Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Nestle India Limited

Brewing a healthy growth recipe

Consumer Goods	Sharekhan code: NESTLEIND	Company Update

Summary

- Nestle India (Nestle) maintained its thrust on achieving double-digit revenue growth by penetrating deep in rural markets (covered 89,288 villages), innovation (that contributes 4.3% of sales) and accelerating footprint through new channels.
- Revenues grew by 8.1%y-o-y in CY2020, driven by a 5.7% volume growth. Barring Q2, volume growth stood at 7-8% (value growth was at 10-11%) in all other quarters.
- OPM stood at 24% in CY2020. Though input prices are rising, efficient procurement and Project Shark are expected to keep OPM high y-o-y.
- The stock has corrected by ~15% from highs and is trading at 53x its CY2022E EPS. Strong return profile, growth prospects and cheery dividend payout make Nestle a good pick. We maintain Buy with unchanged PT of Rs. 19,055.

We attended Nestle India's virtual analyst meet to understand its strategies to achieve steady double-digit earnings growth in the near to medium term. Revenues clocked a CAGR of 11% over CY2016-19, largely driven by volume growth of 8-12% in the same period. Revenues rose by 8.1% in CY2020 as Q2 was affected by supply disruptions amid theCOVID-19 led lockdown. However, once the lockdown norms were eased, revenue growth picked up to 10% in H2, driven by 7-8% volume growth. In CY2020, baring powdered and liquid beverages (that contribute ~10.5% of revenues), all other segments grew by 7-11% in CY2020. Powdered and liquid beverages were affected as consumers reduced out-of-home consumption. The management is banking on 3-4 key growth drivers 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 stands 3.7%; grew by 111% CY2020). Further, the company is planned a capex of Rs. 2,600crore to expand capacity of noodles, confectionary and coffee in phase manner over the next 2-3 years (this will help its strategy to expand fast in smaller towns and rural markets). With out-of-home consumption expected to revive as the scare of the virus receding, we expect the growth to revive in powdered and liquid beverages in CY2021. The prepared dishes segment is expected to maintain double-digit growth while the milk product and nutrition segment is expected to see better growth as penetration improves. OPM rose by 80 bps y-o-y to 24% in CY2020 largely driven by benign input prices. Though prices have started rising, the management is confident of maintaining margins through efficient procurement and an initiative named Project Shark.

Our Call

Valuation - Retain Buy with unchanged PT of Rs. 19,055: 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. A gradual recovery in out-of-home consumption is also a positive.Also, improving demographics with more population expected to come into middle income group and a rise in young population augurs well for Nestle's products. We expect revenues and PAT to clock a CAGR of 12.4% and 18.4% over CY2020-22E. The stock has corrected by ~15% from its highs and is trading at 53x its CY2022E EPS. Strong return profile, future growth prospects and good dividend payout makes a good pick. We maintain a Buy with unchanged PT of Rs. 19,055.

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 (Consolidated) Rs cr

Particulars	CY18	CY19	CY20E	CY21E	CY22E
Revenue	11,292	12,369	13,350	15,129	16,913
OPM (%)	23.6	23.2	24.0	24.5	25.0
Adjusted PAT	1,648	1,970	2,082	2,565	2,942
% YoY growth	29.3	19.5	5.7	23.2	14.7
Adjusted EPS (Rs.)	171.0	204.3	216.0	266.1	305.1
P/E (x)	94.2	78.8	74.5	60.5	52.8
P/B (x)	42.2	80.3	76.9	58.4	42.3
EV/EBIDTA (x)	57.5	53.7	48.0	41.6	36.2
RoNW (%)	46.5	70.3	105.4	109.7	93.0
RoCE (%)	70.3	96.9	144.5	145.8	124.6

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. 16,098**	
Price Target: **Rs. 19,055**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

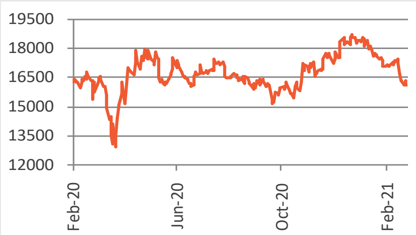
Company details

Market cap:	Rs. 155,210 cr
52-week high/low:	Rs. 18,822/12,589
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

