Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Nestle India Ltd

Risk reward unfavourable; downgrade to Hold

Consumer Goods	Sharekhan code: NESTLEIND

Reco/View: Hold ↓	CMP: **Rs. 22,329**	Price Target: **Rs. 24,650** ↑

↑ 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	Neutral	↑	Positive
RQ	Positive	↔	Positive
RV	Positive	↓	Negative

ESG Disclosure Score NEW

ESG RISK RATING 28.28

Updated Jul 08, 2023

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 2,15,291 cr
52-week high/low:	Rs. 23,390/17,888
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	13.3
DII	9.1
Others	14.9

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.4	2.6	16.2	20.4
Relative to Sensex	-5.9	-5.8	4.5	1.7

Sharekhan Research, Bloomberg

Summary

- Nestlé India Limited's (Nestlé) revenue grew by 15.4% y-o-y to Rs. 4,658.3 crore in Q2CY2023; OPM improved by 196 bps y-o-y to 22.7% and PAT grew by 35.5% y-o-y to Rs. 698.3 crore.
- Volume growth in the domestic business is around mid-single-digit, which is lower than street's expectation of a high single digit for the quarter. We expect mid-to-high single-digit volume growth momentum to sustain in the coming quarters.
- Softening of edible oil, packaging material, and wheat prices from the highs and stabilising of milk prices would provide some relief to margins in the coming quarters.
- The stock has run-up by ~16% in the past six months and trades at premium valuations of 71.3x, 61.6x, and 51.6x its CY2023E, CY2024E, and CY2025E EPS, respectively. In view of a limited upside, we downgrade our rating on the stock to Hold from Buy earlier with a revised PT of Rs. 24,650.

Nestlé India Limited (Nestlé) reported double-digit revenue and PAT growth of 15.4% and 35.5% y-o-y to Rs. 4,658.3 crore and Rs. 698.3 crore, respectively, in Q2CY2023, while OPM expanded by 196 bps y-o-y to 22.7%. Volume growth is expected to have come in mid-single digits, which is lower than expectation of high single-digit growth. All the company's product groups reported fifth consecutive quarter of double-digit growth. The company's key brands continued to perform well, led by Kit Kat, Nescafe, and Maggi among others. E-commerce continued to perform strongly and now accounts for ~6.5% of sales. In H1CY2023, revenue grew by 18.4% y-o-y to Rs. 9,489 crore, OPM expanded by 71 bps y-o-y to 22.7%, and adjusted PAT grew by 29.3% y-o-y. The board has approved to change the financial year of the company from January 1-December 31 to April 1-March 31. Accordingly, the company's current financial year shall be extended up to March 31, 2024, covering a period of 15 months commencing from January 1, 2023, to March 31, 2024.

Key positives

- All the company's product groups and channels posted strong y-o-y growth.
- Export sales grew by 25.4% y-o-y.
- OPM improved by 196 bps y-o-y to 22.7%.

Key negatives

- Volume growth is expected to have come in mid-single digits, which is lower than our expectation of high single-digit growth.

Management Commentary

- Domestic growth of 15% is account of prudent pricing and is supported by mix and volume with targeted brand support.
- The company witnessed softening in the prices of commodities such as edible oils, wheat, and packaging materials and lowering of fuel costs, while fresh milk prices are stabilising. Robusta prices are elevated and are expected to remain volatile.
- Out-of-home business continued to deliver strong growth, led by dual strategies of portfolio transformation and execution of differentiated channels.
- Nestlé improved its penetration through the RURBAN strategy and witnessed strong growth across mega cities and metros, robust performance in tier 1 to 6 towns, and continued strength in rural markets.
- The company launched three new products in the Indian market – Resource Fibre Choice, Everyday Zero, and MUNCH Breakfast Cereals.

Revision in estimates - We have broadly maintained our earnings estimates for CY2023, CY2024, and CY2025 and will keenly monitor the performance in the coming years.

