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Stock Update

Nestle India Ltd

Mixed bag quarter; domestic biz sustains double-digit growth

Consumer Goods	Sharekhan code: NESTLEIND	Result Update

Summary

- Nestle India registered mixed numbers for Q3CY2021 with revenues growing ~10% while OPM declined by 52 bps to 24.4% due to increase in the key input prices. PAT grew by 5.2% y-o-y.
- Domestic business maintained its double-digit growth momentum with a 10.1% growth (driven by volume and mix growth). All key categories registered double-digit growth with improvement in out-of-home (OOH) categories.
- With OOH categories recovering, revenue growth trajectory is expected to improve in the coming quarters. However, input cost inflation is expected to sustain. The management is relying on cost optimisation and efficiencies to maintain profitability.
- Nestle declared a second interim dividend of Rs. 110 per share (in addition to first interim dividend of Rs. 25 per share). We maintain a Buy on the stock with unchanged PT of Rs. 22,395.

In Q3CY2021, Nestle India (Nestle) registered mixed performance with revenues growing by ~10% to Rs. 3,865 crore while PAT grew by 5% to Rs. 617.4 crore (due to a 52 bps decline in OPM and higher interest expenses). Domestic business grew by 10.1%. Organised trade witnessed a recovery in Q3 with strong revenue growth in mid-twenties after a muted second quarter, which was impacted by the second wave of COVID-19. Maggie Noodles, Confectionaries (including Kit-Kat and Munch) and Beverages registered double-digit revenue growth with recovery in the out-of-home sales. The company is focusing on double-digit growth across markets (including urban and rural) by using healthy mix of customised portfolio and enhanced distribution expansion.

Key positives

- Organised trade registered mid-twenties growth after lull Q2 affected by the second wave.
- Maggi, Kit Kat and Nescafe registered strong double-digit growth with recovery in out-of-home sales. Sales likely to recover to pre-pandemic levels in some markets
- The company has paid second interim dividend of Rs. 110 per share (adding to first of Rs. 25 per share).

Key negatives

- Export sales stood flat on a y-o-y basis at Rs. 177 crore.
- Gross margins decreased by 239 bps y-o-y to 55.7%.

Management Commentary

- The management is banking on 3-4 key growth drivers to achieve double-digit growth in the medium term - 1) Increase in presence in rural markets, which contribute 25% of domestic revenues, 2) increase in new product contribution and 3) accelerated footprint through new channels (e-Commerce contributes ~6%).
- Increase in agri commodity and milk prices would keep gross margins under pressure in the near term. A better product mix, cost saving initiatives and operating efficiencies would reduce stress on the margins.

Revision in estimates – We have fine-tuned our CY2021 earnings estimates to factor in little lower gross margins and higher interest cost, while we have broadly maintained it for CY2022 and CY2023.

Our Call

View – Maintain Buy with an unchanged price target of Rs. 22,395: 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. With capacity expansion (commissioned its ninth factory in Sanand, Gujarat) and focus on improving reach in key markets, the company is well-poised to achieve double digit earning growth in the medium term. This along with cheery dividend payout makes it a good pick from a long-term perspective. Thus, we maintain a Buy on the stock with an unchanged price target of Rs. 22,395. The stock has corrected by 6% from its recent high and is currently trading at 55.2x its CY2023E 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	CY20	CY21E	CY22E	CY23E
Revenue	13,350	14,901	17,123	19,493
OPM (%)	24.0	24.3	24.9	25.4
Adjusted PAT	2,082	2,361	2,880	3,382
% YoY growth	5.7	13.4	22.0	17.4
Adjusted EPS (Rs.)	216.0	244.9	298.7	350.7
P/E (x)	89.7	79.1	64.9	55.2
P/B (x)	92.5	84.5	76.6	58.9
EV/EBIDTA (x)	57.9	51.5	43.7	37.6
RoNW (%)	105.4	111.6	123.9	120.6
RoCE (%)	136.4	137.5	148.8	145.5

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. 19,377**	
Price Target: **Rs. 22,395**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

