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Stock Update

Result Update

Nestle India Ltd

Resilient quarter with consistent volume growth

Consumer Goods	Sharekhan code: NESTLEIND

Reco/View: Buy	↔	CMP: **Rs. 19,105**	Price Target: **Rs. 21,700**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↑	

ESG Disclosure Score NEW

ESG RISK RATING 29.33

Updated Jul 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

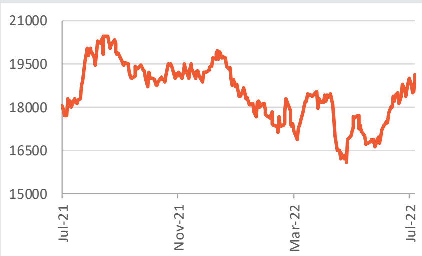
Company details

Market cap:	Rs. 1,84,197 cr
52-week high/low:	Rs. 20,600 / 16,000
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	12.6
DII	9.1
Others	15.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.8	4.2	3.9	6.0
Relative to Sensex	2.9	4.6	4.6	-2.4

Sharekhan Research, Bloomberg

Summary

- Nestle India (Nestle) clocked resilient revenue growth of 16.4% led by a mix of consistent volume growth (~8%) and price hikes (8.5%) while raw material inflation of 15% resulted in a 369 bps decline in OPM to 20.7%; PAT decreased by 4% to Rs. 515.3 crore.
- Domestic volume growth stood at 6-9% in the past few quarters. Management expects volume growth momentum to sustain led by sustained innovation, better penetration of key brands in the rural market and foray into new categories.
- Raw material inflation will curb near-term margins. Better revenue mix, supply chain initiatives, operating efficiencies and stable raw material prices would help EBIDTA margins improve in the coming years.
- Stock trades at 61.2x and 52.2x its CY2023E and CY2024E earnings. We maintain a Buy recommendation on the stock with a revised PT of Rs. 21,700.

Nestle India registered yet another quarter of steady volume growth with domestic business sales volumes rising by 7.9% (as compared to a 6.4% rise in Q1CY2022). Its revenues grew by 16.1% y-o-y to Rs. 4,036.6 crore (grew by 10% on 3 year CAGR basis). This contrasts with the current trend where peers in the domestic consumer goods sector have clocked moderate volume growth due to a slowdown in rural India. A strong recovery in the out-of-consumption categories (such as confectionery and liquid beverages), sustained improvement in penetration of key categories in the rural market and steady demand in urban markets helped Nestle post consistent volume growth. Raw material inflation of 15% led to a 304 bps decline in the gross margins to 54.0% and 369 bps decline in the OPM to 20.7%. PAT decreased by 4.3%y-o-y to Rs. 515.3 crore. In H1CY2022, Nestle's revenues grew by 13.3% to Rs. 7,642.7 crore and PAT decreased by 2.7% y-o-y to Rs. 1,110.1 crore. The company acquired Pet food business from Purina Pet care for Rs. 123.5 crore (valued at price to sales of 3.4x its sales of Rs. 36 crore in FY2022). Pet food business category (around Rs. 3,600 crore) is estimated to grow at CAGR of 50% over CY2022-26. Nestle India has also launched well-known child nutrition brand GERBER in India. The toddlers (2-6 year) nutrition category is worth around Rs. 3,500 crore.

Key positives

- Domestic business volume grew by a sturdy 7.9% in Q2CY2022 despite inflationary pressures.
- Contribution from new product launches has gone to 5.6% from 4.9% in CY2021; more 100 new products launched in last 5 years.
- Small towns and villages clocked a 16-30% growth on the back of improving penetration of key products.

Key negatives

- Gross margins were down by 304 bps y-o-y in Q2CY2022 due to input cost inflation.
- Export sales stood flat at Rs. 158.4 crore.

