

Nestle India



BSE SENSEX 17,362 S&P CNX 5,278

CMP: INR4,657 TP: INR4,838 Neutral



Bloomberg	NEST IN
Equity Shares (m)	96.4
52-Wk. Range (INR)	5,024/3,930
1,6,12 Rel. Perf. (%)	3/6/1
M.Cap. (INR b)	449.0
M.Cap. (USD b)	8.1

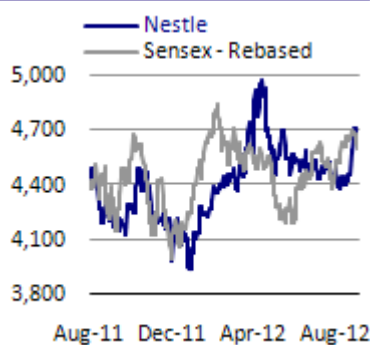
Valuation summary (INR b)

Y/E Dec.	2011	2012E	2013E
Sales	74.9	85.8	102.0
EBITDA	15.5	18.8	22.6
NP	10.2	11.3	13.3
EPS (INR)	105.7	117.1	138.5
EPS Gr. (%)	21.7	10.8	18.3
BV/Sh (INR)	132.1	186.2	249.9
P/E (x)	44.1	39.4	33.3
P/BV (x)	35.2	24.8	18.5
EV/EBITDA (x)	29.3	23.9	19.7
EV/Sales (x)	6.1	5.3	4.4
RoE (%)	95.7	73.6	63.5
RoCE (%)	89.6	61.7	59.6

Shareholding pattern %

As on	Jun-12	Mar-12	Jun-11
Promoter	62.8	62.8	62.8
Dom. Inst	7.8	7.8	8.2
Foreign	11.4	11.4	11.1
Others	18.1	18.0	18.0

Stock performance (1 year)



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Cautious outlook; aggressive capex

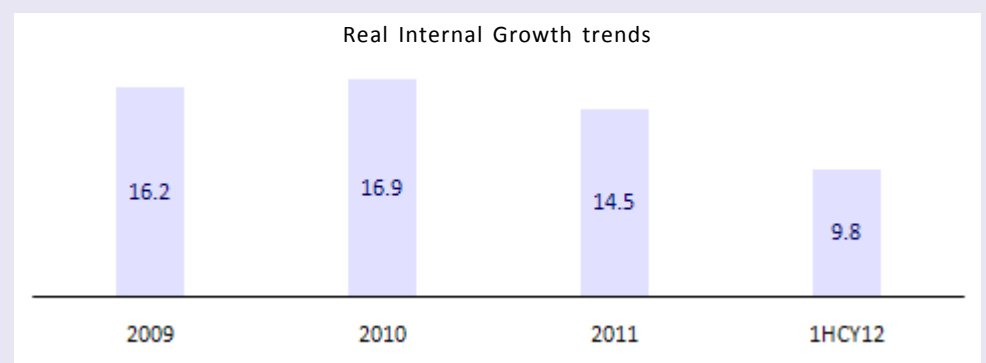
Long-term prospects and positives priced in

We attended the Analyst Meet of Nestle India where management vigorously defended its current strategy of balancing growth v/s margins and reiterated that Nestle will not sacrifice margins for chasing volume growth.

Key takeaways

- Management continues to maintain its cautious stance due to the weak macroeconomic environment. It had been cautious for a long time, and now it is "more cautious".
- Nestle will try to balance volumes and profitability and not chase volumes at the cost of margins. Its volume growth in the past 4-5 quarters has been dismal.
- Management emphasized on the **Real Internal Growth (RIG i.e. growth in sales at previous year's prices)** which captures the impact of volume as well as price mix. RIG for all the categories is higher than reported volume growth as shown in the chart below.