Our Call

View: Downgrade to Hold with a revised PT of Rs. 24,650 - 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 rural markets will help it drive consistent double-digit earnings growth in the long run. The company is supporting its consistent growth agenda through increased investments in capacity enhancement, strong brand support, and better R&D initiatives. The stock price has moved up by 16% in the past six months and is currently trading at 71.3x and 61.6x its CY2023E and CY2024E earnings, respectively. In view of the limited upside, we downgrade our rating on the stock to Hold from Buy earlier with a revised PT of Rs. 24,650.

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	CY22	CY23E	CY24E	CY25E
Revenue	16,897	19,554	21,962	25,019
OPM (%)	22.0	22.8	23.6	24.7
Adjusted PAT	2,391	3,019	3,497	4,169
% YoY growth	4.2	26.3	15.8	19.2
Adjusted EPS (Rs.)	247.9	313.1	362.6	432.3
P/E (x)	90.1	71.3	61.6	51.6
P/B (x)	87.5	78.9	69.6	57.5
EV/EBIDTA (x)	57.8	48.2	41.6	34.8
RoNW (%)	108.5	116.4	120.1	122.0
RoCE (%)	129.2	135.5	138.9	142.3

Source: Company; Sharekhan estimates

Revenue growth at 15% y-o-y; OPM expanded by 196 bps y-o-y

The company's revenue grew by 15.4% y-o-y to Rs. 4,658.3 crore in Q2CY2023, driven by 14.9% y-o-y growth in the domestic business, while export sales grew by 25.4% y-o-y. Revenue came largely in-line with our expectation of Rs. 4,708 crore and average street expectation of Rs. 4,660 crore. Media reports suggest volume growth of 4-5% in the domestic business is lower than street expectation of 7-8%. Despite high input cost inflation (including dairy), gross margins improved by 85 bps y-o-y to 54.8%, while OPM improved by 196 bps y-o-y to 22.7%, driven by better operating efficiencies (better than our expectation of 21.5% and in-line with the average street expectation of 22.7%). Operating profit grew by 26.3% y-o-y to Rs. 1,055.5 crore. This along with higher other income and lower depreciation charges resulted in 35.5% y-o-y growth in reported PAT to Rs. 698.3 crore (against our expectation of Rs. 662 crore and average street expectation of Rs. 693 crore). In H1CY2023, revenue grew by 18.4% y-o-y to Rs. 9,489 crore, OPM expanded by 71 bps y-o-y to 22.7%, and adjusted PAT grew by 29.3% y-o-y. The company had cash and cash equivalents of Rs. 680 crore versus Rs. 945 crore at CY2022-end and total borrowings reduced by ~Rs. 40 crore to Rs. 230 crore.

Double-digit growth across all product groups in the last five quarters

All the company's product groups delivered double-digit growth for five quarters in a row.

- Prepared dishes and cooking aids registered double-digit growth, driven by Maggi Noodles coupled with distribution expansion and impactful consumer activations.
- Milk products and nutrition delivered strong double-digit growth despite inflationary pressures, driven by Milkmaid and Peptamen. Growth was further aided by the launch of Resource Fibre choice and Everyday Zero added sugar.
- Confectionery registered double-digit growth, led by Kitkat and Munch. Performance was supported by strong consumer engagement and media campaigns.
- Beverages registered robust double-digit growth, led by greater household penetration of NESCAFE Classic, NESCAFE Sunrise, and NESCAFE Gold for both hot and cold coffee occasions. NESCAFE continued the journey of innovation, with the launch of cold coffee premix – NESCAFE ALL IN 1 FRAPPE.
- Petcare business continued to provide complete nutrition for cats and dogs. Felix received positive feedback from trade and cat parents.

Growth across all channels in Q2CY2023

- The e-commerce channel contributed to 6.5% of revenue and continued the growth momentum, driven by quick commerce.
- Organised trade channel continued to deliver strong broad-based growth across categories, driven by store expansion and improved footfalls.
- Out of Home (OOH) continued to deliver robust growth through premiumisation and portfolio transformation initiatives. Strong performance is an outcome of kiosk expansion and prioritisation of emerging channels.
- Exports registered robust double-digit growth across all categories through the proliferation of products such as NESCAFE Sunrise and Polo.

