Initiating Coverage

Nestle Ltd.

24-November-2020

Nestle India Ltd.

Industry	LTP	Base Case Fair Value	Bull Case Fair Value	Recommendation	Time Horizon
FMCG	Rs. 17786	Rs. 17450	Rs. 18900	Buy on dips to Rs15900-16100 band and add more on dips to Rs.14850-15050 band	3 quarters

HDFC Scrip Code	NESINDEQNR
BSE Code	500790
NSE Code	NESTLEIND
Bloomberg	NEST:IN
CMP Nov 23, 2020	17786
Equity Capital (cr)	96
Face Value (Rs)	10
Eq- Share O/S(cr)	9.6
Market Cap (Rscr)	170745
Book Value (Rs)	274
Avg.52 Wk Volume	137911
52 Week High	18370
52 Week Low	12200

Share holding Pattern % (Sept 30, 2020)	
Promoters	62.76
Institutions	20.81
Non Institutions	16.43
Total	100.0

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Our Take:

Nestle India Ltd, one the biggest players in FMCG segment, has a presence in milk & nutrition, beverages, prepared dishes & cooking aids & chocolate & confectionery segments. The company is engaged in the food business. Nestle India manufactures and sells products with brands such as Nescafe, Maggi, Milkybar, Milo, Kit Kat, Bar-One, Milkmaid and Nestea. Products of daily consumption and use include Nestle Milk, Nestle Slim Milk, Nestle Fresh 'n' Natural Dahi and Nestle Jeera Raita, Nestle Everyday Dairy Whitener and Nestle Everyday Ghee. Beverages Include Nescafe Classic, Nescafe Sunrise Premium, Nescafe Sunrise Special and Nescafe Cappuccino. Nestle India is a subsidiary of Nestle S.A. of Switzerland. The company has presence across India with 8 manufacturing facilities and four branch offices spread across the region. The four branch offices in the country help facilitate the sales and marketing of its products. Nestle has announced a capex of Rs 2600 cr over the next 4 years with plans to increase the existing manufacturing facilities and including new under-construction facility (Rs700 cr capex) at Sanand, Gujarat. Nestle is engaging in such large capacity addition after almost 7-8 years.

Valuations & Recommendation:

Nestle is a market leader in most categories it is present and hence is one of the most expensive FMCG companies in India. However, we believe the company will always demand a premium compared to its peers due to certain moats. The company is an undisputed leader in many categories like infant formulations where there is very little or no competition. At the same time, regulatory restrictions on advertising such products means it is very difficult for new players to enter and gain share in the market. The domestic consumer associates the noodles category to a brand like Maggi. Nescafe has been the leader in coffee space in India for years. Due to these reasons, Nestle has managed to grow in double digits compared to low single digit growth of the industry. Nestle also has a vast global portfolio which it can leverage and enter new categories in India in the future. For eg. Ice Creams, Petcare, Healthcare Nutrition, Cullinary, Chilled and Frozen Foods, and Bottled Water. The company is constantly innovating with new products which has led to growth outperformance. In all, Nestle had 61 new launches since 2016, of which 70% have been successful. New innovations are estimated to have contributed between 3-4% to domestic sales in CY19 alone. Owing to these factors, we believe Nestle to be a long term compounding story as penetration levels are still low in rural regions which still have a significant presence of unorganized players. Covid related lockdown and confined living have triggered rise in penetration and product trials. This can drive higher consumption of packaged foods.

Nestle India Ltd.

We feel investors can buy the stock on dips in the Rs.15900-16100 band (55.0xCY22E EPS) and add more on dips to Rs.14850-15050 band (51.5xCY22E EPS). We think the base case fair value of the stock is Rs.17450 (60.0xCY22E EPS) and the bull case fair value is Rs.18900 (65.0xCY22E EPS) over the next two quarters.