Nestle's RIG has moderated (%)

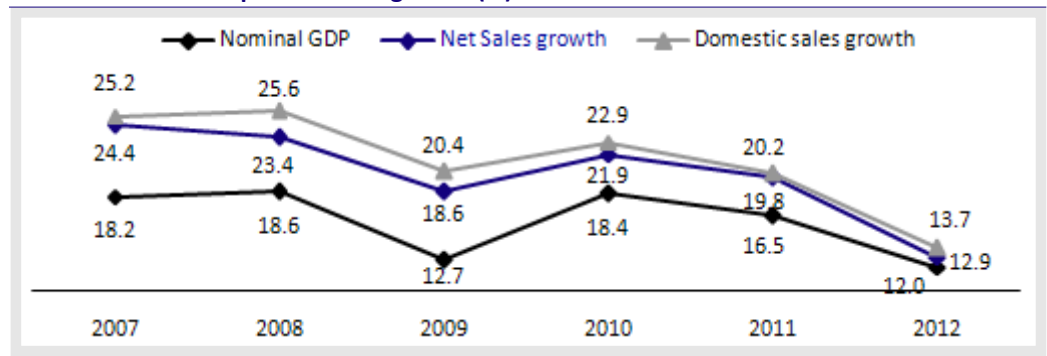


- Nestle has doubled capacities in every category except Coffee and achieved completion of capacities ahead of schedule.
- It has also doubled its distribution reach to 4m outlets since CY09, and is now focusing on deriving better throughput from the same. It will focus on improving its presence in the north-east.
- Procurement of quality raw material is a challenge in the management's view, and it is trying to build a model which allows it to procure the same for its expanded capacities, in turn, serving as a competitive advantage. Nestlé's input cost basket is up 7% for 1HCY12.
- Adjusted for discontinued SKUs and policy changes (excise duty hike), volume growth is 3.9% v/s reported 1.1%. Similarly, top-line growth is 16.4% v/s reported 14.2%. Of the reported 50bp EBIT margin improvement for 1HCY12, 40bp is due to one-offs and non-comparable base (increase in excise post Budget 2012).

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Weak macro does impact revenue growth (%)



Domestic volumes up 1.1% in 1HCY12

Domestic volumes grew 1.1% in 1HCY12, with growth in Q2 estimated to be flat. Export volumes declined 27% YoY. Nestle continued to report muted volume growth on account of (1) Series of price hikes in its mainstay milk, (2) Grammage reduction, (3) Exit from low margin chocolate SKUs (Éclairs), and (4) Channel rationalization (exited milk products supply to the armed forces). Though Nestle has taken some corrective actions in trade, we expect volume growth to recover only gradually.

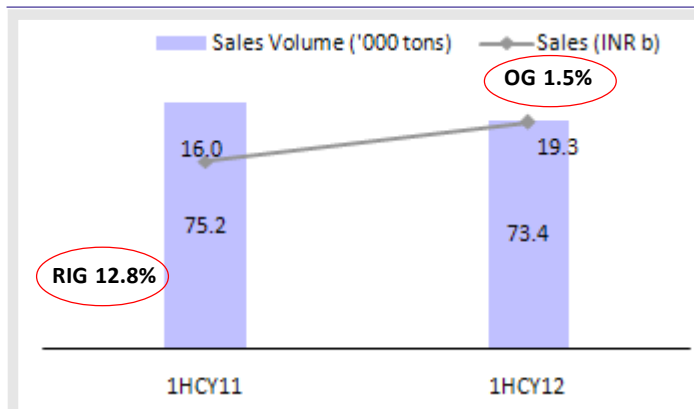
- **Milk division** reported ~2.4% decline in volume terms, but 21% growth in value terms. Low volume growth was due to phasing out of low-margin products and channels, and series of price hikes.
- **Beverages** posted 0.2% volume growth and 7.1% value growth. Management admitted failure of its recent *My First Cup* campaign in Nescafe.
- **Chocolates** was the worst impacted category in 1HCY12 with ~15% volume decline. Base will become comparable post 3QCY12 and hence some recovery will be seen in reported numbers.
- **Prepared Dishes** reported 8.2% growth in volumes and 12.2% growth in value, a clear moderation from the mid-teens volume growth trend. Grammage reduction and severe competitive intensity from ITC has impacted the performance, in our view. However, market shares have now stabilized as per management.