Management Commentary

- Nestle saw broad-based double digit growth across key product categories in Q2. Milk products and nutrition witnessed double digit growth driven by strong growth in Milkmaid brand (growing ahead of category). Out-of-home categories such as confectionaries and liquid beverages registered strong growth of above 20% on back of opening up of corporate/offices and business led initiatives. The foods category continued its strong double-digit streak of growth, with improved market share in MAGGI Noodles.
- Nestle registered steady volume growth of 6-9% despite supply-led disruption and higher commodity inflation. The company is focusing on consistent volume growth through innovations (5.6% of domestic revenues), expanding in rural/tier-2 markets and accelerating footprints through new channels. It has covered 80%+ of target village coverage of 1,20,000 villages.
- Input cost inflation stood at 15% as against 3% inflation over CY2018-20. The company took price increase of 8% to mitigate the pressure of raw material inflation. The focus on remains of keeping the product prices affordable to maintain consistent sales volume growth. On the positive side, the company has witnessed correction in prices of edible oil and packaging material, while prices of wheat and milk remains inflated. Going ahead, the company would maintain a calibrated pricing strategy.
- Margins are expected to remain under pressure in the near term. However, 1) Better revenue mix 2) Leveraging on operating efficiencies and cost savings and 3) Judicious pricing actions will help OPM improve in the medium term.

Revision in estimates – We have broadly maintained our earnings estimates for CY022, CY2023 and CY2024 in view of consistent volume growth momentum while the input cost inflation is likely to moderate in next two to three quarters.

Our Call

View: Retain Buy with a revised price target of Rs. 21,700 - Nestle is India's largest food company in India with a strong portfolio of brands in the packaged food & beverages space with a leading position in more than 80% of portfolio. The company's strong positioning in the domestic food market, innovative product portfolio and improving out-of-home consumption with a thrust on improving penetration in key markets provides visibility of consistent growth in the medium term. This along with a cheery dividend payout, makes it a good pick from a long-term perspective. The stock is currently trading at 61.2x and 52.2x its CY2023E and CY2024E earnings. We maintain a Buy recommendation on the stock with a revised price target of Rs. 21,700.

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	FY21	FY22	FY23E	FY24E
Revenue	14,709	16,600	18,633	20,968
OPM (%)	24.4	22.5	24.0	24.7
Adjusted PAT	2,320	2,465	3,008	3,530
% YoY growth	*11.4*	*6.3*	*22.0*	*17.3*
Adjusted EPS (Rs.)	240.6	255.7	312.0	366.1
P/E (x)	79.4	74.7	61.2	52.2
P/B (x)	88.4	77.4	58.1	41.1
EV/EBIDTA (x)	51.2	49.3	41.2	35.5
RoNW (%)	113.1	110.4	108.4	92.2
RoCE (%)	138.3	127.8	126.5	110.1

Source: Company; Sharekhan estimates

Q2CY2022 performance- Strong revenue growth; miss on profitability

Nestle's revenues grew by 16.1% y-o-y to Rs. 4,036.6 crore in Q2CY2022, driven by 16.4% y-o-y growth in the domestic business while export sales stood flat at Rs. 158.4 crore. Revenues were ahead our as well as average street expectation of Rs. 3,870-3,875 crore. All key categories including Milk food, Chocolate, Beverages and prepared dishes registered double digit growth during the quarter. Gross margins were lower by 304 bps y-o-y to 54.0% led by higher inflation in the milk and other agri commodity prices; OPM was down by 369 bps y-o-y decline in OPM to 20.7% (lower than ours and the street's average expectation 22.8-23.0%). Operating profit stood flat at Rs. 835.5 crore while lower other income and higher depreciation charges resulted in a 4.3% decline in the reported PAT to Rs. 515.3 crore (as against our and average street expectation of Rs. 568-570 crore).

All key product categories registered strong double digit growth in H1CY2022

For H1CY2022, revenues grew by 12.7% y-o-y to Rs. 7,957.8 crore with domestic business growing by 13.3% y-o-y to Rs. 7,647.7 crore. The double digit growth was driven by mix of 8% volume growth and 5% price led growth. Milk products and nutrition (contributing 41.2% to domestic business) registered a growth of 7.2% led by strong double-digit growth in the Milkmaid brand. Prepared dishes and cooking aids (contributing 32.4% of domestic business) registered 13.9% y-o-y driven by strong performance by Maggie noodles and other related products. Out-of-home consumption categories such as confectionery and beverages registered strong double-digit growth of 24.4% and 21.7% respectively in H1CY2022.