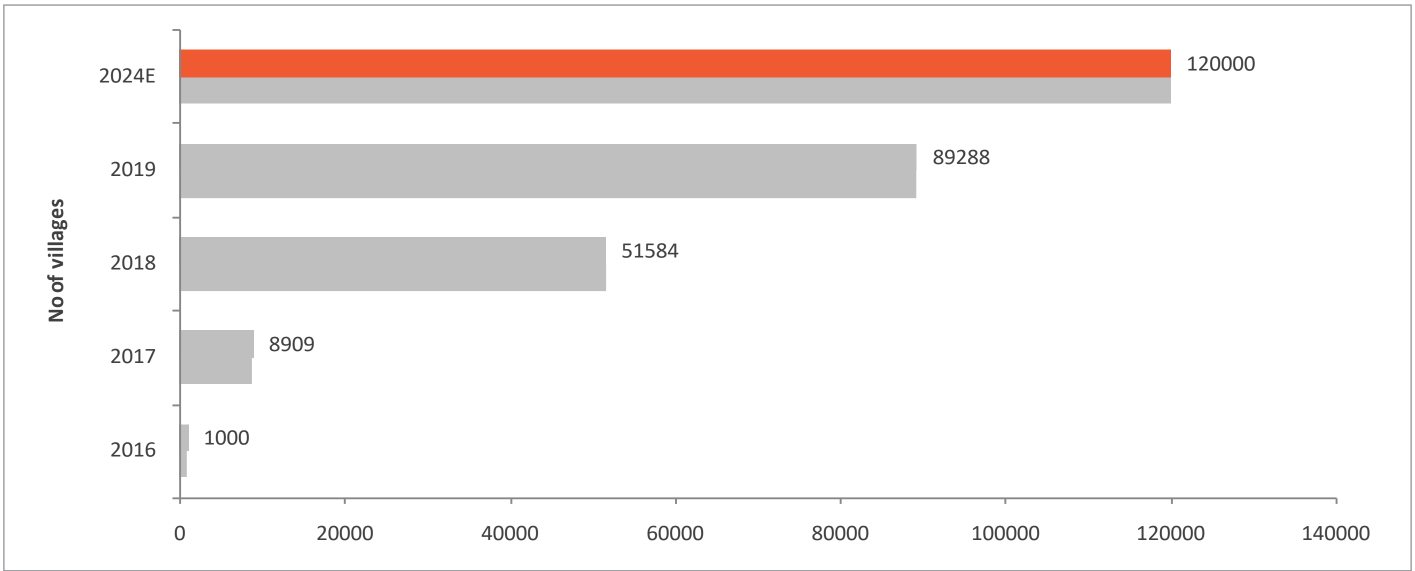
(%)	1m	3m	6m	12m
Absolute	-8.3	-9.3	-0.6	-1.0
Relative to Sensex	-11.8	-20.3	-26.2	-24.1