Volume deceleration across categories

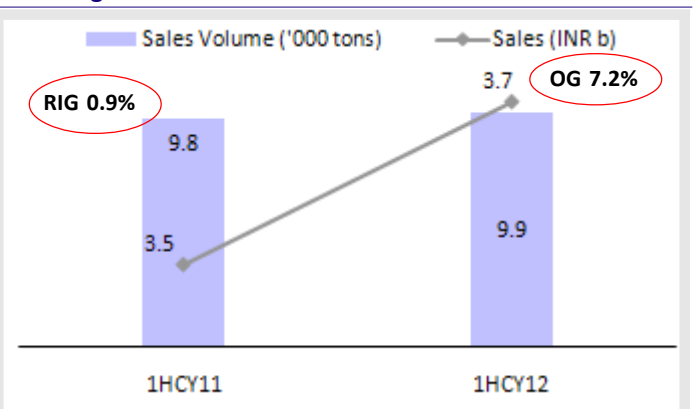
Category	1HCY12 v/s 1HCY11	
	Volume Gr.	Value Gr.
Milk Products & Nutrition	-2.4	20.9
Beverages	0.2	7.1
Prepared Dishes & Cooking Aids	8.2	12.2
Chocolate & Confectionery	-14.7	1.7

Source: Company, MOSL

Milk Products & nutrition: Volumes decline 2.4%

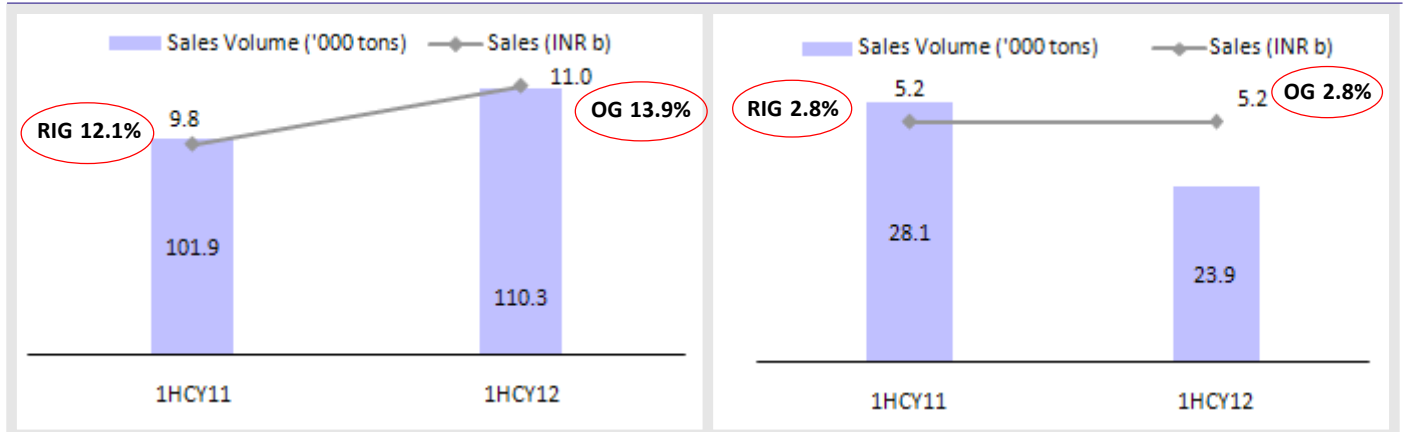


Beverages: Flat volumes



Prepared Dishes & Cooking Aids

Chocolates & confectionery



*OG: Organic Growth; RIG: Real Internal Growth, Pricing impact = OG - RIG

Source: Company, MOSL

Input cost index up 7.3% in 1HQ12; sugar, wheat and coffee remain firm

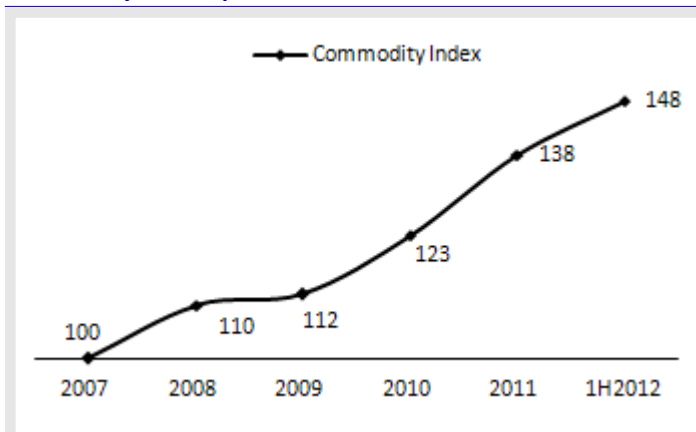
- Rising input costs remain a concern. With key inputs like sugar, coffee and wheat witnessing continued inflation, the company’s cost index has risen by 7.3% in 1HCY12 itself.
