Stock Update

Result Update

Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Nestle India Ltd

Premium valuation; retain Hold

Consumer Goods		Sharekhan code: NESTLEIND	
Reco/View: Hold ↔		CMP: **Rs. 24,248**	Price Target: **Rs. 26,805** ↑

↑ 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 Updated Aug 08, 2023				28.28
Medium Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

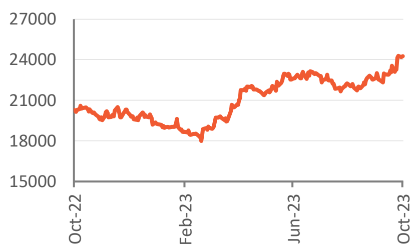
Company details

Market cap:	Rs. 2,33,789 cr
52-week high/low:	Rs. 24,736 / 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	13.0
DII	9.3
Others	14.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.1	8.6	15.3	19.6
Relative to Sensex	10.1	12.0	9.1	12.0

Sharekhan Research, Bloomberg

Summary

- Nestlé India Limited's (Nestlé) revenues grew by ~10% y-o-y to Rs. 5,036.8 crore in Q3CY23; OPM improved by 230 bps y-o-y to 24.3% and PAT grew by 24% y-o-y to Rs. 828.8 crore.
- Domestic volumes grew in low single-digit, slightly lower than street's expectation of 5-7%. Consistent double-digit growth in the out-of-home categories will drive growth in the near term.
- Lower input prices drove up margins in H1. However, deficient rainfall and global uncertainties might lead to volatility in input prices and can act as a risk to profitability in the near term.
- Stock continues to trade at premium valuations of 77x, 67x, and 56x its CY2023E, CY2024E, and CY2025E EPS, respectively. We maintain a Hold rating on the stock with a revised price target of Rs. 26,805.

Nestlé Q3CY2023 performance was largely in-line with expectation due to higher expected OPM driven by lower input prices. Revenues grew by ~10% y-o-y to Rs.5,036.8 crore with domestic business growing by 11% while export sales saw a dip of 10% during the quarter. Volumes grew in low single-digit, lower than the street expectation of 5-7%. Milk products and beverages categories registered double-digit growth during the quarter. Lower input cost inflation led to 371 bps y-o-y expansion in gross margin to 56.5%, while OPM improved by 230 bps y-o-y to 24.3% driven by better operating efficiencies. Operating profit grew by 21.2% y-o-y to Rs. 1,224.9 crore and adjusted PAT grew by 24% y-o-y to Rs.828.8 crore. The company declared a stock split in the ratio of 1:10. Further, it has declared second interim dividend of Rs. 140 per share (cumulative dividend paid till now is Rs. 167 per share).

Key positives

- Out-of-home category registered double-digit volume led growth in Q3CY2023.
- OPM improved by 230 bps y-o-y to 24.3%; ahead of our as well as street expectation.

Key negatives

- Volume growth in 9MCY2023 stood at 1.6% as compared to 9MCY22. Double-digit value growth is largely driven by price hikes undertaken in the past few quarters.

Management Commentary

- The overall food industry is worth ~$800 billion in India with branded package food & beverage industry standing at just $40 billion. Rising aspiration for branded products will help branded packaged food industry to grow strong in the coming years.
- Company is focusing on driving volume led growth through improvement in penetration and good traction for product launches.
- Company launched 125 new products in last seven years (contributes 6% to overall revenues). It is planning to launch 10 new products in the coming years.
- Its products are sold in more than 5.2 million outlets. The company has strong partnership with 2,000 distributors (around 80% distributors have more than 20 years of association). The company is focusing on more such partnerships to expand its reach in the coming years.
- Nestle is planning to do capex of Rs. 5,000 crore over 2023-2025. Out of which it has already invested Rs. 900 crore for setting up new facility in Odisha. Capex will largely be done for expansion in capacity, improving the supply & logistics and add-in more efficiencies.
- Project Shark led to cost saving of Rs. 150-200 crore every year. The company will continue to focus more savings initiatives to support margins in the coming years.
- E-commerce channel is gaining strong traction; around 50% of business generated on the channel is through quick commerce.

Revision in estimates – We have broadly maintained our earnings estimates for CY2023, CY2024, and CY2025 in view of better-than-expected OPM. We shall keenly monitor the performance in the coming quarters.

Our Call

View: Retain Hold with a revised PT of Rs. 26,805: 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. Company is supporting its consistent growth agenda through increased investments in capacity enhancement, strong brand support, and better R&D initiatives. The stock price continues to trade at premium valuation of 77x and 67x its CY2023E and CY2024E earnings, respectively. In view of the limited upside from current levels, we maintain our Hold recommendation on the stock with a revised PT of Rs. 26,805.