Financial Summary (Rs Cr)

Particulars (Rs cr)	Q3CY20	Q3CY19	YoY-%	Q2CY20	QoQ-%	CY19	CY20E	CY21E	CY22E
Net Revenues	3542	3216	10.13	3051	16.10	12369	13411	14822	16428
EBITDA	908	779	16.49	768	18.26	2927	3289	3572	4000
APAT	587	595	(1.36)	487	20.65	1988	2222	2455	2802
Diluted EPS (Rs)	60.90	61.70	(1.30)	50.50	20.59	206.20	230.50	254.60	290.60
P/E (x)						86.26	77.16	69.86	61.20
EV/EBITDA						58.15	51.82	47.75	42.70
RoE-%						33.66	34.56	34.64	37.65

(Source: Company, HDFC sec)

Long term Triggers

Market Leader: Nestle has a leadership in ~85% of the products in its portfolio. Nestle currently is market Leader in Infant Cereals under Cerelac brand with 96.3% market share, in Infant formula with Lactogen NAN brand having 67.5% market share, in Tea Creamer with Nestle Everyday having 44.9% market share, in Instant Noodles, with Maggi having 59.1% market share, in Instant Coffee with Nescafe having 50.5% market share, in White & Wafers category, with KitKat, Munch and Milkybar collectively having 61.9% market share, and in Instant Pasta, with Pazzta having 68.9% market share. It is also no.2 in the Ketchups & Sauces category with its Maggi sauces. It thus has leadership in seven out of the nine product categories that it exists in, and it stands at no.2 in the balance. With such strong presence, Nestle has a good hold on the Indian market, and can experiment with new launches and bring more innovative products to India from its global portfolio.

Nestle has been able to successfully build its market share and sustain it against key competitors in all the segments like Danone, Abbott and Amul in Infant formula and cereals, Amul and Mother Dairy in milk products, HUL in beverages, ITC, Patanjali, HUL & Nissin in Prepared Dishes and Mondelez, Mars and Ferrero in Chocolates.

Demographics: India has huge demographic dividend given that it has the world's second largest population base. The growth momentum in FMCG sector largely depends on its strong structural drivers like high population and rising affluence level. India is reporting an annual population growth of 1.1%. Nearly half of India's population is under the age of 25 and two-thirds are less than 35. India is expected to have the world's largest workforce by 2027, with a billion people aged between 15 and 64. This indicates that the growth in the non-discretionary consumer demand, like food, healthcare, household and personal care products, are likely to grow for a very long period. In addition, India is also witnessing strong growth in per capita income. While the young population is likely to provide the steady growth in revenue for FMCG companies, rising affluence and disposable income level is likely to bring the incremental growth for the sector. Over 65% of India's population stays in rural areas and they spend ~50% of their total spending on FMCG products. Rising demand for premium products and faster growth in sales through modern trade are likely to bring incremental growth for these companies.

MOAT intact in Maggi: After the Maggi fiasco in 2015, Nestle India revenues had dropped 17% YoY. The company has come a long way since then and the market share for Maggi noodles today stands at over ~59% and Nestle has already crossed the value and volume delivery on Maggi as compared to 2014 levels. The demand for instant noodles had suddenly vanished in Maggi's absence, which shows the value attached to the Maggi brand – a clear moat for Nestle. However prior to its ban, it held ~90% market share and the Maggi brand contributed ~30% to Nestle revenue. Since then many new players have entered the market and the market has grown in size. With the right marketing and the existing distribution in place, Nestle is growing its market share every year (has grown ~9% market share in the last 4 years). Currently Prepared dishes segment which majorly includes Maggi Brands is the fastest growing segment with revenue growth of ~13% in CY19. As we deal with the post virus world, the demand for Maggi and other RTC products is expected to increase even further (est.16-18%). Nestle is also the market leader in the instant pasta category (73.7% share) and is no.2 (20.5% share) in the ketchups and sauces category under the Maggi brand.

Baby Food Market – a Cash Cow: Baby food industry consists of companies that manufacture packaged foods for babies. The baby food market in India is witnessing rapid growth and is growing by 10-12% a year. India has the largest population of 0-4 year olds in Asia. Additionally, due to the increasing number of working women, and the increasing parental concerns about nutrition have led to the growth of this industry. There has been a lot of consolidation in this industry with major players including Nestle, Amul, Abbott Nutrition, Mead Johnson Nutrition, Wockhardt, etc. involved in various M&A deals. Nestlé's acquisition of Gerber Food and Pfizer Nutrition are among some of the prime examples intensifying the competition in the market. One of the main reasons for this is huge demand and long term growth visibility in the sector. As per government regulations in India, Infant nutrition products are not allowed to be advertised, making it very difficult for the companies to market their products. In this case, only the well known brands having a good distribution Pan India are able to survive and compete. It is also very difficult for companies to get the licensing in the baby formula business and no new licenses have been issued in the past few years. There are very high entry barriers - virtually no threats to the business once established. Nestle has a 96.5% market share in infant cereals (cerelac) and 66.6% market share in infant formula (lactogen NAN). Formulas are sold in pharmacies and not retail store. As a result of which, Nestle has faced some competition in the formula business in recent times from players like Abbott and Mead Johnson who are pharma players and have a better distribution compared to Nestle. However, there is still a lot of potential to expand the market and Nestle's market leadership is in no immediate danger.