Sharekhan Research, Bloomberg

Focus on improving penetration in the rural markets

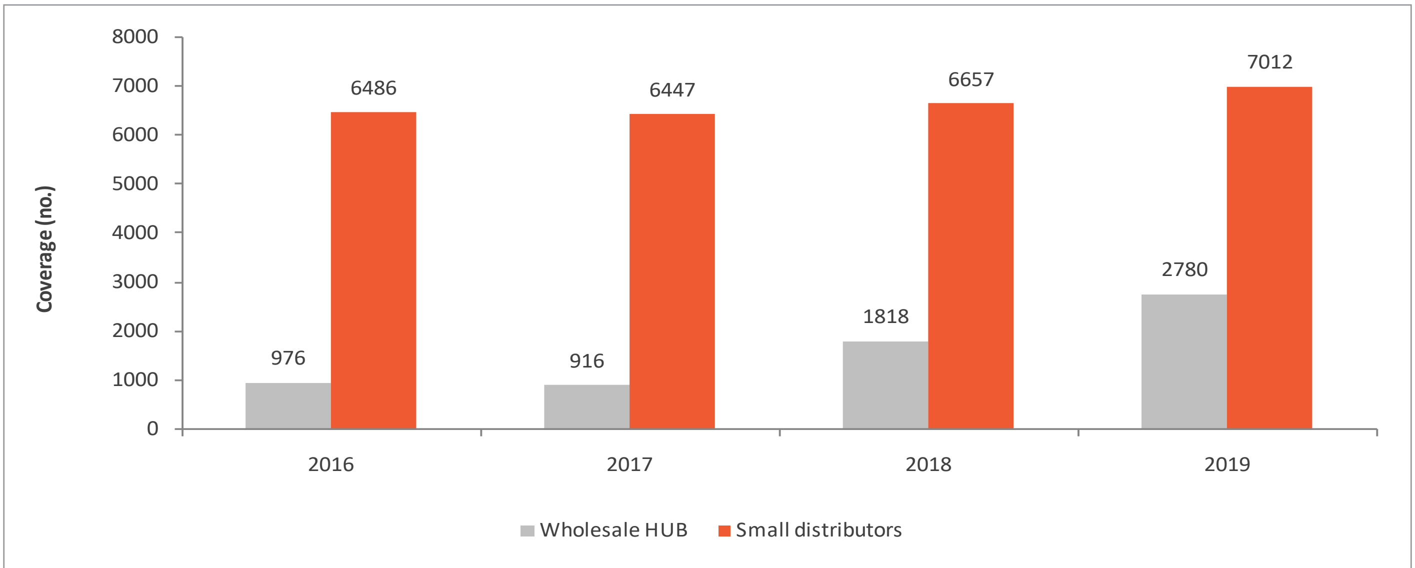
Rural India contributes around 25% of Nestle's domestic revenues. Improving aspirations and availability of products helped Nestle see the rural market growing 2-3x ahead of urban markets in the recent times. Villages covered have risen to 89,288 villages from a mere 1,000 villages in 2016. The company aims to cover 1,20,000 villages by 2024. Further the company is currently focusing carving out relevant SKUs from the current portfolio for rural markets and in next phase will focus on launching rural-centric products. Demand for Nestle Maggi double packs have gone up significantly in rural markets. Ramping up of rural infrastructure will help the company to faster penetrate in these regions and improve contribution in the coming years.