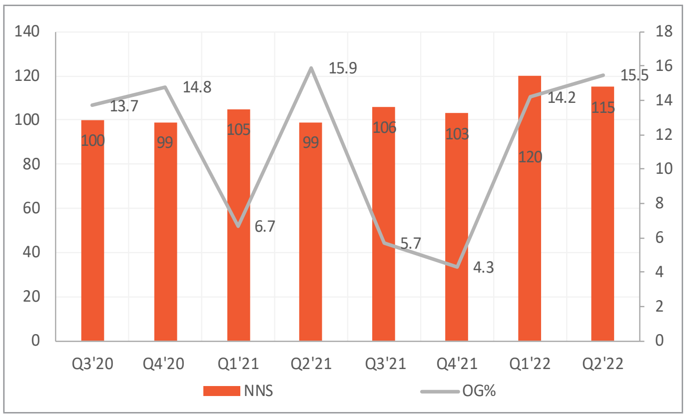
Consistent volume growth in tough environment

Nestle registered steady volume growth in the range of 6-9% despite supply led disruption and higher commodity inflation. The company is focusing on consistent volume growth through innovations (5.6% of domestic revenues), expanding in rural/tier-2 markets and accelerating footprints through new channels. It has covered 80%+ of target village coverage of 1,20,000 villages.

RURBAN strategy working well

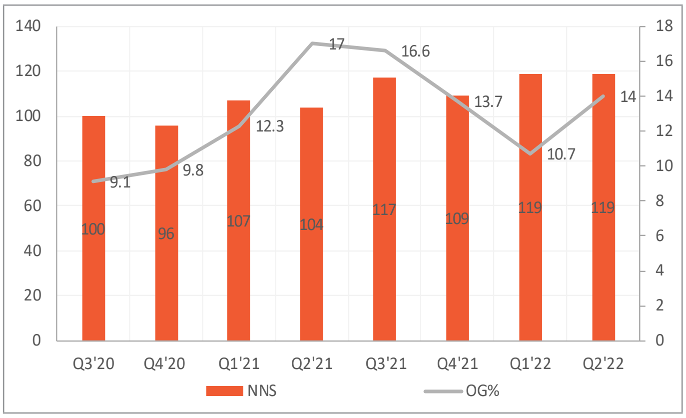
Nestle continued to see strong momentum in mega cities and metros, as well as strong acceleration across smaller town classes which reinforces the execution of our RURBAN strategy. It also saw a smart uptick in sales in rural markets in Q2 which augurs well to drive consistent growth in the coming quarters. The company brought in bulk of its portfolio into the rural markets. The company is focused on 12 states in the country (both rural and urban) and are attracting consumers with relevant pack sizes ranging from large, medium and small based on the specific geography.

Strong growth in TC1 markets (above 1lakh & less than 10lakh population)