Short term Triggers

Premiumisation of Products: Nestle registered a 21% YoY growth in the contribution of premium products to domestic sales in FY20. Higher premiumisation directly translates into better margins. However, Nestle's premium portfolio sales can take a hit in the current scenario where consumers are expected to focus more only on essentials as their disposable income takes a hit. ~55% of Nestle sales come from urban region which is one of the main reasons for its high growth in premium products. The management can either downtrade the portfolio or production of premium SKUs itself might be reduced in order to keep the inventory levels in check. Hence a short term pressure on the margins might be seen. However, Nestle holds a very strong brand value and being the market leader in almost all categories means there is customer stickiness and preference to Nestle products. This can be evidenced from the 10% YoY revenue growth of the company in Q3CY20 and EBITDA margin expansion of 140bps YoY mainly driven by improved volumes and product mix. Even if the premium products sales get affected now due to Covid, they will bounce back the fastest once situation normalises.

Entering New Segments and Innovation with Existing Products: With a very strong presence in the existing portfolio, the next phase of growth for Nestle India is expected to come from the new product launches by the company. Last year, Nestle already entered the breakfast cereals market by adding the product from its Cereal Partners Worldwide basket. CPW is a 50/50 joint venture which combines the expertise of Nestlé S.A, Switzerland and General Mills Inc., United States. The management has also hinted towards a possible entry into the oral nutrition supplement, pediatric, allergy, critical care nutrition and disease specific supplements. Last year, Nestle launched the Maggi Baked Noodles, Nescafe E Coffee smart machine and Everyday Chai Life to its Indian portfolio. Nestle has had 39 launches in the past 2 years in India out of which only 11 were product withdrawals. This shows the high acceptance and popularity of its products in the market.

The company management has also guided on more focus on the health and nutrition space going forward. The company is being more health conscious with its products. This can be clearly seen with the re-launch of Maggi atta and oats noodles. Even with its chocolates like Milkybar, Nestle is going to increase the milk content and reduce the sugar. Management has also decided to reduce the salt in the Maggi Noodles and increase the iron content. These small changes will ensure long term sustainability and acceptance of the existing products in the market.

Additionally, Nestle's global portfolio is much larger than its current Indian portfolio. It has a well-established ice creams, pet care, food service, bottled water, healthcare nutrition and drinks portfolio apart from its existing segments in India, with many product offerings in all the segments. The management will keep on bringing its existing products from the global portfolio to the Indian market and might even tweak them a little to cater to the Indian consumers, thus it saves immensely in R&D costs compared to other competitors.

Current Distribution & Rural Opportunity: Total distribution reach is 4.6mn for Nestle. Nestle currently reaches ~8400 stores which includes retail, cash & carry and chain pharmacy. Currently ~55% of the sales happen from the urban regions. Out of +600,000 villages in India, Nestle has a direct reach of only ~52,000 villages. This shows the tremendous potential the company has to penetrate rural markets and drive higher volumes in the longer term. There is also tremendous potential of growth in the rural markets which are growing at ~12% as compared to the ~6% growth of the urban markets. E-com growth will enable the company to increase penetration and reach a wider customer base. Contribution to sales from E-com was 1.5% in CY19 compared to 0.6% in 2016. In Q3YCY20, E-com sales were up 97% YoY. This has mainly happened as modern trade channels have suffered since March-April 2020. While E-com currently only accounts for ~4% of domestic sales, this contribution is expected to grow. Over the past few years, Nestle has aggressively increased its distribution reach by +30% and the company is expected to gain a significant customer base in rural regions at this rate which bodes very well for the company.

Milk prices to stabilize in FY21: Milk makes up the bulk of RM costs for Nestle at 42%. FY20 witnessed the steepest rise in milk procurement prices in a decade, an increase of 19% YoY between April to December 2019. The inflation was at 18-20% on year at the end of the fiscal, according to a recent Crisil report. Milk retail prices also rose by 3-4% over April-December 2019, and were higher at 5 per cent for fiscal 2020. A sharper rise in milk procurement costs compared to retail prices led to a decline of 200 bps in the EBITDA margins of large dairy players in the second and third quarters of FY20. However, both milk procurement and retail prices have stabilized by the second quarter of FY20-21, as milk procurement has increased. As per a Crisil report, the first half of fiscal 2021, the margin contraction should ease to 50-100 bps as milk procurement prices moderate which will be beneficial for Nestle.