Aims to cover 1.2lakh villages by CY24



Source: Company

Steady increase in small distributors and wholesale hubs

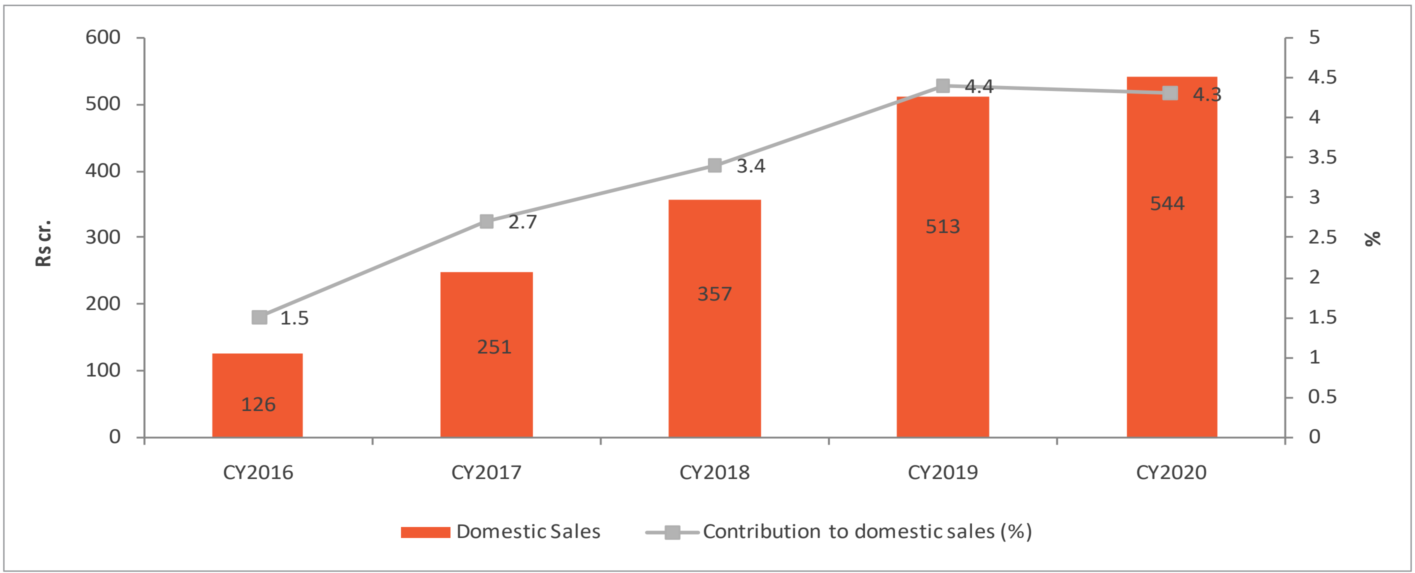


Source: Company

New products remain key growth drivers

Innovation stays at the core of Nestle's growth strategy. Out of its 35 billionaire brands globally, only nine brands are present in India, which provides a huge opportunity for the company to scale up its product portfolio. Over 80 new products were launched in the last five years. The company isinnovating at pace of 3x as compared to the last five years. However, CY2020 was muted in terms of new product launches as large focus was on investment in core. Still, the management's focus is back on the innovation strategy with 40 new products in pipeline for launch. Around 70% of the new launches have hit the success ratio. Contribution from new products rose to 4.3% in CY2020 from 1.5% in CY2016.

Substantial increase in contribution from new launches

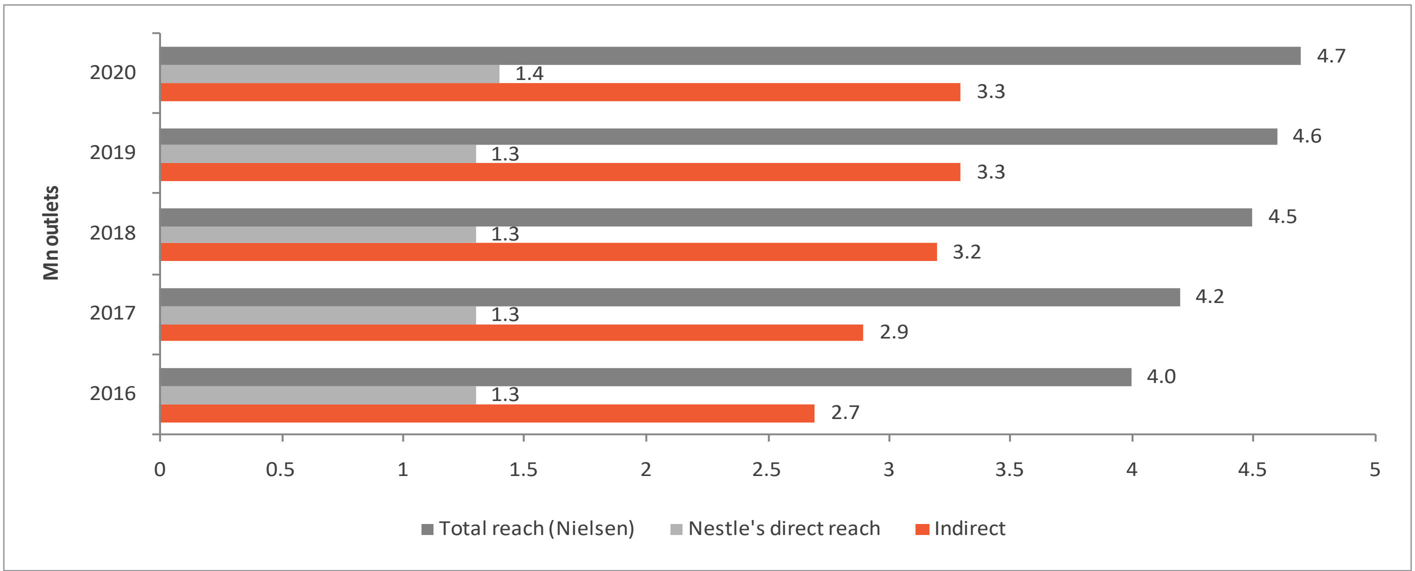


Source: Company

Enhance distribution reach; scale-up in new channels augurs well from long term perspective