- The company has seen a total adverse impact of INR1.3b due to commodity prices in 1HCY12.
- Procurement of quality RM for expanded capacities will be a challenge but a source of competitive advantage, in management’s view.
- Sugar and coffee prices are higher by 16% each since December 2011. Despite a ~370bp increase in raw material costs, reduction in operating expenses resulted in EBITDA margin expansion.

Milk, Coffee and SMP impact contribution by INR1.3b in 1HCY12

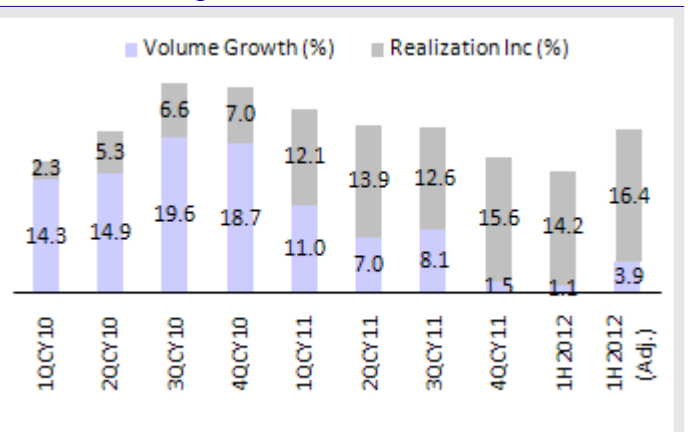
	Raw Material % of Total	1HCY12 Raw material cost			Current Trend (post-Dec, %)
		INR m	price trend %	Impact (INR m)	
Milk	35.0	6,700	10.8	-800	5.5
Sugar	7.5	1,000	6.0	-50	16.0
Wheat Flour	9.6	1,400	0.6	50	30.0
SMP	8.0	2,100	9.1	-200	4.2
Palmoil	8.5	900	-5.4	-100	-8.7
Green Coffee	11.0	1,300	14.4	-200	16.0
Total		13,400	16.5	-1,300	