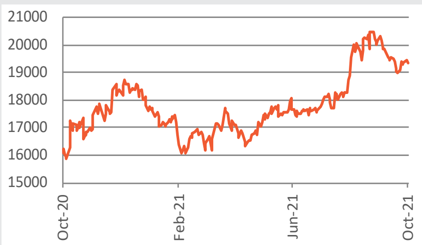
Company details

Market cap:	Rs. 1,86,830 cr
52-week high/low:	Rs. 20,600/15,435
NSE volume: (No of shares)	0.7 lakh
BSE code:	500790
NSE code:	NESTLEIND
Free float: (No of shares)	3.6 cr

Shareholding (%)

Promoters	62.8
FII	13.3
DII	7.9
Others	16.1

Price chart



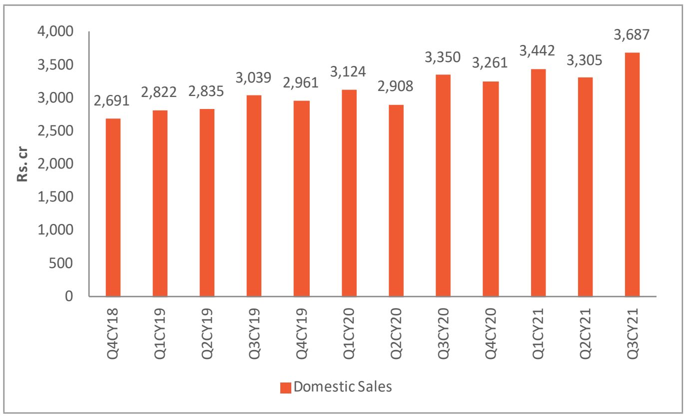
Price performance

(%)	1m	3m	6m	12m
Absolute	-4.7	7.6	13.3	20.4
Relative to Sensex	-10.2	-9.2	-16.1	-32.3

Sharekhan Research, Bloomberg

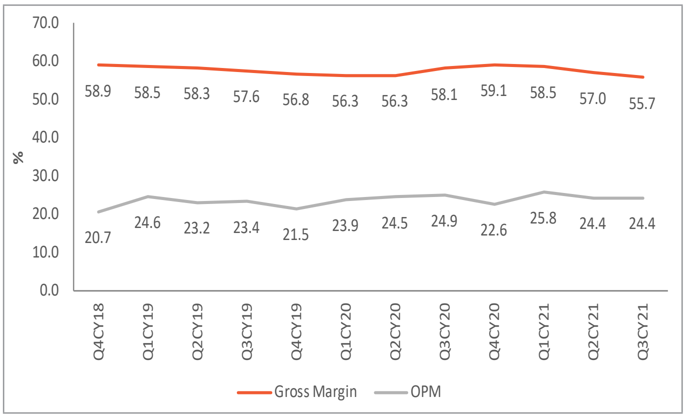
Revenues grew by 9.6% y-o-y; OPM to marginally decline by 52 bps y-o-y: Revenue grew by 9.6% y-o-y to Rs. 3,865 crore in Q3CY2021. Domestic revenue grew by 10.1% y-o-y and delivered broad based growth largely driven by volume and mix. Gross margins contracted by 239 bps y-o-y and 130 bps q-o-q to 55.7%, impacted by a spike in the raw material cost. Operating profit grew by 7.3% y-o-y to Rs. 949 crore. OPM declined marginally by 52 bps y-o-y to 24.4%. Lower other income coupled with higher interest cost led to just 5.2% growth in the reported PAT to Rs. 617 crore.