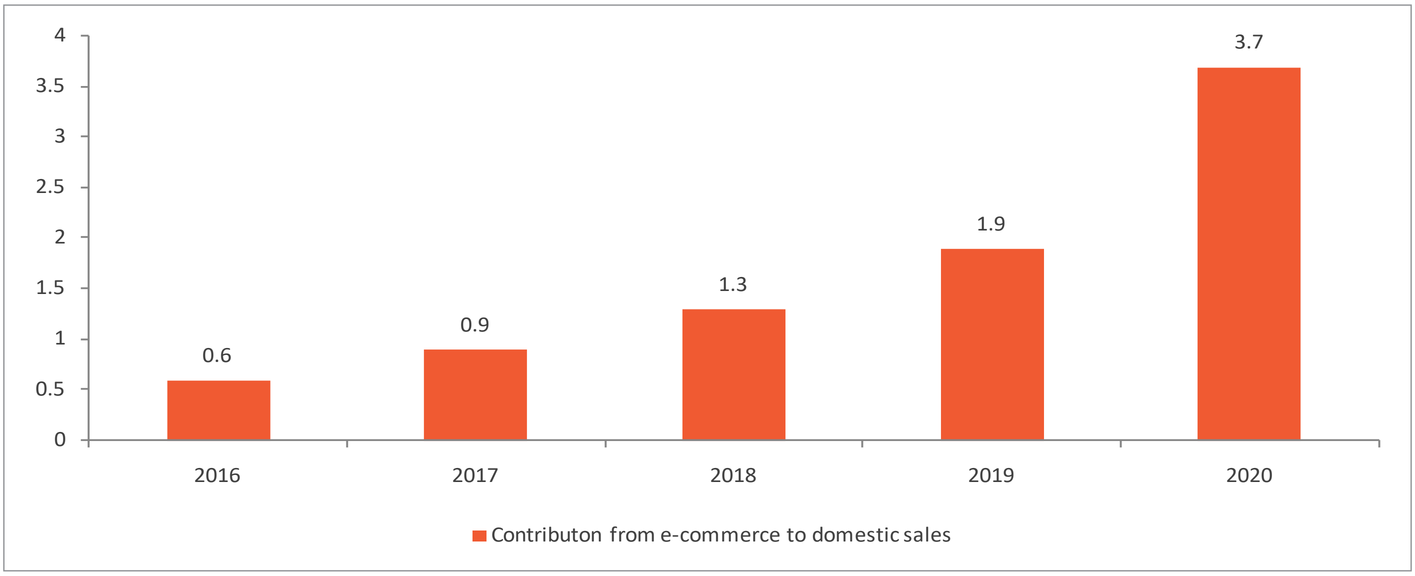
Nestle is working on the mantras of availability, visibility and consumer connect to improve its growth prospects in long run. Its total reach is currently 4.7 million outlets (3.3million indirect outlets and 1.4million direct outlets), which improved from 4million outlets in CY2016.Though 90% of the sales happen through the general trade, e-Commerce channels have seen a strong jump in contribution to 3.7% in CY2020 from 0.6% in CY2016 (grew by 111% in y-o-y in CY2020).

