Nestle India

Long-term growth prospects intact

Consumer Goods | Sharekhan code: NESTLEIND | Company Update

Summary

- We maintain a Buy on Nestle India with a revised price target of Rs. 22,395. Revenues and PAT are expected to clock a CAGR of 14% and 18% over CY2020-23.
- H1CY2021 numbers were good with revenues and PAT growing by 12% and 13%, respectively and OPM standing at 25%.
- It 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.
- Nestle is planning to reward its shareholders with a higher dividend in the coming years by transferring Rs. 837 crore from the general reserve to retained earnings.

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. 19,861**	
Price Target: **Rs. 22,395**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

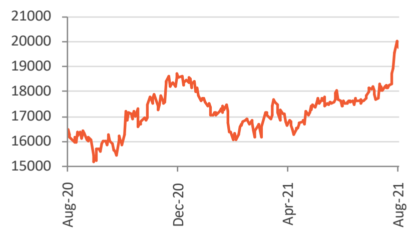
Company details

Market cap:	Rs. 191,491 cr
52-week high/low:	Rs. 20,334/15,104
NSE volume: (No of shares)	0.8 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	9.7	11.9	21.5	21.9
Relative to Sensex	3.9	2.5	11.3	-22.1

Sharekhan Research, Bloomberg

Nestle India (Nestle) posted decent performance in H1CY2021 with revenues and PAT growing by 12% and 13%, respectively and OPM improving by 92 bps to 25%. The e-commerce channel continued to perform well for the company and grew by over 100% in H1CY2021 (contribution of e-Commerce channel stood at 6.4%). Rural India contributed ~25% of Nestle's domestic revenues. Improving aspiration and availability of products helped the company see the rural market growing by 2-3x ahead of urban market in the recent times. 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. The management is banking on 3-4 key growth drivers to achieve double-digit growth in the medium term such as - 1) A wider presence in 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) Contribution of new products (4.9% of revenues with ~40 new innovations in pipeline) and 3) Accelerated footprint through new channels (e-Commerce contributes ~6%). We expect the prepared foods category to maintain double-digit volume growth while confectionaries and liquid beverages will see a sequential rise in sales led by an expected improvement in domestic mobility as COVID-19 cases reduce. Prices of key inputs and packaging materials have started rising and the impact of same on gross margins have to be keenly monitored. We expect Nestle to undertake prudent price hikes and focus on efficiencies to mitigate the impact of input cost inflation in the quarters ahead. The company has invested Rs. 1,000 crore of the planned investment of Rs. 2,600 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 Nestle's strong financial position in CY2022. The same can be utilised for higher dividend payouts to shareholders.

Our Call

View - Maintain Buy with a revised 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. We expect revenues and PAT to clock a CAGR of 14% and 18% over CY2020-23. With transfer of funds of Rs. 837 crore to retained earnings we should expect higher dividend payouts in CY2022. The stock is currently trading at 65.4x its CY2022E EPS and 55.9x its CY2023E EPS. We maintain a Buy on the stock with a revised price target of Rs. 22,395 (rolling it over to 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.

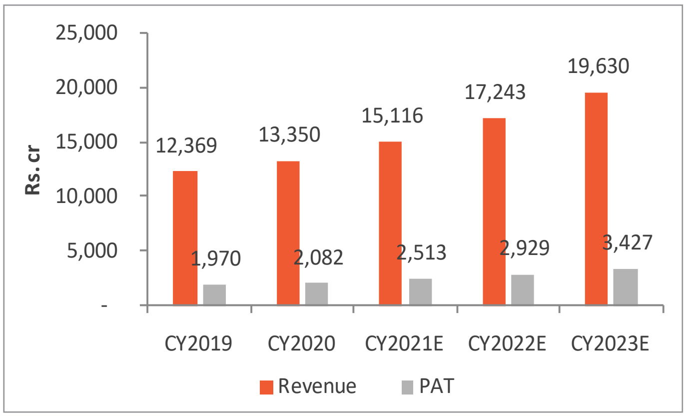
Valuation (Standalone) Rs cr

Particulars	CY20	CY21E	CY22E	CY23E
Revenue	13,350	15,116	17,243	19,630
OPM (%)	24.0	24.6	25.0	25.6
Adjusted PAT	2,082	2,513	2,929	3,427
% YoY growth	5.7	20.7	16.6	17.0
Adjusted EPS (Rs.)	216.0	260.6	303.8	355.5
P/E (x)	92.0	76.2	65.4	55.9
P/B (x)	94.8	81.1	72.5	56.1
EV/EBIDTA (x)	59.3	51.4	44.3	38.1
RoNW (%)	105.4	114.7	117.1	113.2
RoCE (%)	136.4	139.7	141.9	137.7