Steady growth in domestic revenue



Source: Company, Sharekhan Research

Quarterly trend in margins



Source: Company, Sharekhan Research

Other key highlights

- **Category-wise performance**
    - **Prepared Dishes and Cooking Aids category:** Despite the high base effect, continuing momentum and improved availabilty helped achieve good growth in this category. Maggi Noodles and Maggi Masala-ae-Magic posted healthy growth while Maggi Sauces had somewhat muted growth due to reduced in-home consumption, high base and increased competitive intensity.
    - **Milk Products and Nutrition:** The toddler range (CEREGROW, NANGROW) and MILKMAID reported strong double-digit growth.
    - **Confectionery:** All power brands KitKat, Munch and MilkyBar reported high double digit growth led by media campaigns, attractive consumer promotions and distribution drives.
    - **Beverages:** Nescafe Classic reported strong double-digit growth led by increased penetration, visibility actions and sustained generating demand inputs.
- The organised trade witnessed a resurgence during the quarter with strong revenue growth in mid-twenties after a muted Q2, which was impacted by the pandemic second wave. E-commerce channel showed strong acceleration on the back of convenience and pandemic-driven consumer behaviour.
- The management has guided that price outlook for key categories like wheat, coffee, edible oils remains firm to bullish while costs of packaging materials continue to increase amid supply constraints, rising fuel and transportation costs. Input prices expected to be on bullish trend both globally and to some extent locally. Fresh milk prices are expected to remain firm with continued increase in demand and rise in feed costs to farmers. The recent announcement of scrapping of import duties on edible oils, if continued next year, beyond March 2022, can have positive impact in muting food inflation pressures.
- During the quarter, the company's ninth factory in Sanand, Gujarat became operational. Equipped with a state-of-the-art biomass boiler, Sanand factory aspires to be a zero-carbon emission unit.
- The company declared a second interim dividend for 2021 of Rs. 110 per equity share (Face value Rs. 10 per equity share). This is in addition to the first interim dividend of Rs. 25 per equity share paid in Q2CY2021.

Results (standalone) Rs cr

Particulars	Q3CY21	Q3CY20	YoY (%)	Q2CY21	QoQ (%)
Net Sales	3,865.0	3,525.4	9.6	3,462.4	11.6
Other Operating income	17.6	16.3	8.0	14.4	22.6
Total Revenue	**3,882.6**	**3,541.7**	**9.6**	**3,476.7**	**11.7**
Raw Material Cost	1,719.8	1,484.3	15.9	1,494.8	15.1
Employee Cost	388.3	369.7	5.0	378.3	2.6
Other Expenses	826.0	804.2	2.7	755.6	9.3
Total Operating Cost	2,934.1	2,658.1	10.4	2,628.7	11.6
Operating Profit	**948.5**	**883.6**	**7.3**	**848.0**	**11.9**
Other Income	33.7	34.5	-2.3	29.5	14.2
PBIDT	982.2	918.1	7.0	877.5	11.9
Interest & Other Financial Cost	51.9	40.5	28.3	51.7	0.4
Depreciation	96.1	91.1	5.4	95.3	0.8
Profit Before Tax	**834.2**	**786.5**	**6.1**	**730.5**	**14.2**
Tax Expense	216.9	199.4	8.8	191.9	13.0
Adjusted PAT	**617.4**	**587.1**	**5.2**	**538.6**	**14.6**
Adj. EPS (Rs.)	64.0	60.9	5.2	55.9	14.6
			BPS		**BPS**
GPM (%)	55.7	58.1	-239	57.0	-130
OPM (%)	24.4	24.9	-52	24.4	4
NPM (%)	15.9	16.6	-68	15.5	41
Tax rate (%)	26.0	25.4	64	26.3	-28

Source: Company; Sharekhan Research

Outlook and Valuation

Sector outlook – Demand remains resilient; Margins to improve sequentially

After second wave disruption in April-May 2021, companies witnessed faster recovery in performance in June-July 2021. The rural market is gaining momentum and, with monsoon expected to be normal, rural growth is expected to be stronger than urban growth in the quarters ahead. Further, corporates opening up with full capacity and improving mobility would improve demand for out-of-home categories such as colour cosmetics, beverages and juices, deodorants and hair colour. Thus, we expect consumer goods companies to post better sales volume in the quarters ahead. 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.