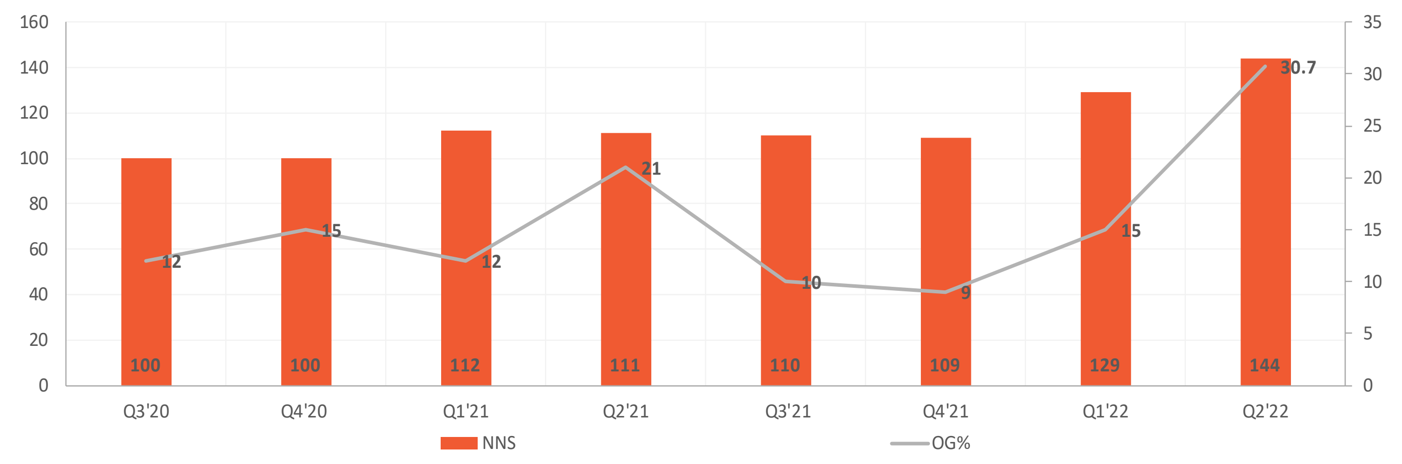
Source: Company, Sharekhan Research

Strong growth in TC2 markets (less than 1lakh population)



Source: Company, Sharekhan Research

Improving penetration in villages (agri-India)

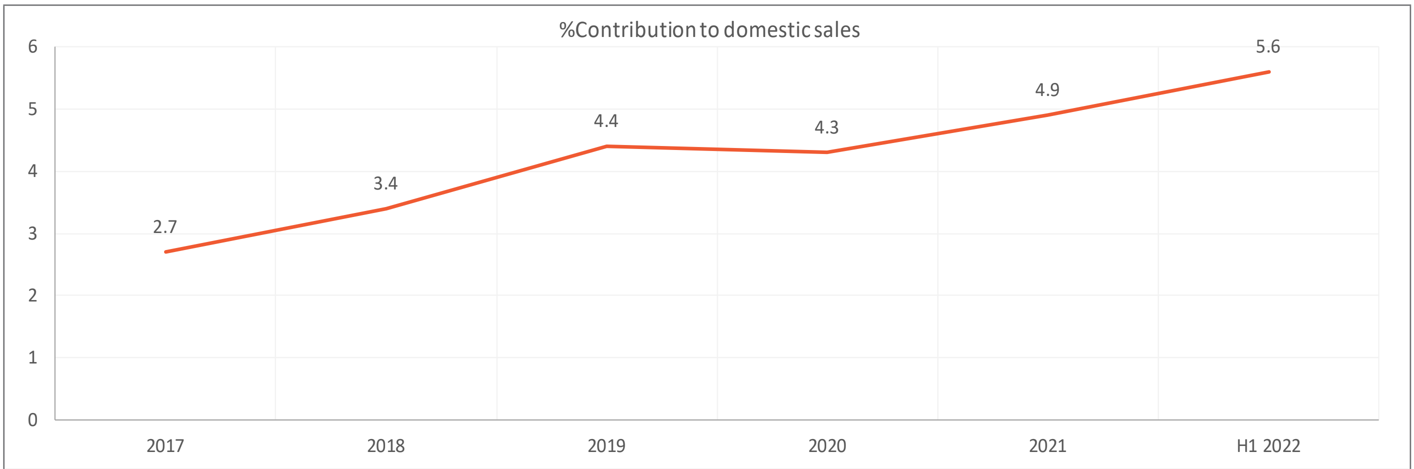


Source: Company, Sharekhan Research

Innovation remains key of growth strategies

Nestle has launched more than 100 products in last five years. New launches are gaining strong traction in the key markets. It has 15 new products in the pipeline, which will be launched in the coming quarters. The contribution of new product launches to the domestic revenues have increased to 5.6% in H1CY2022 from 2.7% in CY2017.