Source: Company; Sharekhan estimates

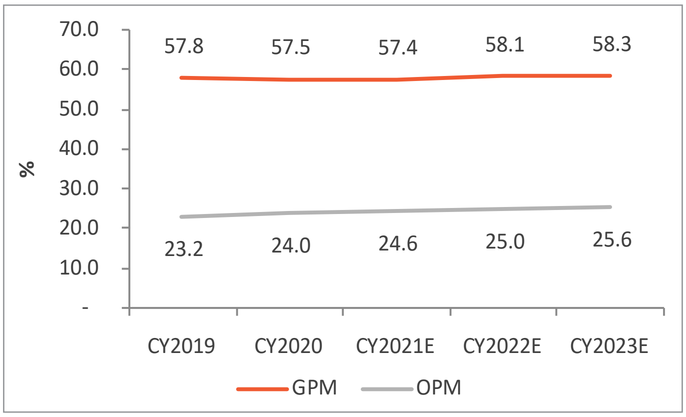
Financials in charts

Steady growth in revenue and PAT



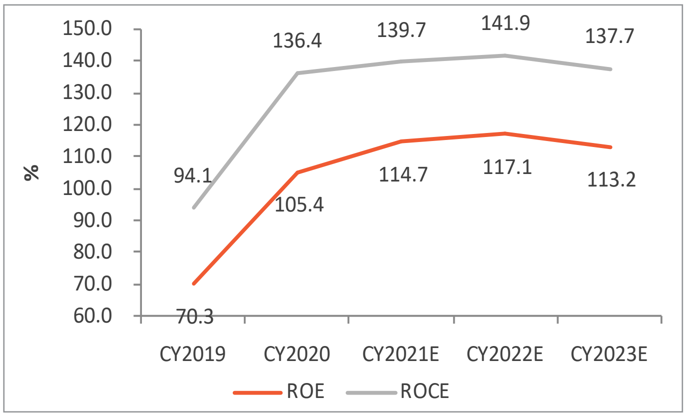
Source: Company, Sharekhan Research

Margins to remain stable



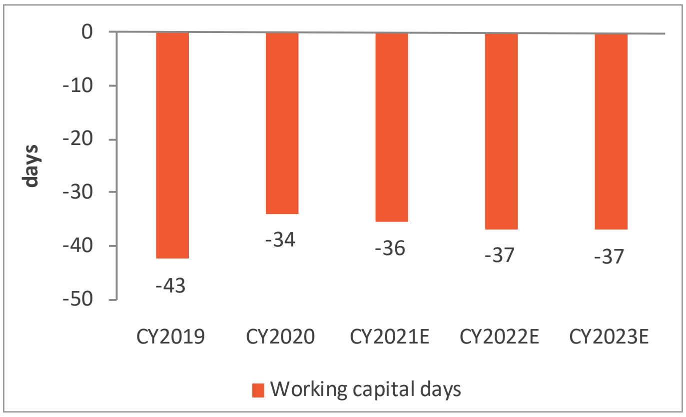
Source: Company, Sharekhan Research

Consistency in high return ratios



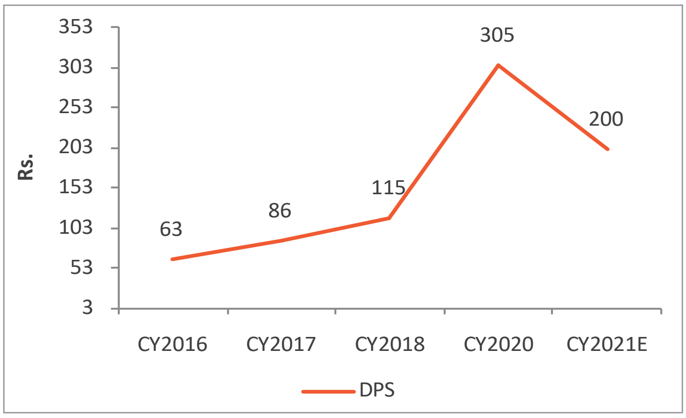
Source: Company, Sharekhan Research

Trend in working capital days



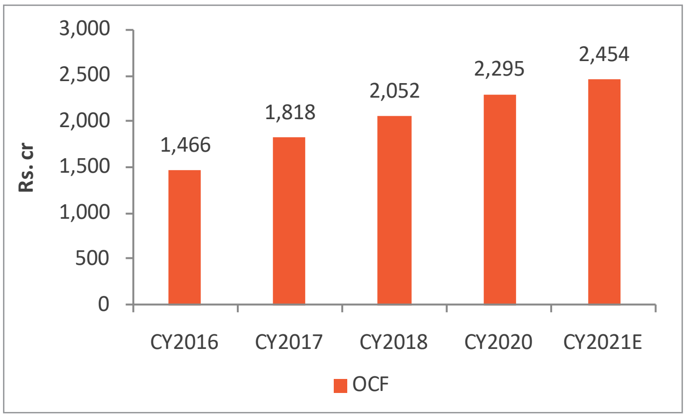
Source: Company, Sharekhan Research

Consistent dividend payout



Source: Company, Sharekhan Research

Strong operating cash flow generation



Source: Company, Sharekhan Research

Outlook and Valuation

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

After the disruption in April-May, 21, companies witnessed faster recovery in performance in June-July. The rural market is gaining momentum and with monsoon expected to be normal, the rural growth is expected to be stronger than urban growth in the quarters ahead. Further, with corporates opening up with full capacity and improving mobility would improve the demand for out-of-home categories such as color cosmetics, beverages & juices, deodorants and hair colours, etc. 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, copraand 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.