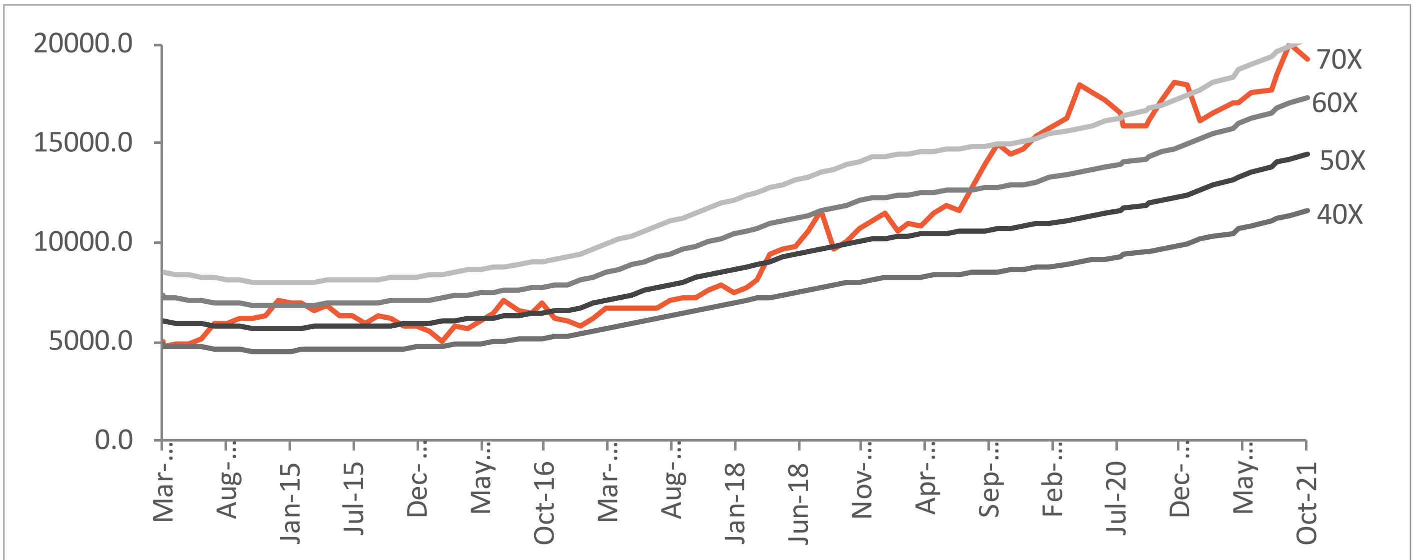
Company outlook – Recovery in out-of-home consumption to drive growth

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 contribute 4.3% of revenues (40 new innovation projects in pipeline) and 3) accelerated footprints through new channels (e-Commerce contributes ~6%). We expect prepared foods category continue to maintain double digit volume growth while confectionary and liquid beverages will sequential improvement in the sales on back of expected to improvement in the domestic mobility with reduction in covid-19 cases. The key input prices and packaging material have started going up and the impact of same on the gross margins have to be keenly monitored. We expect company to take prudent price hikes and focus on efficiencies to mitigate the impact of input cost inflation in the quarters ahead.

Valuation – Maintain Buy with an unchanged price target of Rs. 22,395

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. With capacity expansion (commissioned its ninth factory in Sanand, Gujarat) and focus on improving reach in key markets, the company is well poised to achieve double digit earning growth in the medium term. This along with cheery dividend payout makes it a good pick from a long-term perspective. Thus, we maintain a Buy on the stock with an unchanged price target of Rs. 22,395. The stock has corrected by 6% from its recent high and is currently trading at 55.2x its CY2023E earnings.

One-year forward PE band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY22E
HUL	73.5	65.2	53.0	52.4	46.1	38.3	36.5	25.2	31.1
Britannia Industries	49.4	48.4	40.6	37.3	36.1	30.5	31.3	32.8	36.0
Nestle India*	89.7	79.1	64.9	57.9	51.5	43.7	136.4	137.5	148.8

*Source: Company, Sharekhan estimates; *Values for Nestle India are for CY20, CY21E and CY22E*

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 McDaniel	Executive Director - Finance & Control and CFO
B Murli	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	BlackRock Inc	1.32
2	Axis Asset Management Co Ltd/India	1.30
3	Vanguard Group Inc	1.20
4	SBI Funds Management Pvt Ltd	1.14
5	UTI Asset Management Co Ltd	0.57
6	ICICI prudential Life Insurance Co.	0.38
7	Norges bank	0.30
8	FundRock Management Co SA	0.22
9	Government Pension Investment Fund Japan	0.22
10	PineBridge Investments LP	0.17

Source: Bloomberg

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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