Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Nestle India

Good quarter; Long-term growth prospect intact

Consumer Goods	Sharekhan code: NESTLEIND

Reco/View: Buy	↔	CMP: Rs. 19,621	Price Target: Rs. 22,590	↓

↑ 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 29.22

Updated Dec 08, 2022

Medium Risk

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

Source: Morningstar

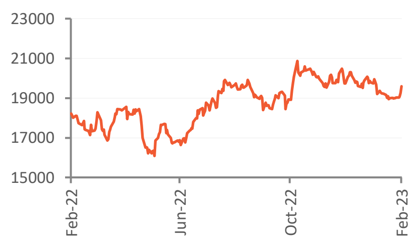
Company details

Market cap:	Rs. 1,89,174 cr
52-week high/low:	Rs. 20,053/16,000
NSE volume: (No of shares)	0.5 lakh
BSE code:	500790
NSE code:	NESTLEIND
Free float: (No of shares)	3.6 cr

Shareholding (%)

Promoters	62.8
FII	13.0
DII	9.1
Others	15.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.7	-1.6	0.2	7.6
Relative to Sensex	-2.8	-1.1	-1.5	1.8

Sharekhan Research, Bloomberg

Summary

- Nestle India Limited's (Nestle) revenue grew by 13.8% y-o-y to Rs. 4,256.8 crore; OPM stood almost flat at 22.9% and PAT grew by 12% y-o-y to Rs. 628.5 crore.
- Price hikes in small packs led to flat volumes in the domestic market (grew by ~8% in 9MCY2022). Management expects domestic volume growth to recover in the quarters ahead with resilient growth in the urban market and penetration-led growth in rural markets.
- The company plans for capex of Rs. 1,200 crore in CY2023 and Rs. 2,000 crore in CY2024, considering strong growth opportunities in the domestic market. Focus remains on expansion in rural markets, calibrated new product launches, and improved growth in core in the long run.
- The stock is currently trading at 64.4x and 54.7x its CY2023E and CY2024E earnings, respectively. We maintain our Buy recommendation on the stock with a revised PT of Rs. 22,590.

Nestle India Limited (Nestle) registered good performance in the environment of demand slowdown in rural markets and higher commodity inflation by achieving double-digit revenue and PAT growth. The company's revenue grew by 13.8% y-o-y to Rs. 4,256.8 crore, driven by 14.8% growth in the domestic business, which was entirely price-led growth with sales volume remaining flat. Domestic sales volume moderated due to substantial price hikes in small packs (one-third volumes), which saw a large impact in small towns. Higher raw-material prices led to a 217-bps y-o-y decline in gross margin to 54.9%. Efficiencies led by Project Shark and cost-saving measures led to flat OPM at 22.9%. Adjusted PAT grew by 12% y-o-y to Rs. 628.5 crore. For CY2022, Nestle's revenue grew by 14.7% y-o-y to Rs. 16,789.5 crore (with volume growth at ~5% in the domestic market); OPM decreased by 240 bps y-o-y to 22.0% and adjusted PAT grew by 3% y-o-y to Rs. 2,390.5 crore. The company paid a dividend of Rs. 220 per share in CY2022 (including the final dividend of Rs. 75 per share).

Key positives

- All key categories, including milk food, chocolate, beverages, and prepared dishes, registered double-digit growth in Q4CY2022.
- Metro, TC1, and Villages registered growth of 21% y-o-y, 19% y-o-y, and 26% y-o-y in Q4, respectively.

Key negatives

- Gross margin decreased by 217 bps y-o-y to 54.9% due to inflation in raw-material prices.
- Domestic sales volume moderated to negative 1% from ~8% volume growth in 9MCY2022.

Management Commentary

- Nestle's Q4CY2022 sales volume stood flat, impacted by 40% price increase in lower unit packs. Management expects it to be a temporary dip and expects volumes to recover in the coming quarters. Demand in metros remained resilient, while the focus is on achieving penetration-led growth in the rural market.
- In CY2022, raw-material inflation stood at 18.5% (800 bps y-o-y). Better revenue mix, calibrated price hikes, and cost savings through Project Shark (savings of 150 bps) led to just 240 bps moderation in OPM. The company remained focused on cost efficiencies through various initiatives.
- Contribution from new product launches has gone up to 5.4%. The company is focusing on calibrated new launches to support growth in the quarters ahead. Focus will be growing on every channel (e-commerce 6.5% of domestic sales).
- Nestle did capex of Rs. 500 crore in CY2022. The company will be doing capex of Rs. 1,300 crore in CY2023 and Rs. 2,000 crore in CY2024, which will be largely utilised for capacity expansion and setting up new facilities, sensing the large opportunities in the domestic market.