Source: Company, MOSL

Commodity Index up 7.3% in 1HCY12



1HCY12 volume growth continues to be low

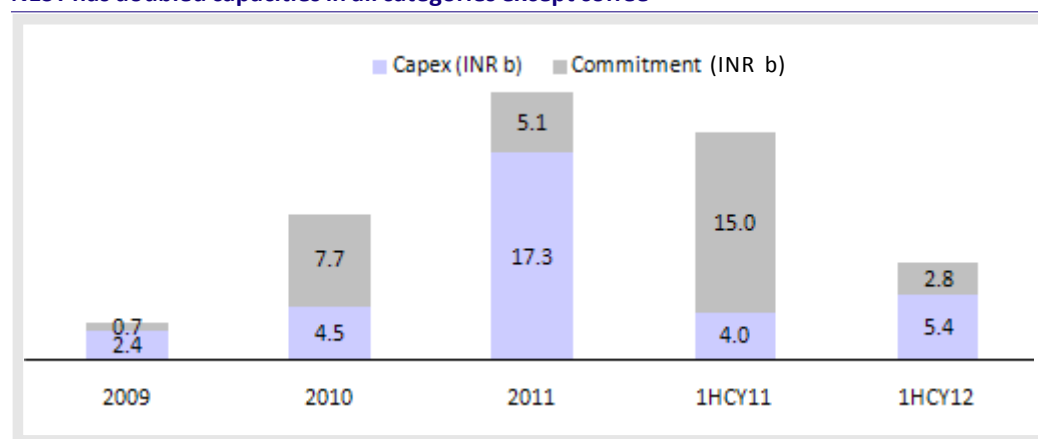


Source: Company, MOSL

Capex on track; spent INR28b on capex since CY10

- The company's capex plan is on track. It has spent INR5.4b in 1HCY12 and has a commitment of INR2.8b. Over the last 2.5 years Nestle has spent INR28b on capex and doubled capacities across categories except Coffee.
- It has commissioned capacities on time or ahead of schedule.
- We expect new launches to further accelerate as the company adds new capacity across product lines.
- Higher capital costs on the back of increased capacities could restrict the earnings growth.

NEST has doubled capacities in all categories except coffee



Source: Company, MOSL

Valuation and view: Long-term growth outlook intact; positives priced in; maintain Neutral

- Notwithstanding management's frank and unambiguous defense of its strategy, moderation in volume growth in Nestle's categories is well evident, even after adjusting for discontinued SKUs and one-offs.
- Real internal growth trends have slowed down across its key categories with Chocolates and Coffee among the worst impacted. While management has taken corrective actions (price cuts, aggressive S&D spends, increasing reach, etc), recovery in volume growth will be gradual, in our view.
- We revise our revenue and earnings estimates downwards by 6-8% and 5-7%, respectively, to incorporate subdued volumes and higher capital costs. We now expect EPS CAGR of 14.5% for CY12-14.
- Long-term opportunity in Indian processed foods remains immense given favorable demographics, increasing income, and rising urbanization trends. We expect Nestle to be the single largest beneficiary of the same given its dominating market presence in its core categories. However, the stock is currently trading at 39x CY12E and 33x CY13E earnings. Most of the long-term positives seem factored in, more so, given near-term muted volume performance and expected higher capital costs on the back of recent capex. Maintain **Neutral** with a revised Sep-13 target price of INR4,838 (5% discount to 3 year average P/E).

Financials and Valuation

Income Statement					(INR Million)
Y/E December	2009	2010	2011	2012E	2013E
Domestic Sales	48,938	60,262	72,834	84,746	100,358
Export Sales	3,286	3,503	3,902	3,256	4,073
Excise	930	1,218	1,828	2,225	2,478
Net Sales	51,294	62,547	74,908	85,777	101,953
Change (%)	18.6	21.9	19.8	14.5	18.9
Total Expenditure	40,949	50,051	59,381	66,953	79,359
EBITDA	10,345	12,497	15,528	18,824	22,593
Change (%)	19.8	20.8	24.3	21.2	20.0
Margin (%)	20.2	20.0	20.7	21.9	22.2
Depreciation	1,113	1,278	1,533	2,564	3,333
Int. and Fin. Ch.	14	11	51	651	660
Other Inc.- Rec.	378	427	509	586	747
PBT	9,596	11,635	14,452	16,194	19,347
Change (%)	19.4	21.2	24.2	12.1	19.5
Margin (%)	18.7	18.6	19.3	18.9	19.0
Tax	2,669	3,252	4,162	4,759	5,758
Deferred Tax	-49	13	102	147	240
Tax Rate (%)	27.3	28.1	29.5	30.3	31.0
Adjusted PAT	6,976	8,370	10,188	11,287	13,349
Change (%)	23.5	20.0	21.7	10.8	18.3
Margin (%)	13.6	13.4	13.6	13.2	13.1
Non-rec. (Exp)/Inc.	426	184	573	630	693
Reported PAT	6,550	8,187	9,615	10,657	12,656