Distributions reach inching close to 5 mn outlets



Source: Company

Increase in contribution from e-Commerce channel

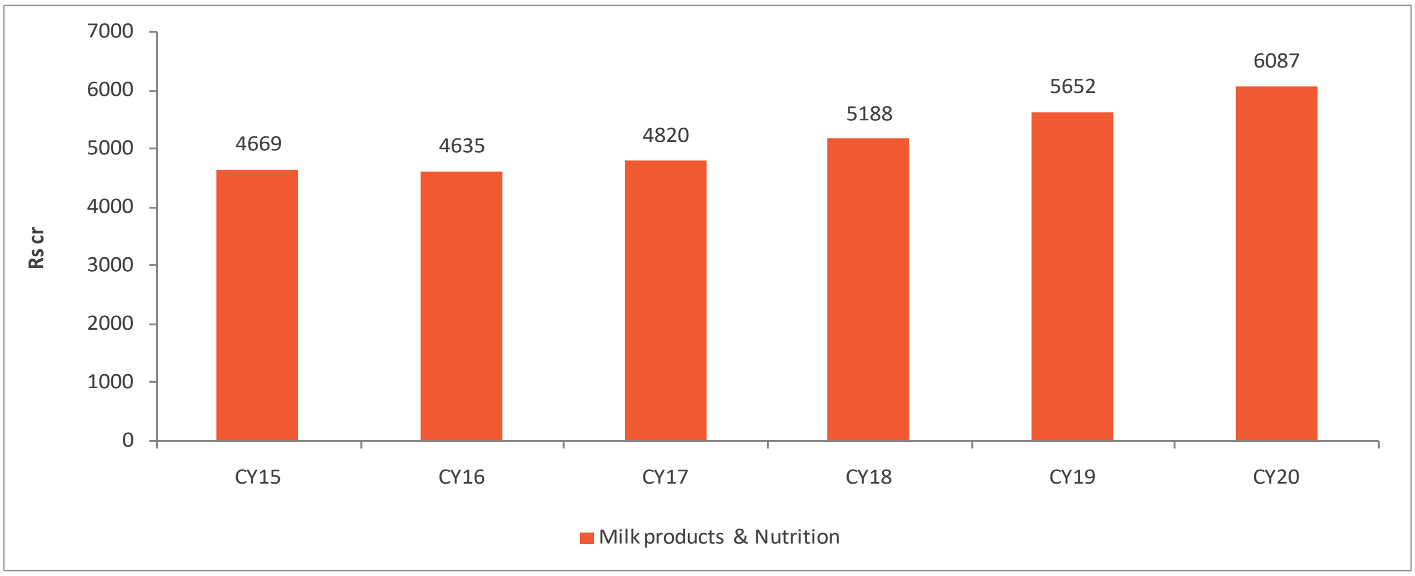


Source: Company

Milk products & Nutrition space to see healthy growth aspenetration improves

The milk products and nutrition segment contributes around 46% of domestic revenues grew by ~9% in CY2020. The management expects the segment to grow strongly in the coming quarters on back of strong product portfolio, a rise in the population of working women and aspirations for better nutrition for children. The company is also focusing on launching innovative new product in the segment. Research & Development facility in Manesar, the company is focusing on introducing innovative scientific products for infant growth.

Trend in revenues of Milk products &Nutrition segment



Source: Company; SharekhanResearch

Out-of-home consumption to recover in CY2021

Nestle powder and liquid beverages business stood flat in CY2020 as out-of-home consumption was affected by the onslaught of the pandemic. However, with the scare of the virus receding and progress on vaccination improving in domestically and globally, we expect out-of-home consumption to see a strong come back in CY2021. The company has introduced touchless vending machines, digital payment machines and food products such as rice mixes and customised sauces to see faster recovery in the out-of-home product sales in the post-pandemic era.

Nestle Health Science - Another big opportunity

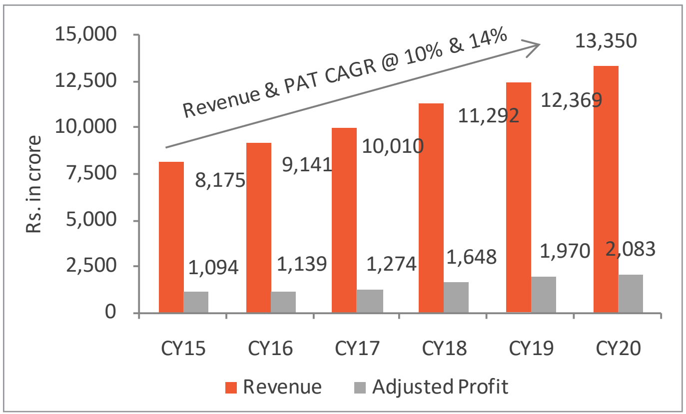
In-line with its parent strategy, Nestle India continued to build Nestle Health Science into a nutritional powerhouse. There are products such resource-high proteins and resource diabetics which have the potential to achieve good traction with more and more people are becoming health cautious. Awareness for such products improves if they are recommended by health advisors and see repetitive buying by consumers.

Other key conference call highlights

- The company has planned a capital expenditure (capex) of Rs. 2,600crore in the next 3-4 years. Capex will currently done in large three categories - noodles (new plant is established at Sanand, Gujarat); a coffee facility in Nanjangud, Karnataka and Chocolate & confectionary facility at Ponda, Goa. All these facilities will come up in a phased manner.
- Gross margins improved by 146 bps in H2FY2021 to 58.3% driven by benign input prices (especially the milk prices). However the prices of some of the key inputs have started seeing an upswing. Though prices have started showing an upward trend, the management is confident of maintaining the margins through efficient procurement and Project Shark.