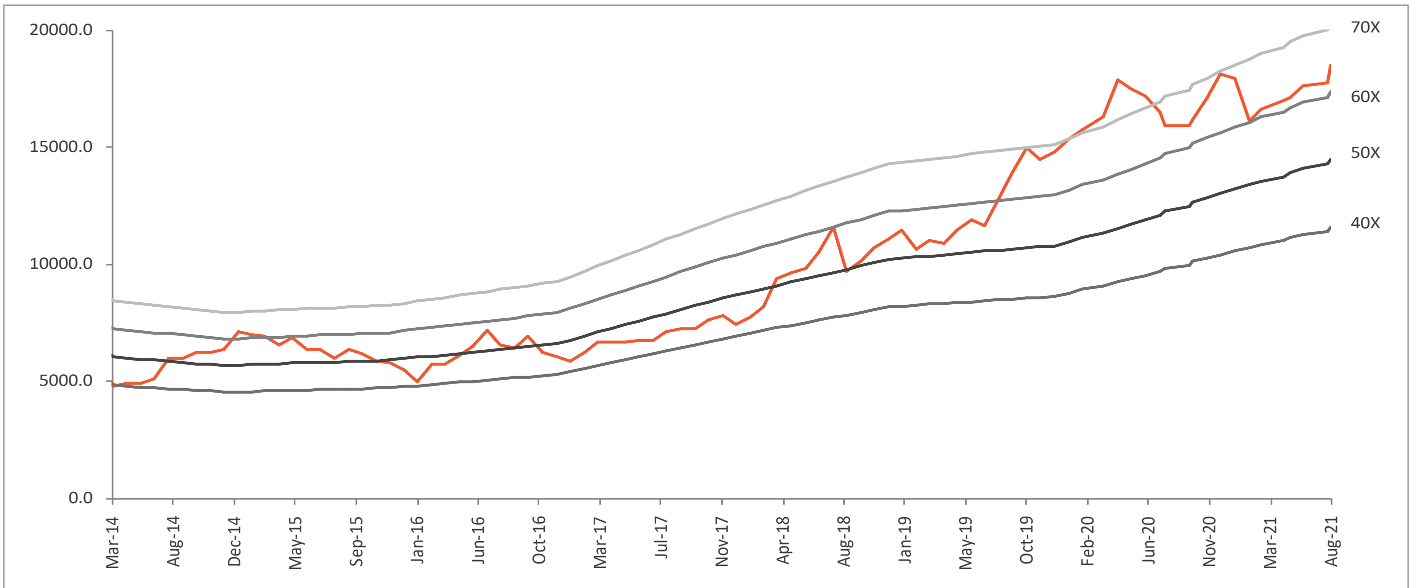
■ Company outlook - Revenue growth to recover to double digits in CY2021

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 as 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 4.3% of sales) and accelerating footprint through new channels. We expect OPM to remain at 24-25% in the medium term.

■ Valuation - Maintain Buy with revised 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. We expect revenues and PAT to clock a CAGR of 14% and 18% over CY2020-23. With a transfer of funds of Rs. 837 crore in retained earnings, we should expect higher dividend payouts in CY2022. The stock is currently trading at 65.4x its CY2022E EPS and 55.9x its CY2023E EPS. We maintain a Buy on the stock with a revised price target of Rs. 22,395 (rolling it over to CY2023E earnings).

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY21E	FY23E
HUL	76.4	64.8	53.5	54.4	45.4	38.9	36.5	26.4	31.6
Britannia Industries	50.0	49.0	41.1	37.8	36.5	30.9	31.3	32.8	36.0
Nestle India*	92.0	76.2	65.4	59.3	51.4	44.3	136.4	139.7	141.9

*Source: Company, Sharekhan estimates; *values for Nestle India are for calendar year*

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 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's Place 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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