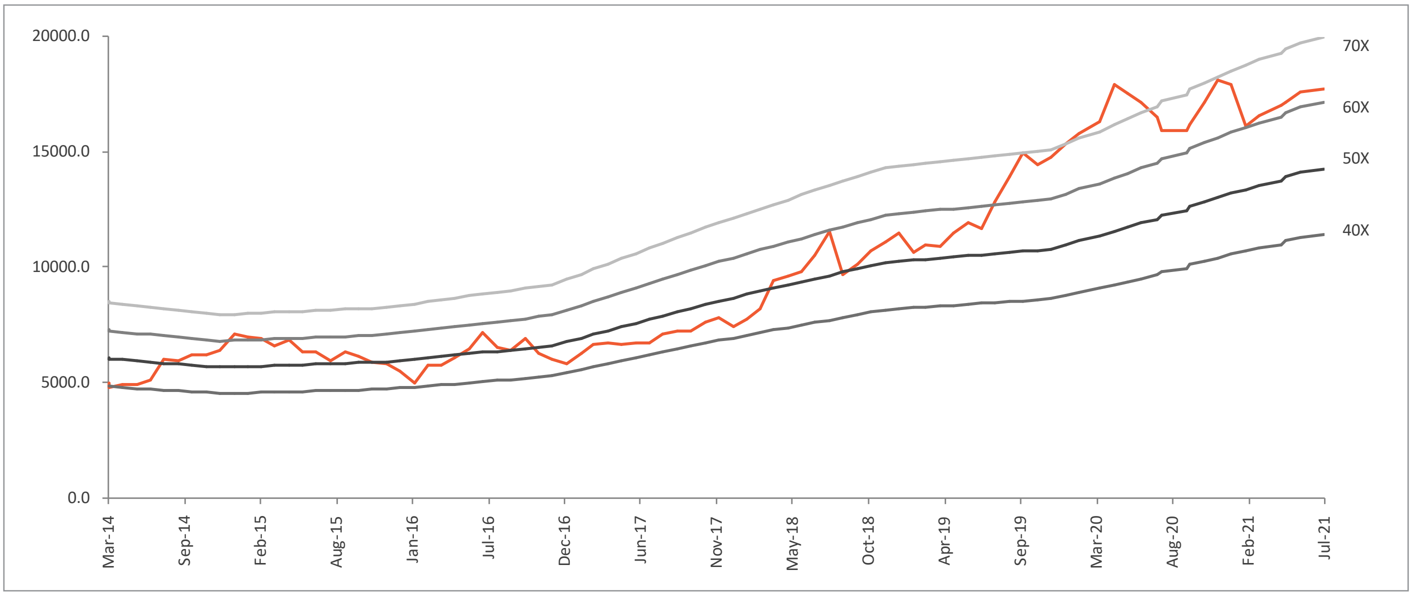
■ Company outlook - Revenue growth to recover to double digits in CY2021

Revenues grew by 8% in CY2020 affected by lower exports and COVID-led disruptions in Q2CY2020. CY2021 began on a good note with revenue and PAT growing by 12% and 13% each in H1CY2021. With strong product portfolio of brands and established distribution reach, recovery would be faster for Nestle compared to other small consumer goods companies. In the medium term, the thrust remains on achieving double-digit revenue growth by penetrating deep in rural markets (covered 89,288 villages), innovation (that contributes 4.9% of sales) and accelerating footprint through new channels. We expect OPM to remain at 24-25% in the medium term.

■ Valuation - Retain Buy with a revised PT of Rs. 20435

We have broadly maintained our earnings estimates for CY2021 and CY2022 and introduced CY2023 earnings in this note. Nestle is the largest food company with a strong portfolio of brands in the packaged food & beverages space, which will help it achieve good growth at a time when consumers are shifting to trusted brands, rural aspirations are improving, thereby boosting overall penetration. We expect the company's revenues and PAT to clock a CAGR of 13.1% and 18% over CY2020-23. With transfer of funds of Rs. 837 crore in the retain earnings we should expect higher dividend payouts in CY2022. The stock is currently trading at 59.3x its CY2022E EPS and 50.7x its CY2023E EPS. We maintain a Buy recommendation on the stock with a revised price target of Rs. 20,435 (rolling it over average of CY2022-23 earnings).

One-year forward P/E band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY21E	FY23E
HUL	68.2	57.9	47.8	48.5	41.9	34.7	36.5	26.4	31.6
Britannia Industries	44.6	40.0	35.1	33.8	29.4	25.5	31.3	35.2	36.3
*Nestle India	83.4	69.1	59.3	53.7	46.6	40.1	136.4	139.7	141.9

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

About company

Nestle is the largest food company in India with a turnover of over Rs. 13,000 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

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. Strong return profile, future growth prospects and good dividend payout makes it a better pick in the FMCG space.

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
David Mc Daniel	Executive Director - Finance and CFO
B Murli	Company Secretary

Source: Company

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	St. James'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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