Contribution of new launches rising



Source: Company, Sharekhan Research

Forays into niche categories by acquiring Pet food business from Purina Petcare and launch of brand Gerber

Nestle is continuously focusing on entering into new categories to maintain the consistent growth momentum in the medium to long term. The company acquired the pet food business of Purina Pet care for Rs. 123.5 crore (valued at price to sales of 3.4x its sales of Rs. 36 crore in FY2022). The pet food business category (around Rs. 3,600 crore) is estimated to grow at CAGR of 50% over CY2022-26. Pet Food business has evolved very positively and has an exciting future with pet adoption on the rise post pandemic (30 million pets; growing at 11% per annum). The Pet Food Business of Purina Petcare India has gained traction amongst Indian pet owners and established the Pet Food brands across key segments, while building a robust pet specialty distribution network. Going forward, leveraging Nestle's network would further accelerate the growth of Pet Food Business in India. Revenues of Purina pet care business improved to Rs. 46.3 crore in H1CY2022 from Rs. 11.5 crore in CY2018. Further, the company launched the global toddler nutrition brand – Gerber in India sensing a big opportunity in the niche kids' nutrition segment (Rs. 3,500 crore category). These products are 'Made in India' and 'Made for India'. The product is priced at 700x the base price of Maggi. The scale up in the sales of Gerber will help the revenue mix to improve in the long run.

Results (standalone) Rs cr

Particulars	Q2CY22	Q2CY21	Y-o-Y %	Q1CY22	Q-o-Q %
Total Revenue	**4,036.6**	**3,476.7**	**16.1**	**3,980.7**	**1.4**
Raw Material Cost	1,858.3	1,494.8	24.3	1,775.7	4.7
Employee Cost	408.4	378.3	7.9	396.6	3.0
Other Expenses	934.4	755.6	23.7	883.7	5.7
Total Operating Cost	3,201.1	2,628.7	21.8	3,056.1	4.7
Operating Profit	**835.5**	**848.0**	**-1.5**	**924.7**	**-9.6**
Other Income	19.4	29.5	-34.3	21.4	-9.7
PBIDT	854.9	877.5	-2.6	946.1	-9.6
Interest & Other Financial Cost	37.0	51.7	-28.5	35.6	3.9
Depreciation	117.6	95.3	23.4	104.3	12.7
Profit Before Tax	700.4	730.5	-4.1	806.2	-13.1
Tax Expense	185.0	191.9	-3.6	211.5	-12.5
Reported PAT	**515.3**	**538.6**	**-4.3**	**594.7**	**-13.3**
Adj. EPS (Rs)	53.4	55.9	-4.3	61.7	-13.3
			bps		**bps**
GPM (%)	54.0	57.0	-304	55.4	-143
OPM (%)	20.7	24.4	-369	23.2	-253
NPM (%)	12.8	15.5	-272	14.9	-217
Tax rate (%)	26.4	26.3	15	26.2	18.0

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Deflating commodity prices augurs well; good monsoon key for rural demand

High consumer inflation and slowdown in the rural demand will keep pressure on the sales volume in the near term. However, a normal monsoon, cool-off in the commodity prices and improved consumer sentiments will help volume growth to recover in H2FY2023. Consumer good companies' margins are expected to be lower y-o-y in Q1FY2023 with raw material prices remaining high during most of the quarter. However, the scenario has changed in last 15-20 days with commodity prices cooling from its high providing some breather for consumer goods companies. The companies are expected to see expansion in margins from H2FY2023. Overall we expect H2FY2023 to be much better compared to H1FY2023 with expected recovery in the volume growth and likely expansion in the margins in Q3/Q4 FY2023. Low penetration levels in key categories (especially in rural India), lower per capita consumption compared to other countries, a large shift to branded products, and emergence of new channels such as e-commerce/D2C provide a number of opportunities for achieving sustainable growth in the medium to long run.

