Sharekhan by BNP PARIBAS

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Nestle India

Domestic biz powers strong quarter

Consumer Goods	Sharekhan code: NESTLEIND

Reco/View: Buy	↔	CMP: Rs. 19,800	Price Target: Rs. 23,550	↑

↑ 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 Aug 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. 190,903 cr
52-week high/low:	Rs. 20,200 / 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	5.5	5.1	8.2	2.2
Relative to Sensex	5.6	-1.1	4.5	6.5

Sharekhan Research, Bloomberg

Summary

- Nestle India (Nestle) clocked strong y-o-y revenue growth of 18.2% in Q3CY2022 led by a mix of consistent volume growth and price hikes, while raw material price inflation resulted in a 242-bps y-o-y decline in OPM to 22%; PAT grew by 8.3% y-o-y to Rs. 668.3 crore.
- Domestic volume growth is sustained at high-single digits for the past few quarters. We expect volume growth momentum to sustain in quarters ahead driven by sustained innovation, better penetration of key brands in the rural market and foray into new categories.
- Dairy, grain and coffee prices firmed up and will put pressure on near-term margins. A better mix and efficiencies would help to post better margins in the medium term.
- Stock has underperformed the broader indices and is trading at 61.8x and 52.1x its CY2023E and CY2024E earnings. We maintain a Buy recommendation on the stock with a revised PT of Rs. 23,550.

Nestle India registered yet another quarter of strong double digit revenue growth in Q3CY2022 with revenues growing by 18.2% y-o-y to Rs. 4,591 crore (grew by 13% on 3-year CAGR basis). Growth was strong in large metros and mega cities while in rural India it has remained strong due to improvement in the penetration. Raw material inflation led to a 292-bps y-o-y decline in the gross margins to 52.8% and 242 bps y-o-y decline in the OPM to 22%. PAT grew by 8.3% y-o-y to Rs. 668.3 crore. For 9MCY2022, revenues grew by 15% to Rs. 12,003.9 crore and PAT stood flat at Rs. 1,778.4 crore. The company acquired the pet food business from Purina Petcare India Private Limited for Rs. 142 crore after the end of the quarter i.e. with effect from October 1, 2022. It declared second interim dividend of Rs. 120 per share (first interim dividend paid in Q2CY2022 was Rs. 25 per share).

Key positives

- Domestic business reported yet another quarter of strong 18.3% y-o-y growth despite inflationary pressures while exports grew by 15.7% y-o-y.
- All key categories including milk food, chocolate, beverages and prepared dishes registered double-digit growth in Q3CY2022.
- The company launched its D2C platform www.mynestle.in, which will accelerate growth of e-commerce channel, which currently contributes 7.2% of its domestic sales.

Key negatives

- Gross margin/OPM were down by 292/242 bps y-o-y in Q3CY2022 impacted by input cost inflation.

Management Commentary

- Nestle saw broad-based double-digit growth across key product categories in Q3. Domestic business registered yet another quarter of double-digit growth driven by mix of volumes and value.
- Input cost inflation led to ~300 bps y-o-y decline in the gross margins. On the positive side, the company has witnessed correction in prices of edible oil and packaging material, while prices of grain, milk and green coffee have firmed up in the recent past.
- 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 raised our earnings estimates by 3-4% for CY2022/23/24E to factor in better-than-expected revenue growth in Q3CY2022. We are enthused by consistent double digit revenue growth for past few quarters and expect the momentum to sustain in the quarters ahead.

Our Call

View: Retain Buy with a revised price target of Rs. 23,550 – Nestle'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 is helping it to deliver consistent double-digit revenue growth for past few quarters. This along with a cheery dividend payout, makes it a top pick in the consumer staples space. The stock has underperformed the broader indices and is currently trading at 61.8x and 52.1x its CY2023E and CY2024E earnings. We maintain a Buy on the stock with a revised price target of Rs. 23,550 (rolled over price target to CY2024E 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	CY21	CY22E	CY23E	CY24E
Revenue	14,709	16,865	18,917	21,292
OPM (%)	24.4	22.7	24.2	25.2
Adjusted PAT	2,320	2,529	3,089	3,663
% YoY growth	11.4	9.0	22.1	18.6
Adjusted EPS (Rs.)	240.6	262.3	320.4	379.9
P/E (x)	82.3	75.5	61.8	52.1
P/B (x)	91.6	78.1	57.6	40.1
EV/EBIDTA (x)	53.0	49.9	41.6	35.5
RoNW (%)	113.1	111.7	107.3	90.7
RoCE (%)	138.3	129.4	125.8	108.9