Revision in estimates – We have lowered our earnings estimates by 5-6% for CY2023 and CY2024 to factor in lower than earlier expected operating margins and higher depreciation in view of strong capex plan over the next two years.

Our Call

View: Retain Buy with a revised PT of Rs. 22,590 – 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 rural markets will help it drive consistent double-digit earnings growth in the long run. The company is supporting its consistent growth agenda by higher investments in capacity enhancement, strong brand support, and better R&D initiatives in the coming years. The stock is currently trading at 64.4x and 54.7x its CY2023E and CY2024E earnings, respectively. We maintain our Buy rating on the stock with a revised price target (PT) of Rs. 22,590.

Key Risks

Any slowdown in domestic consumption or regulatory hurdles in key food categories or an increase in key input prices would act as a key risk to our earnings estimates.

Valuation (standalone) Rs cr

Particulars	CY21	CY22	CY23E	CY24E	CY25E
Revenue	14,709	16,897	19,024	21,538	24,537
OPM (%)	24.4	22.0	23.0	23.7	24.2
Adjusted PAT	2,320	2,391	2,937	3,457	4,042
% YoY growth	11.4	3.0	22.8	17.7	16.9
Adjusted EPS (Rs.)	240.6	247.9	304.6	358.5	419.2
P/E (x)	81.5	79.1	64.4	54.7	46.8
P/B (x)	90.8	76.9	54.6	38.6	28.1
EV/EBIDTA (x)	52.5	50.9	43.2	37.0	31.6
RoNW (%)	113.1	105.2	99.1	82.6	69.6
RoCE (%)	138.3	124.8	116.1	99.3	85.7

Source: Company; Sharekhan estimates

Price-led, double-digit revenue growth in Q4CY2022; Margins remain flat y-o-y

Nestle's revenue grew by 13.8% y-o-y to Rs. 4,256.8 crore in Q4CY2022, driven by 14% y-o-y growth in the domestic business to Rs. 4,062 crore and 17.1% y-o-y growth in the export business to Rs. 171 crore. Domestic revenue growth was driven by a price led growth during the quarter, with volumes remaining flat. Gross margin was down by 217 bps y-o-y to 54.9%, impacted by higher inflation in milk and other agri-commodity prices, while OPM stood flat y-o-y at 23%, aided by cost efficiencies undertaken by the company. Operating profit grew by 12.5% y-o-y to Rs. 973.5 crore. In line with operating profit growth, adjusted PAT grew by 11.9% y-o-y to Rs. 628.5 crore. In CY2022, revenue grew by 14.7% y-o-y to Rs. 16,790 crore, driven by 15% y-o-y growth in the domestic business to Rs. 16,098 crore (volume growth of 5% and rest price-led), while export sales grew by 8.2% y-o-y to Rs. 692 crore. Sustained input cost inflation led to 291 bps and 244 bps y-o-y contraction in gross margin and OPM to 54.1% and 22%, respectively, in CY2022. Operating profit grew by 3.4% y-o-y to Rs. 3,713 crore and adjusted PAT grew by 3% y-o-y to Rs. 2,391 crore in CY2022. The board has declared a final dividend of Rs. 75 per share for CY2022, taking the total dividend for CY2022 to Rs. 220 per share.

Broad-based, double-digit volume and price-led growth across categories in CY2022

Despite a challenging and highly volatile economic environment, the company witnessed broad-based, double-digit, volume and mix led growth in CY2022. Volume growth in CY2022 stood at 5% with substantial moderation in sales volume in Q4CY2022 due to price hike in lower unit packs.