What could go wrong

Concentration in Urban markets: Nestle derives ~55% of its revenues from the urban markets, failure to capture the rural markets can lead to concerns. Also extended slowdown in urban region and/or job losses could impact the sales growth.

Competition: Even though Nestle is the undisputed leader in core markets, the industry is flooded with products from competitors like Dabur, HUL, Abbott, Nissin etc. Hence the competitive intensity is always high with a constant need to innovate and market the products and expand the distribution channels.

Forex Exposure: The company has significant operations in foreign markets and hence is exposed to forex risk. Any unforeseen movement in the forex market can adversely affect the company.

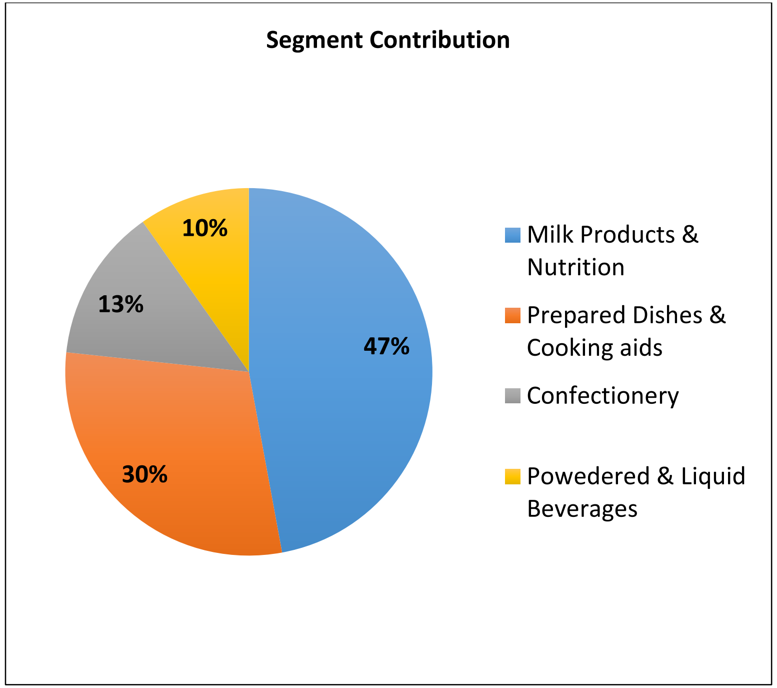
GDP falling: Neslte being a consumer products company does rely on a healthy domestic growth rate. Any major fall in consumer sentiment index or changes in consumption patterns due to extended slowdown will affect the company.

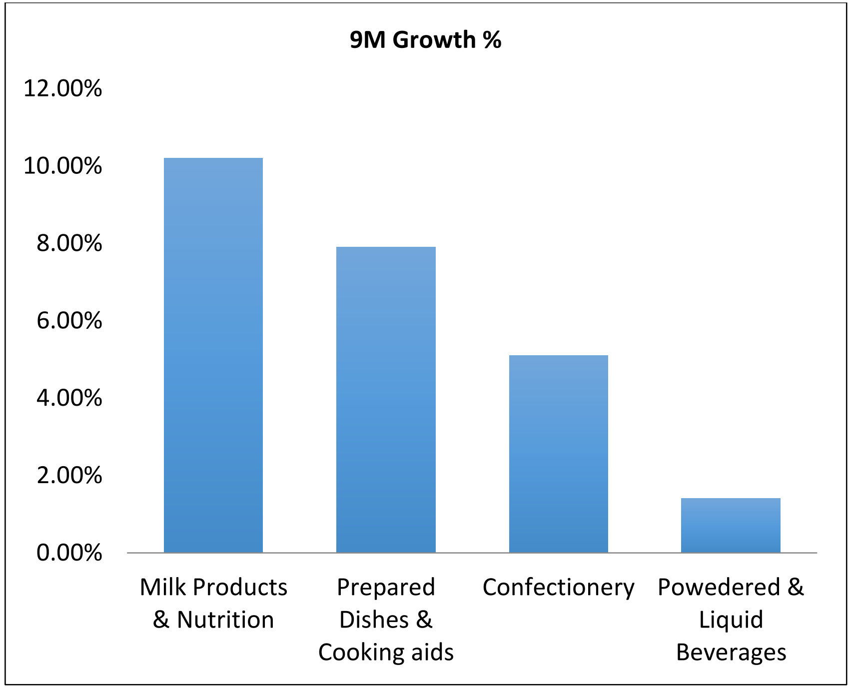
Raw material costs fluctuation: Any sharp rise in prices of key commodity raw materials like milk, wheat, coffee, cacao and sugar could impact the margins of the company till the time it can pass over the increased costs to consumers.