Source: Company; Sharekhan estimates

Q3CY22 - Revenue and PAT ahead of estimates; Miss on margins

Nestle India (Nestle) revenues grew by 18.2% y-o-y to Rs. 4,591 crore in Q3CY2022, driven by 18.2% y-o-y growth in the domestic business and 15.7% y-o-y growth in the export business. Revenues were ahead of our expectation of Rs. 4,369.8 crore as well as average street expectation of Rs. 4,415 crore. Domestic revenue growth was driven by mix of volume and realisation growth during the quarter. Large metros and mega cities delivered strong growth while growth continued to be robust across smaller town classes including rural markets. All key categories including milk food, chocolate, beverages and prepared dishes registered double-digit growth during the quarter. Gross margins were down by 292 bps y-o-y to 52.8% led by higher inflation in the milk and other agri-commodity prices; OPM was down by 242 bps y-o-y to 22.0% during the quarter (lower than our and average street expectation 22.8%-23.4%). Operating profit grew by 6.6% y-o-y to Rs. 1,010.7 crore while lower interest expenses resulted in 8.3% y-o-y growth in the reported PAT to Rs. 668.3 crore (ahead of our and average street expectation of Rs. 653-655 crore). The board has declared second interim dividend of Rs. 120 per share (amounting to Rs. 1,157 crore) for CY2022. This is in addition to the first interim dividend of Rs. 25 per share paid in Q2CY2022.

Broad-based growth across categories

Growth in the Prepared Dishes and Cooking Aids category was driven by Maggi noodles and further aided by media and distribution expansion. Milk Products and Nutrition category performed well with strong growth reported in MILKMAID. Confectionery category continued its strong performance in Q3CY2022 aided by aggressive media campaigns, festive executions, consumer promotions and focused distribution drives. In the Beverages category, strong growth was witnessed in Nescafé Classic, Sunrise and vending mixes.

All channels contributed to growth

The e-Commerce channel showed strong acceleration with growth being largely fuelled by new, emerging formats such as quick commerce and click & mortar and contributed 7.2% to Q3CY2022 sales. organized trade channel continued to witness strong growth across customers and categories led by high footfalls during the quarter while the Out of Home (OOH) channel grew at a robust pace driven by faster channel reopening and business led initiatives. For export markets, proliferation of Indian product portfolio in new markets and expanding new categories, especially wider offerings in Maggi and confectionery remain key focus for the company.

Direct-to-Consumer (D2C) platform launched in Q3CY2022

Nestle launched its D2C platform www.mynestle.in where consumers can buy all Nestle products. The company plans to offer curated product bundles, personalized gifting, subscriptions, discounts, and much more on its D2C platform. Consumers can also try gourmet recipes on the site and get free nutrition counselling. Initially, MyNestlé will be launched in Delhi-NCR and will eventually be expanded to other parts of the country. The D2C platform will add to revenue of the e-Commerce channel and will aid in accelerating the e-commerce channel's growth in the medium term.

Pet food business to help diversify product basket

The company acquired the pet food Business from Purina Petcare India Private Limited for Rs. 142 crore after the end of the quarter i.e. with effect from October 1, 2022. The acquisition is in-line with the company's strategy of entering into new categories to maintain consistent growth momentum in the medium to long term.

Results (standalone) Rs cr

Particulars	Q3CY22	Q3CY21	y-o-y (%)	Q2CY22	q-o-q (%)
Total Revenue	**4,591.0**	**3,882.6**	**18.2**	**4,036.6**	**13.7**
Raw Material Cost	2,167.9	1,719.8	26.1	1,858.3	16.7
Employee Cost	417.9	388.3	7.6	408.4	2.3
Other Expenses	994.5	826.0	20.4	934.4	6.4
Total Operating Cost	3,580.3	2,934.1	22.0	3,201.1	11.8
Operating Profit	**1,010.7**	**948.5**	**6.6**	**835.5**	**21.0**
Other Income	30.6	33.7	-9.0	19.4	58.2
Interest & Other Financial Cost	37.0	51.9	-28.7	37.0	0.0
Depreciation	98.1	96.1	2.1	117.6	-16.5
Profit Before Tax	**906.2**	**834.2**	**8.6**	**700.4**	**29.4**
Tax Expense	237.9	216.9	9.7	185.0	28.6
Reported PAT	**668.3**	**617.4**	**8.3**	**515.3**	**29.7**
Adj. EPS (Rs)	69.3	64.0	8.3	53.4	29.7
			bps		bps
GPM (%)	52.8	55.7	-292	54.0	-118
OPM (%)	22.0	24.4	-242	20.7	132
NPM (%)	14.6	15.9	-134	12.8	179
Tax rate (%)	26.3	26.0	26	26.4	-17

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - H2FY2023 to be relatively better compared to H1

Consumer goods companies would start seeing the benefit of correction in the key input prices from Q3FY2023. Recent sharp correction in some key input prices helped companies to pass on benefits to the customer in the form of price cuts in highly-penetrated categories (such as soaps). This along with good monsoon in most parts of the country (except for some parts in the North and East) will help in good recovery in the sales volume in the coming quarters. A decline in commodity prices has also helped inflationary pressures to ease out boosting the consumer sentiments. Hence, some tailwinds are building up for the sector to improve its growth in the coming quarters. Overall, we expect H2FY2023 will be much better compared to H1FY2023 with expected recovery in sales volumes and OPM is also expected to improve from Q3FY2023. 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 several opportunities for achieving sustainable growth in the medium to long run.