- Prepared dishes and cooking aids (32.2% share) delivered 15.6% y-o-y growth in CY2022 with a healthy balance of product mix, pricing, and volume growth in MAGGI Noodles and MAGGI Masala-ae-Magic, aided by strong consumer engagements, market presence with media campaigns, and attractive consumer activations.
- Milk products and nutrition (40.4% share) reported 9.5% y-o-y growth in CY2022 (6% pricing growth and remaining 3.5% volume growth), led by strong growth in MILKMAID and Ready-to-Drink (RTD). Milk products continued to face challenges due to unprecedented increase in milk price.
- Confectionery (16% share) gained market share in CY2022 and delivered robust 25% y-o-y growth, driven by KITKAT and MUNCH.
- Beverages (11.4% share) grew by 19.2 y-o-y, with NESCAFÉ Classic, NESCAFÉ Sunrise, and NESCAFÉ GOLD delivering broad-based, double-digit growth. Nestle recorded the highest-ever, single-year growth in household penetration and cemented its leadership position in the category with the highest-ever market share. NESCAFÉ RTD and out-of-home also delivered strong double-digit growth in CY2022.
- In line with its premiumisation strategy, in CY2022, the company acquired PURINA Petcare business, which delivers nutrition to pets, and launched globally renowned GERBER cereals, catering to the nutrition needs of toddlers.

All channels contributed to growth

- The e-commerce channel (6.5% contribution to domestic sales) delivered strong accelerated growth of 41% y-o-y in CY2022, driven by new emerging formats such as quick commerce and click and mortar. Quick commerce growth was fuelled by new user-acquisition initiatives through targeted digital communication.
- The organised trade channel continued to witness strong growth across customers and categories in CY2022.
- Out-of-Home (OOH) channel made a strong comeback in CY2022, recovering its pre-Covid base (20% growth over pre-Covid) and delivering robust 39% y-o-y growth, aided by revamping and resetting geography, channel, and sales priority.

- In CY2022, the company launched its first-ever 'direct to consumer' (D2C) platform, www.mynestle.in, where products manufactured by the company in India are available in Delhi-NCR.
- Exports delivered growth as the company continued to expand its presence in new markets through both traditional and mainstream channels.

The company's direct reach improved from 1.4 million at CY2021-end to 1.5 million at CY2022-end. Management has indicated the company's focus would be to achieve a balanced relation between different channels of e-commerce, modern trade, and traditional channel and not focus on growing just one channel.

High inflation in raw-material prices

Nestle's raw-material inflation in CY2022 stood at 18.5% (800-bps higher on a y-o-y basis). Few of the company's key input materials continued to see prices increasing with the price of milk, skimmed milk powder, edible oil, wheat, green coffee, and packaging materials up by 13%, 17%, 42%, 18%, 34%, and 14% y-o-y, respectively. Key categories such as cereals, grains, and coffee continued to be at a 10-year high. Edible oil was also at a 10-year high and moderated towards Q4CY2022. Fresh milk prices continued to remain firm due to Lumpy Skin Disease in H2CY2022 and an increase in feed costs to farmers. With some respite in crude oil, input materials such as packaging have witnessed relief. The company plans to mitigate part of the input inflation through price hikes and premiumisation; but still with inflation at elevated levels across all major input materials, management expects margin pressure to continue. Despite significant raw-material inflation, OPM deduction was just 240 bps to 22% as cost-saving initiatives, calibrated price hikes, and better mix mitigated the significant input cost pressure.

Varied growth trend across town classes

The company witnessed varied trends across town classes (TC) in Q4CY2022 with metros, TC1, and villages reporting q-o-q growth, while mega cities and TC 2-6 delivered a decline q-o-q. Mega cities continued post double-digit growth but witnessed a dip on a q-o-q basis due to price hikes taken by the company. TC1 continued to remain strong, led by the RURBAN strategy, deeper penetration, and activations during the quarter. TC 2-6 was impacted due to the pricing impact of small packs, while villages continued the growth momentum in Q4.