Nestlé India's tenth factory to be set up in Odisha

The company has received Odisha state government's approval to set up a food processing unit at Mundaamba, Khordha district, Orissa. This would be the 10th manufacturing plant for Nestlé in India and the company plans an investment of ~Rs 894.10 crore to set up the unit. The capex is part of Nestlé India's Rs. 2,600 crore capex for capacity expansion and setting up new facilities, sensing the large opportunities in the domestic market.

Change in the financial year

The board has approved to change the financial year of the company from January 1 – December 31 to April 1 – March 31. Accordingly, the current financial year of the company shall be extended up to March 31, 2024, covering a period of 15 months commencing from January 1, 2023, to March 31, 2024. Subsequent financial years would begin April 1 every year and end on March 31 of the subsequent year.

Results (Standalone) Rs cr

Particulars	Q2CY23	Q2CY22	YoY (%)	Q1CY23	QoQ (%)
Total Revenue	**4,658.5**	**4,036.6**	**15.4**	**4,830.5**	**-3.6**
Raw Material Cost	2,105.0	1,858.3	13.3	2,231.5	-5.7
Employee Cost	457.2	408.4	12.0	454.3	0.7
Other Expenses	1,040.7	934.4	11.4	1,049.3	-0.8
Total Operating Cost	3,603.0	3,201.1	12.6	3,735.1	-3.5
Operating Profit	**1,055.5**	**835.5**	**26.3**	**1,095.5**	**-3.6**
Other Income	24.0	19.4	23.6	33.7	-28.9
PBIDT	1,079.5	854.9	26.3	1,129.2	-4.4
Interest & Other Financial Cost	32.8	37.0	-11.3	37.0	-11.4
Depreciation	107.4	117.6	-8.7	101.7	5.6
Profit Before Tax	939.3	700.4	34.1	990.5	-5.2
Tax Expense	241.0	185.0	30.3	253.8	-5.1
Reported PAT	**698.3**	**515.3**	**35.5**	**736.7**	**-5.2**
Adj. EPS (Rs.)	72.4	53.4	35.5	76.4	-5.2
			bps		**bps**
GPM (%)	54.8	54.0	85	53.8	101
OPM (%)	22.7	20.7	196	22.7	-2
NPM (%)	15.0	12.8	222	15.2	-26
Tax rate (%)	25.7	26.4	-76	25.6	3

Source: Company, Sharekhan Research

Outlook and Valuation

Sector view - Rural recovery on cards; margin improvement to sustain

Rural demand bottomed out with sales returning to the positive growth path in Q4FY2023. With price inflation stabilising and a decline in key input prices, managements of most companies are confident of witnessing a gradual pick-up in rural demand in the quarters ahead. Moreover, the expectation of a well spread-out monsoon and the government offering some incentives prior to the budget might provide some boost to rural sentiments in the coming quarters. In FY2024, revenue growth is expected to be volume-led growth with companies focusing on passing on the benefits of the decline in input cost to customers in the coming quarters. The decline in input prices will drive gross margins in the coming quarters. Despite higher media spends, OPM is expected to remain high on a y-o-y basis in the near term.