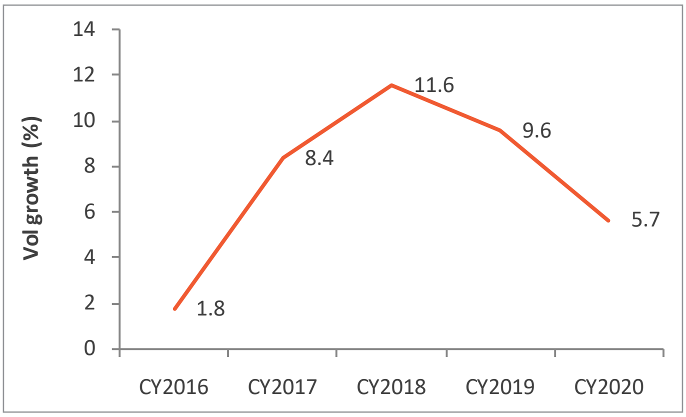
Financials in charts

Trend in revenues and PAT



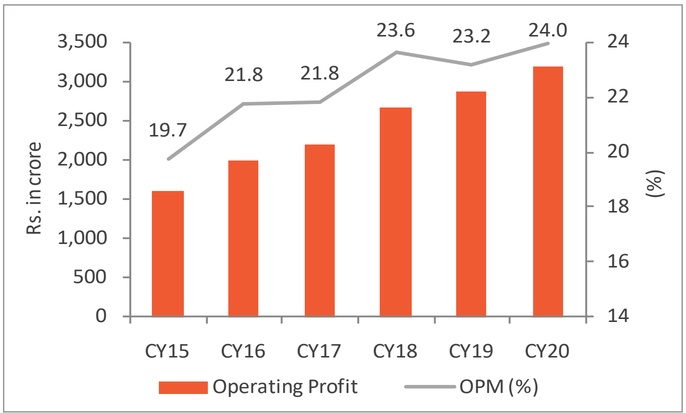
Source: Company, Sharekhan Research

Volume growth moderated in CY2020



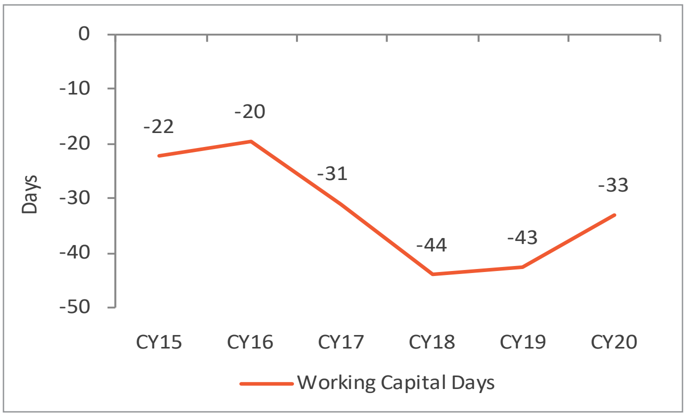
Source: Company, Sharekhan Research

Consistent improvement in the OPM



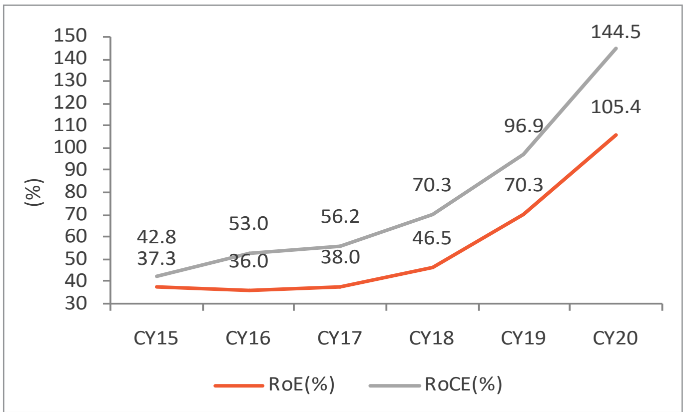
Source: Company, Sharekhan Research

Working capital remains negative



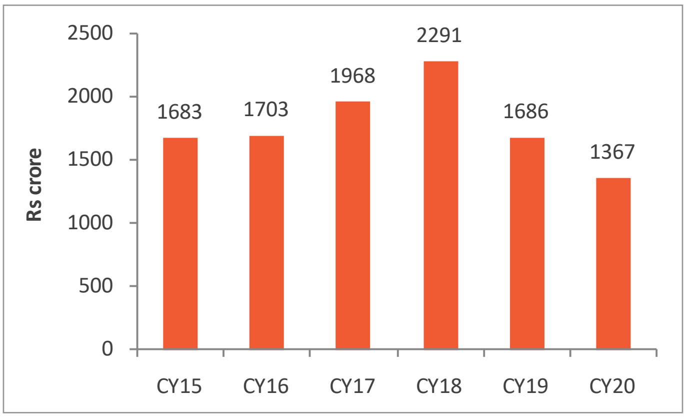
Source: Company, Sharekhan Research

Strong return profile



Source: Company, Sharekhan Research

Strong FCF



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. The structural growth story of domestic consumer goods market is intact with lower per capita consumption of products as compared to other countries, lower penetration in rural markets and opportunities to launch new differentiated products and gaining market share from smaller players.