Expanding roots in rural India through the Rurban strategy

Nestle strengthened its RURBAN approach by sharpening its geographic focus, increasing distribution points, and going deeper into smaller towns and cities. The company increased its presence in villages with >2,000 population to 91,683 villages at CY2022-end from 61,427 villages at CY2021-end and total village coverage increased from 1.1 lakh at CY2021-end to 1.65 lakh at CY2022-end. The company aims to reach 120,000 villages with >2,000 population by FY2024. To increase its presence in RURBAN areas, the company has implemented a multipronged strategy of strengthening its distribution infrastructure (increased distribution touch points by ~22% y-o-y to over 14,000 outlets), scaling up the HAAT activation (scaled up HAAT activities by over 10x y-o-y in CY2022 to 20,605) and improving in-shop visibility (64% y-o-y increase in the RURBAN Smart Stores to 16,000 stores). Having said this, RURBAN growth moderated to 13% in CY2022 from 15% in CY2021 due to the impact of price increases in small packs. However, management expects the decline to be temporary and has indicated that volumes would recover in the coming quarters.

Focus on integrating millets into relevant product categories

With 2023 being declared as the International Year of Millets, the company aims to integrate millets into relevant product categories in its portfolio. On these lines, Nestle launched a new sub-brand, CEREGROW Grain Selection, inspired by traditional ingredients, a nutritious cereal for 2/4 toddlers made from ragi (finger millet), mixed fruits, and ghee. As per management, the company is expected to launch more products under this brand.

New product contribution rising

The contribution of new products to domestic sales grew from 4.9% in CY2021 to 5.4% in CY2022. Management has indicated that due to the current weak demand environment, the company is focusing on strengthening its core rather than launching new products. However, the company has over 30 new projects in the pipeline across categories and price points and the company will launch the projects at an appropriate time.

Significant capex planned over the next three years

Management has indicated that the company is planning to come up with a large capex plan in the next two years as the company's plants are currently running at a very high-capacity utilisation. Nestle Global has indicated to invest Rs. 5,000 crore in Nestle India in the coming three years, which will be utilised for capacity enhancement. The company plans to incur a capex of Rs. 1,300 crore in CY2023 and Rs. 2,000 core in CY2024 and balance Rs. 1,700 in CY2025.

Results (standalone) Rs cr

Particulars	Q4CY22	Q4CY21	YoY (%)	Q3CY22	QoQ (%)
Total Revenue	**4,256.8**	**3,739.3**	**13.8**	**4,591.0**	**-7.3**
Raw-Material Cost	1,921.5	1,606.7	19.6	2,167.9	-11.4
Employee Cost	406.5	386.6	5.1	417.9	-2.7
Other Expenses	955.4	880.3	8.5	994.5	-3.9
Total Operating Cost	3,283.3	2,873.6	14.3	3,580.3	-8.3
Operating Profit	**973.5**	**865.7**	**12.5**	**1,010.7**	**-3.7**
Other Income	29.6	27.3	8.1	30.6	-3.6
PBIDT	1,003.0	893.0	12.3	1,041.3	-3.7
Interest and Other Financial Cost	44.8	43.6	2.9	37.0	21.3
Depreciation	98.7	105.8	-6.7	98.1	0.6
Profit Before Tax	859.5	743.7	15.6	906.2	-5.2
Tax Expense	231.0	182.0	26.9	237.9	-2.9
Adjusted PAT	**628.5**	**561.7**	**11.9**	**668.3**	**-6.0**
Exceptional Items	0.0	175.0	-100.0	0.0	-
Reported PAT	628.5	386.7	62.5	668.3	-6.0
Adj. EPS (Rs.)	65.2	58.3	11.9	69.3	-6.0
			bps		**bps**
GPM (%)	54.9	57.0	-217	52.8	208
OPM (%)	22.9	23.2	-28	22.0	85
NPM (%)	14.8	10.3	442	14.6	21
Tax rate (%)	26.9	24.5	240	26.3	63

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – H2FY2023 to be better compared with H1

Sustained slowdown in rural demand will continue to put a toll on sales volume of consumer goods companies in Q3FY2023. However, any uptick in the festive season, sustained demand for premium categories along with stable demand in urban markets will lead to a sequential improvement in sales volume. Overall, we expect H2FY2023 to be much better compared with H1FY2023, with expected recovery in sales volumes. OPM is also expected to improve from Q4FY2023. Low penetration in key categories (especially in rural India), lower per capita consumption compared with 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.