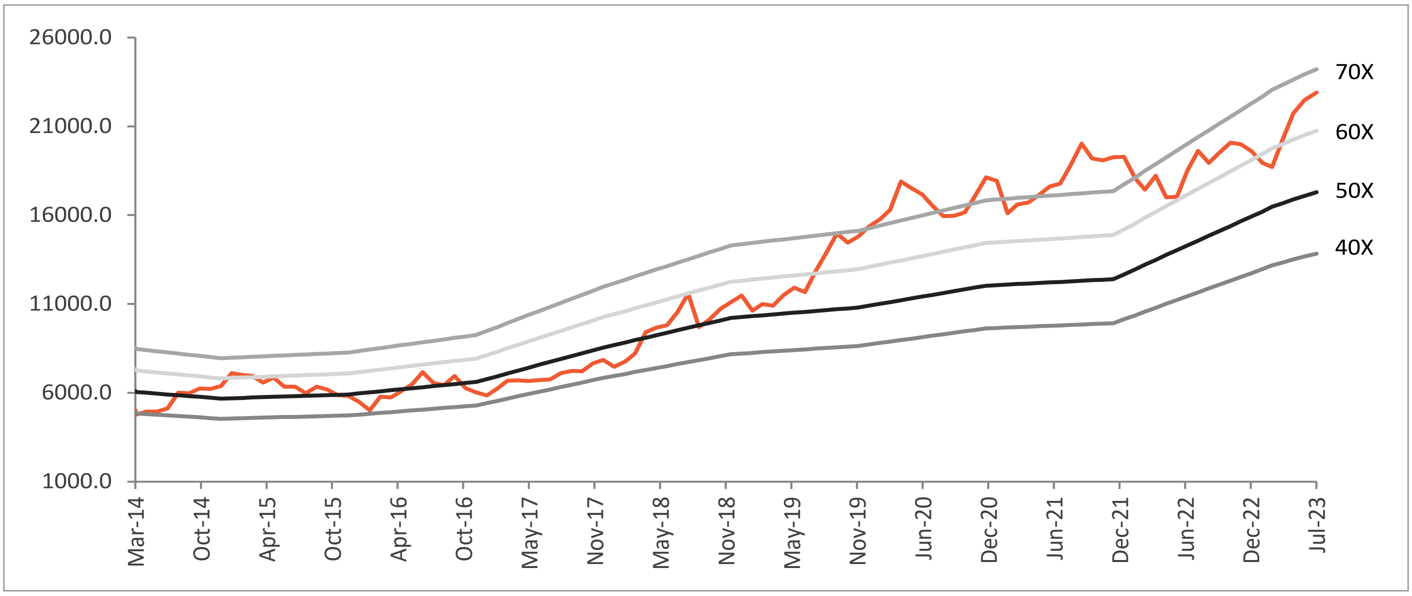
Company outlook - Focusing on achieving consistent growth

In H1CY2023, the company's revenue grew by 18.4% y-o-y to Rs. 9,489 crore, OPM expanded by 71 bps y-o-y to 22.7%, and adjusted PAT grew by 29.3% y-o-y. The company is focusing on consistent growth through innovations (5.4% of domestic revenue), expanding in rural/tier-2 markets, and accelerating footprints through new channels. Nestlé has achieved 80% of the target village coverage of 1,20,000 villages. Raw-material inflation stood at a high single digit for the company. Nestlé 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 the employee cost level, adding to OPM.

Valuation - Downgrade to Hold with a revised PT of Rs. 24,650

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 rural markets will help it drive consistent double-digit earnings growth in the long run. The company is supporting its consistent growth agenda through increased investments in capacity enhancement, strong brand support, and better R&D initiatives. The stock price has moved up by 16% in the past six months and is currently trading at 71.3x and 61.6x its CY2023E and CY2024E earnings, respectively. In view of the limited upside, we downgrade our rating on the stock to Hold from Buy earlier with a revised PT of Rs. 24,650.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
HUL	60.3	55.0	47.2	43.9	39.0	33.3	25.6	28.2	31.9
Britannia Industries	60.2	52.1	43.9	42.0	36.4	31.1	32.8	33.4	36.4
Nestle India*	90.1	71.3	61.6	57.8	48.2	41.6	129.2	135.5	138.9

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

About company

Nestlé 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 internationally 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 Nestlé Milk and Nestlé Slim Milk. Nestlé 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. Nestlé is the market leader in the categories of 'Instant Noodles' and 'Infant Cereals & Infant Formula'.

Investment theme

Nestlé 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 the 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.
- **Higher 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
Svetlana Boldina	Executive Director – Finance and Control and CFO
Pramod Kumar Rai	Company Secretary and Compliance Officer

Source: BSE; Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	1.89
2	Axis Asset Management Co. Ltd.	1.59
3	BlackRock Inc.	1.31
4	SBI Funds Management	1.30
5	Vanguard Group Inc.	1.30
6	UTI Asset Management Co. Ltd.	0.70
7	Norges Bank	0.31
8	ICICI Prudential Life Insurance Co. Ltd.	0.23
9	Government Pension Investment Fund Japan	0.21
10	SBI Pension Funds Pvt. Ltd.	0.20

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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