Key Risks

A 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)	97.8	77.4	66.9	56.1
P/B (x)	95.1	85.6	75.6	62.5
EV/EBIDTA (x)	62.8	52.3	45.1	37.8
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 10% y-o-y; OPM expanded by 230 bps y-o-y

Nestle's revenue grew by 10% y-o-y to Rs. 5,036.8 crore in Q3CY2023, driven by 11% y-o-y growth in the domestic business while export sales decreased by 10% y-o-y. Domestic volumes grew in low single-digit, lower than our as well as street expectation of 5-7%. Cooling of inflationary pressure drove up gross margins by 371 bps y-o-y to 56.5%, while OPM improved by 230 bps y-o-y to 24.3% driven by better operating efficiencies. Operating profit grew by 21.2% y-o-y to Rs. 1,224.9 crore. In line with operating profit growth, adjusted PAT grew by 24% y-o-y to Rs. 828.8 crore. In 9MCY2023, revenue growth of 15.2% y-o-y to Rs. 14,526 crore and OPM expansion of 126 bps y-o-y to 23.2% led to 27.3% y-o-y growth in the adjusted PAT to Rs. 2,264 crore. The board has declared second interim dividend of Rs. 140 per share for CY2023. The board has also approved the split of existing equity shares of face value (FV) of Rs. 10 into 10 equity shares of FV of Re. 1.

Milk products and nutrition and NESCAFÉ portfolio delivered double-digit growth

- Prepared dishes and cooking aids continued its growth momentum across the portfolio, driven by combination of market visibility, impactful media campaigns and targeted consumer engagement initiatives aided by innovation especially for RURBAN markets.
- Milk products and nutrition delivered double-digit growth in Q3CY2023. MILKMAID and PEPTAMEN continued to receive positive consumer response. The company launched Nestlé a+ Masala Millet with bajra, in two variants, Tangy Tomato and Veggie Masala, in Q3CY2023.
- In confectionery, all key products registered strong growth led by KITKAT and supported by MUNCH, with performance being aided by consistent media support, digital first campaigns and a mega launch plan on KITKAT's premium portfolio.
- Beverages registered strong growth across NESCAFÉ portfolio with all key brands - NESCAFÉ CLASSIC, NESCAFÉ Sunrise and NESCAFÉ GOLD registering double-digit growths. NESCAFÉ continued to cement its leadership position in the category with highest ever market share and strong household penetration gains.
- In the petcare business, Felix Wet Cat food continued to receive positive feedback from trade and cat parents.

Double-digit growth in retail channel in Q3CY2023

- E-commerce channel contributed to 6.1% of revenue (versus 6.5% in Q2CY2023) and continued the growth momentum across product groups, driven by quick commerce.
- Within the organised trade channel, the retail channel continued delivering strong double-digit growth.
- The out-of-home (OOH) channel registered strong double-digit volume led growth, with product transformation driving consistent performance.
- In exports, the company expanded its product offerings across key international markets to delight Indian diaspora. MAGGI and NESCAFÉ SUNRISE range met with strong demand in both ethnic and mainstream channels.

Results (Standalone) **Rs cr**

Particulars	Q3CY23	Q3CY22	Y-o-Y %	Q2CY23	Q-o-Q %
Net Sales	**5,009.5**	**4,566.6**	**9.7**	**4,619.5**	**8.4**
Other Operating income	27.3	24.4	11.9	39.0	-30.1
Total Revenue	**5,036.8**	**4,591.0**	**9.7**	**4,658.5**	**8.1**
Raw Material Cost	2,191.6	2,167.9	1.1	2,105.0	4.1
Employee Cost	517.6	417.9	23.8	457.2	13.2
Other Expenses	1,102.8	994.5	10.9	1,040.7	6.0
Total Operating Cost	3,812.0	3,580.3	6.5	3,603.0	5.8
Operating Profit	**1,224.9**	**1,010.7**	**21.2**	**1,055.5**	**16.0**
Other Income	33.3	30.6	8.6	24.0	38.9
PBIDT	1,258.1	1,041.3	20.8	1,079.5	16.6
Interest & Other Financial Cost	31.4	37.0	-15.1	32.8	-4.3
Depreciation	111.2	98.1	13.3	107.4	3.5
Profit Before Tax	1,115.6	906.2	23.1	939.3	18.8
Tax Expense	286.8	237.9	20.6	241.0	19.0
Adjusted PAT	**828.8**	**668.3**	**24.0**	**698.3**	**18.7**
Exceptional Items	-79.3	0.0	-	0.0	-
Reported PAT	**908.1**	**668.3**	**35.9**	**698.3**	**30.0**
Adj. EPS (Rs.)	86.0	69.3	24.0	72.4	18.7
			bps		**bps**
GPM (%)	56.5	52.8	371	54.8	167
OPM (%)	24.3	22.0	230	22.7	166
NPM (%)	18.0	14.6	347	15.0	304
Tax rate (%)	25.7	26.3	-54	25.7	5