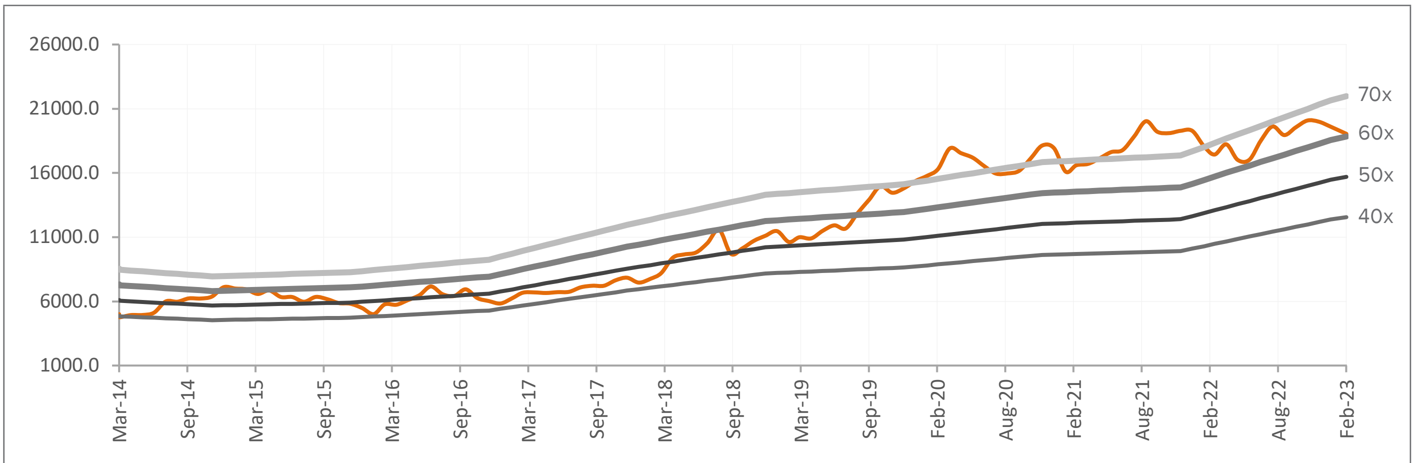
■ Company Outlook – Focusing on achieving consistent growth

Nestle's revenue grew by 15% in CY2022, driven by a mix of volume and value. The company's volume stood at 5% with moderate sales volume in Q4CY2022, impacted by price hikes in lower unit packs. Management expects a gradual recovery in sales volume in the coming quarters. The company is focusing on consistent growth through innovations (5.4% of domestic revenues), expanding in rural/tier 2 markets, and accelerating footprints through new channels. It has achieved 80% of the 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), and 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. 22,590

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 rural markets will help it drive consistent double-digit earnings growth in the long run. The company is supporting its consistent growth agenda by higher investments in capacity enhancement, strong brand support, and better R&D initiatives in the coming years. The stock is currently trading at 64.4x and 54.7x its CY2023E and CY2024E earnings, respectively. We maintain our Buy rating on the stock with a revised PT of Rs. 22,590.

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	67.1	62.1	52.5	47.0	43.3	36.9	24.1	25.9	30.1
Britannia Industries	72.6	57.0	49.7	51.3	40.8	35.8	28.0	36.1	36.8
Nestle India*	81.5	79.1	64.4	52.5	50.9	43.2	138.3	124.8	116.1

*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. 17,000 crore. The company is present across India with nine manufacturing facilities, four branch offices, one R&D centre, and approximately 8,000 employees. The company manufactures products under international famous brand names such as *Nescafé, Maggi, Milkybar, KitKat, Bar-One, Milkmaid*, and *Nestea*; and in recent years, the company has introduced products of daily consumption and use such as *Nestle Milk* and *Nestle Slim Milk*. Nestle has a diversified portfolio of brands divided into four segments: *Milk Products and Nutrition, Prepared Dishes and 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. A strong return profile, future growth prospects, and good dividend payout make 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, and infant cereals 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 Control and CFO
Pramod Kumar Rai	Company Secretary and Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	2.62
2	Axis Asset Management Co. Ltd.	1.42
3	BlackRock Inc.	1.41
4	Vanguard Group Inc.	1.24
5	SBI Funds Management	1.22
6	UTI Asset Management Co. Ltd.	0.68
7	Veritas AMC	0.41
8	St James Place PLC	0.28
9	Credit Agricole Group	0.27
10	Norges Bank	0.25

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

by BNP PARIBAS

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