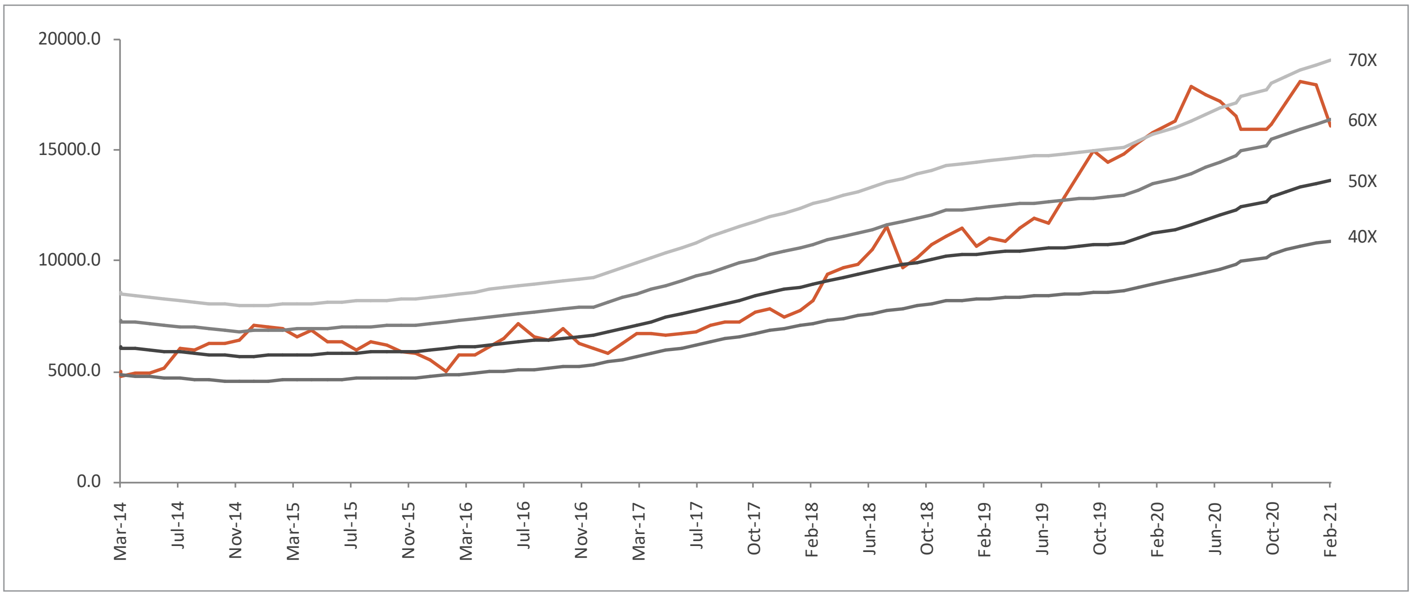
■ Company outlook - Revenue growth to recover to double digits in CY2021

Revenues grew by 8% in CY2020 affected by lower exports and COVID-led disruptions in Q2CY2020. H2CY2020 saw strong rebound with a double-digit growth in revenues. Sustained innovations, going deep into the rural markets and rising trend of eating out would help the company 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 - Retain Buy with unchanged PT of Rs. 19,055

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. A gradual recovery in out-of-home consumption is also a positive. Also, improving demographics with more population expected to come into middle income group and increase in young population augurs well for Nestle's products. We expect revenues and PAT to clock a CAGR of 12.4% and 18.4% over CY2020-22E. The stock has corrected by ~15% from its highs and is trading at 53x its CY2022E EPS. Strong return profile, future growth prospects and good dividend payout makes a good pick. We maintain a Buy with unchanged PT of Rs. 19,055.

One year forward P/E band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
HUL	63.2	48.0	41.9	42.8	34.6	30.0	37.1	28.3	30.7
Britannia Industries	44.5	40.1	34.6	32.8	28.6	24.9	30.6	32.5	33.0
*Nestle India	74.5	60.5	52.8	48.0	41.6	36.2	144.5	145.8	124.6

Source: Company, Sharekhan estimates

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
David McDaniel	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	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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