Balance Sheet					(INR Million)
Y/E December	2009	2010	2011	2012E	2013E
Share Capital	964	964	964	964	964
Reserves	4,848	7,590	11,775	16,984	23,126
Net Worth	5,813	8,554	12,740	17,949	24,090
Loans	6	0	9,709	12,000	10,000
Capital Employed	5,819	8,554	22,448	29,949	34,090
Gross Block	16,408	18,547	25,522	41,962	50,631
Less: Accum. Depn.	7,446	8,420	9,765	12,329	15,662
Net Fixed Assets	8,962	10,127	15,758	29,633	34,969
Capital WIP	796	3,489	14,186	6,760	5,730
Investments	2,033	1,507	1,344	2,588	3,300
Curr. Assets, L&A	8,566	10,460	12,730	15,822	19,354
Inventory	4,987	5,760	7,340	8,163	9,615
Account Receivables	642	633	1,154	1,447	1,717
Cash and Bank Balance	1,556	2,553	2,272	3,749	5,307
Others	1,380	1,514	1,964	2,464	2,715
Curr. Liab. and Prov.	14,218	16,696	21,135	24,272	28,440
Account Payables	5,817	7,454	9,979	11,250	13,340
Other Liabilities	53	167	113	106	125
Provisions	8,348	9,075	11,043	12,917	14,975
Net Curr. Assets	-5,652	-6,236	-8,404	-8,450	-9,086
Def. Tax Liability	-320	-333	-435	-582	-822
Appl. of Funds	5,819	8,554	22,448	29,949	34,090

E: MOSL Estimates

Financials and Valuation

Ratios

Y/E December	2009	2010	2011	2012E	2013E
Basic (INR)					
EPS	72.4	86.8	105.7	117.1	138.5
Cash EPS	83.9	100.1	121.6	143.7	173.0
BV/Share	60.3	88.7	132.1	186.2	249.9
DPS	48.5	48.5	48.5	48.5	58.0
Payout %	78.4	65.1	53.3	48.3	48.8

Valuation (x)

P/E			44.1	39.4	33.3
Cash P/E			38.3	32.1	26.7
EV/Sales			6.1	5.3	4.4
EV/EBITDA			29.3	23.9	19.7
P/BV			35.2	24.8	18.5
Dividend Yield (%)			1.0	1.0	1.2

Return Ratios (%)

RoE	132.3	116.5	95.7	73.6	63.5
RoCE	167.8	151.8	89.6	61.7	59.6

Working Capital Ratios

Debtor (Days)	4.5	3.6	5.5	6.0	6.0
Asset Turnover (x)	8.4	7.1	3.3	2.8	2.9

Leverage Ratio

Debt/Equity (x)	0.0	0.0	0.8	0.7	0.4
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Cash Flow Statement

(INR Million)

Y/E December	2009	2010	2011	2012E	2013E
OP/(loss) before Tax	9,232	11,219	13,994	16,259	19,260
Int./Div. Received	378	427	509	586	747
Depn. and Amort.	927	974	1,345	2,564	3,333
Interest Paid	14	11	51	651	660
Direct Taxes Paid	2,669	3,252	4,162	4,759	5,758
Incr in WC	-1,088	-1,397	-1,418	-892	-1,502
CF from Operations	8,943	10,754	13,054	14,890	18,424
Incr in FA	2,064	4,832	17,672	9,013	7,639
Pur of Investments	1,684	-526	-163	1,245	712
CF from Invest.	-3,748	-4,306	-17,509	-10,257	-8,351
Incr in Debt	-2	-6	9,709	2,291	-2,000
Dividend Paid	5,471	5,448	5,430	5,448	6,515
Others	-103	3	-104		0
CF from Fin. Activity	-5,576	-5,451	4,175	-3,156	-8,515
Incr/Decr of Cash	-381	997	-281	1,476	1,558
Add: Opening Balance	1,937	1,556	2,553	2,272	3,749
Closing Balance	1,556	2,553	2,272	3,749	5,307

E: MOSL Estimates

N O T E S

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2. Group/Directors ownership of the stock	No
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