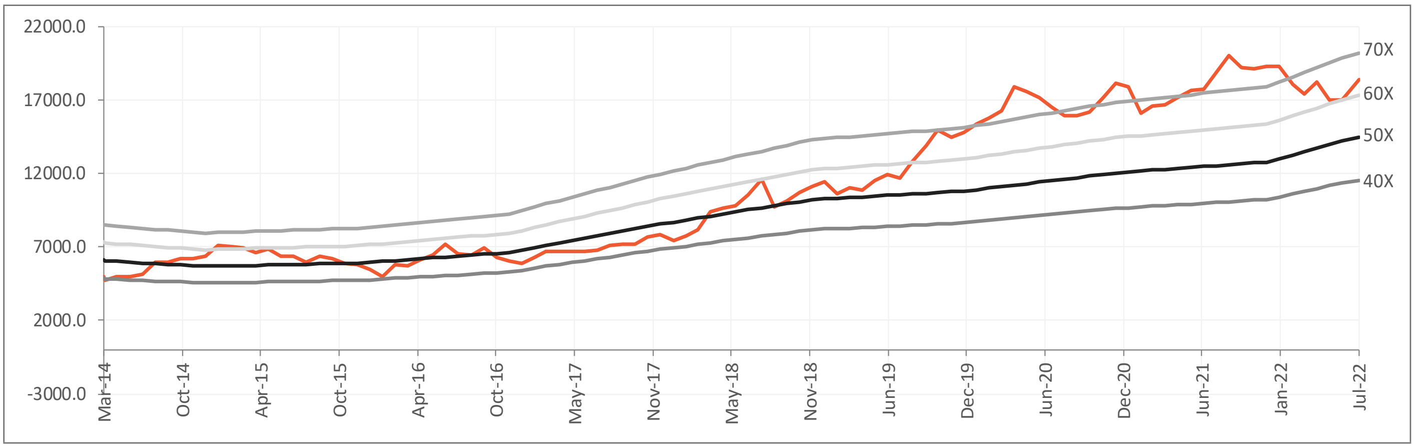
■ Company Outlook – Focusing on achieving consistent growth

Nestle ended CY2021 with a volume growth of 9.6% (versus a CAGR of 10.5% Over 2016-21). The company is focusing on consistent growth through innovations (4.9% of domestic revenues), expanding in rural/tier 2 markets and accelerating footprints through new channels. It has covered 80% of target village coverages of 1,20,000 villages. Raw material inflation stood at high single digit for the company. It will continue to safeguard OPM through 1) Better revenue mix 2) benefits from Project Shark (1.5% of net sales in CY2021) 3) leveraging on operating efficiencies and cost savings and Judicious pricing actions. The change in the pension plan would lead to savings at employee cost level, adding to OPM.

■ Valuation – Retain Buy with revised price target of Rs. 21,700

Nestle is India's largest food company in India with a strong portfolio of brands in the packaged food & beverages space with a leading position in over 80% of portfolio. The company's strong positioning in the domestic food market, innovative product portfolio and improving out-of-home consumption with a thrust on improving penetration in key markets provides visibility of consistent growth in the medium term. This along with a cheery dividend payout, makes it a good pick from a long-term perspective. The stock is currently trading at 61.2x and 52.2x its CY2023E and CY2024E earnings. We maintain a Buy recommendation on the stock with a revised price target of Rs. 21,700.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HUL	69.6	61.1	50.7	48.7	42.7	35.7	24.1	27.1	31.8
Britannia Industries	61.5	52.6	42.6	43.6	39.1	31.8	28.0	33.1	36.8
Nestle India	88.5	79.4	74.7	57.0	51.2	49.3	136.4	138.3	127.8

Source: Company, Sharekhan estimates

About company

Nestle is the largest food company in India with a turnover of ~Rs. 15,000 crore. It has presence across India with nine 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 Beverages*. The brands are broadly segregated on the basis of nutrition, health, comfort, variety, indulgence and taste. Nestle 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	Life Insurance Corp of India	2.86
2	Vanguard Group Inc	1.40
3	BlackRock Inc	1.40
4	Axis Asset Management Co.Ltd	1.37
5	SBI Funds Management	1.17
6	UTI Asset Management Co Ltd	0.64
7	Veritas AMC	0.41
8	Norges Bank	0.25
9	SBI Pension Funds Pvt Ltd	0.22
10	Government Pension Investment Fund Japan	0.22

Source: Bloomberg

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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

Sharekhan

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