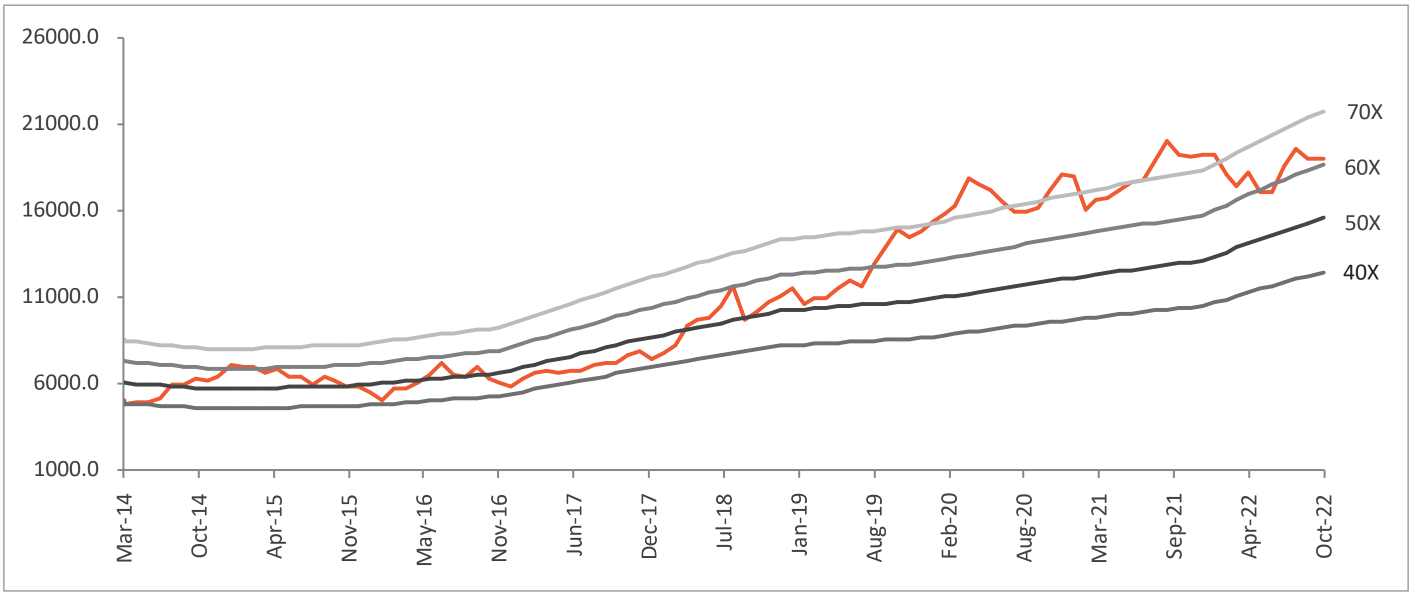
■ Company outlook - Focusing on achieving consistent growth

Nestle revenues grew by 15% in 9MCY2022 driven by mix of volume and value. Its volume growth has remained consistent in the range of 6-9% for past few quarters. 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. 23,550

Nestle'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 is helping it to deliver consistent double-digit revenue growth for past few quarters. This along with a cheery dividend payout, makes it a top pick in the consumer staples space. The stock has underperformed the broader indices and is currently trading at 61.8x and 52.1x its CY2023E and CY2024E earnings. We maintain a Buy on the stock with a revised price target of Rs. 23,550 (rolled over price target to CY2024E earnings).

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
HUL	68.6	60.2	50.0	48.0	42.1	35.1	24.1	27.1	31.8
Britannia Industries	59.7	55.7	44.3	42.4	40.5	32.6	28.0	30.9	35.7
Nestle India	82.3	75.5	61.8	53.0	49.9	41.6	138.3	129.4	125.8

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

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
Pramod Kumar Rai	Company Secretary & Compliance Officer

Source: BSE; Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	2.86
2	BlackRock Inc	1.45
3	Axis Asset Management Co.Ltd	1.36
4	Vanguard Group Inc	1.24
5	SBI Funds Management	1.19
6	UTI Asset Management Co Ltd	0.67
7	Veritas AMC	0.41
8	St James Place PLC	0.28
9	Norges Bank	0.25
10	SBI Pension Funds Pvt Ltd	0.24

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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