Source: Company; Sharekhan Research

Outlook and Valuation

Sector Outlook – Rural recovery on cards; margin improvement to sustain

As food inflation eases and a stable kharif crop is eyed, managements of most consumer goods companies are confident of witnessing a pick-up in rural demand in H2FY2024. This will also be supported by the upcoming festive season and higher government spending prior to the general elections. Overall, we expect a gradual improvement in volume growth of consumer goods companies in the quarters ahead. Crude oil prices moved up from its low but continue to remain in a comfortable zone. Other input prices are yet to see a significant jump and will provide lesser stress on the profitability in the near term. Thus, we expect gross margin expansion to sustain in the quarters ahead. Despite higher media spends, OPM is expected to remain elevated y-o-y in the near term. Most of the consumer goods companies are optimistic about medium-term growth outlook aided by low penetration in most categories, emerging distribution channels, and improving per-capita income.

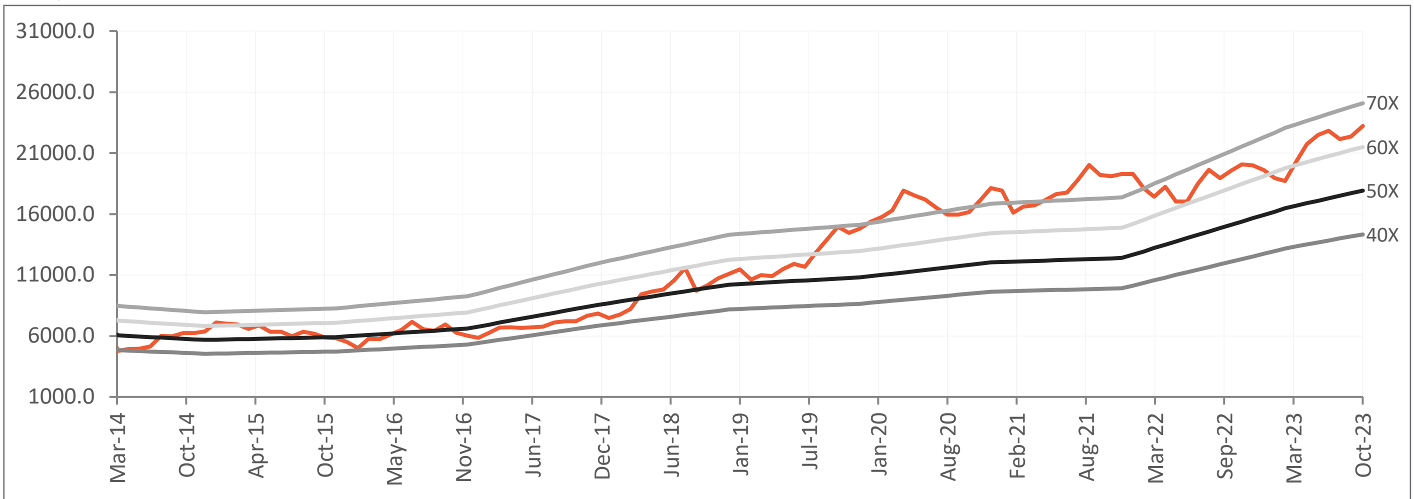
Company Outlook – Focusing on achieving consistent growth

In 9MCY2023, revenues grew by 15.2% y-o-y to Rs. 14,526 crore and OPM improved by 126 bps y-o-y to 23.2% leading to 27.3% y-o-y growth in the adjusted PAT to Rs. 2,264 crore. 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 – Retain Hold with a revised PT of Rs. 26,805

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. Company is supporting its consistent growth agenda through increased investments in capacity enhancement, strong brand support, and better R&D initiatives. The stock price continues to trade at premium valuation of 77x and 67x its CY2023E and CY2024E earnings, respectively. In view of the limited upside from current levels, we maintain our Hold recommendation on the stock with a revised PT of Rs. 26,805.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
HUL	58.1	53.5	46.8	42.3	38.3	33.1	25.6	28.0	31.1
Britannia Industries	55.9	51.2	42.4	39.1	35.5	29.7	32.8	31.9	36.0
Nestle India*	97.8	77.4	66.9	62.8	52.3	45.1	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. We expect the company's revenue and PAT to clock 14% and 20% CAGR over CY2022-25E, respectively.

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	Vanguard Group Inc	1.54
3	Axis Asset Management Co.Ltd	1.48
4	SBI Funds Management	1.30
5	BlackRock Inc	1.24
6	UTI Asset Management Co Ltd	0.71
7	Norges Bank	0.31
8	ICICI Prudential Life Insurance Co Ltd	0.27
9	Government Pension Investment Fund Japan	0.21
10	FIL 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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