About Company

Nestle India Ltd, one the biggest players in FMCG segment, has a presence in milk & nutrition, beverages, prepared dishes & cooking aids & chocolate & confectionery segments. The company is engaged in the food business. Nestle India manufactures brands such as Nescafe, Maggi, Milkybar, Milo, Kit Kat, Bar-One, Milkmaid and Nestea. Products of daily consumption and use include Nestle Milk, Nestle Slim Milk, Nestle Fresh 'n' Natural Dahi and Nestle Jeera Raita, Nestle Everyday Dairy Whitener, Nestle Everyday Ghee. Beverages Include Nescafe Classic, Nescafe Sunrise Premium, Nescafe Sunrise Special and Nescafe Cappuccino. Nestle India is a 62.8% subsidiary of Nestle S.A. of Switzerland. The company has presence across India with 8 manufacturing facilities and four branch offices spread across the region. The four branch offices in the country help facilitate the sales and marketing of its products.

Nestle India Ltd.





(Source: Company, HDFC sec)

Nestle India Ltd.

Financials

Income Statement

(Rs Cr)	CY18	CY19	CY20E	CY21E	CY22E
Net Revenues	11292	12369	13411	14822	16428
Growth (%)	12.81	9.53	8.42	10.53	10.83
Operating Expenses	8532	9441	10122	11250	12428
EBITDA	2760	2927	3289	3572	4000
Growth (%)	**22.76**	**6.07**	**12.34**	**8.61**	**11.99**
EBITDA Margin (%)	**24.44**	**23.67**	**24.52**	**24.10**	**24.35**
Depreciation	336	316	367	372	378
EBIT	2424	2611	2922	3200	3622
Other Income	259	247	154	154	154
Interest expenses	112	120	163	171	180
PBT	2429	2675	2827	3183	3596
Tax	822	705	718	808	914
APAT	1683	1988	2222	2455	2802
Growth (%)	28.63	18.12	11.78	10.48	14.14
EPS	174.54	206.20	230.50	254.60	290.60

Balance Sheet

As at March	CY18	CY19	CY20E	CY21E	CY22E
SOURCE OF FUNDS					
Share Capital	96	96	96	96	96
Reserves	3577	1836	2168	2540	2893
Shareholders' Funds	**3674**	**1932**	**2264**	**2637**	**2989**
Long Term Debt	35	53	53	53	53
Short Term Debt	0	0	0	0	0
Net Deferred Taxes	59	18	18	18	18
Non Current Liabilities	2465	2907	2936	2878	2791
Minority Interest	**0**	**0**	**0**	**0**	**0**
Total Source of Funds	**6233**	**4911**	**5272**	**5585**	**5852**
APPLICATION OF FUNDS					
Net Block	2401	2227	2200	2016	1824
CWIP	105	143	143	143	143
Other Non-Current Assets	2658	1751	2256	2753	3331
Total Non Current Assets	**5164**	**4121**	**4599**	**4912**	**5298**
Inventories	966	1283	1396	1503	1665
Trade Receivables	125	124	147	162	180
Cash & Equivalents	1610	1308	1134	997	737
Other Current Assets	224	222	300	361	400
Total Current Assets	**2924**	**2937**	**2976**	**3023**	**2982**
Trade Payables	1240	1495	1680	1816	1982
Other Current Liab & Provisions	615	653	624	534	446
Total Current Liabilities	**1855**	**2148**	**2304**	**2350**	**2429**
Net Current Assets	1069	790	673	673	554
Total Application of Funds	**6233**	**4911**	**5272**	**5585**	**5852**

Nestle India Ltd.

Cash Flow Statement

(Rs Cr)	CY18	CY19	CY20E	CY21E	CY22E
Reported PBT	2429.0	2675.0	2826.9	3182.5	3596.5
Non-operating & EO items	-247.7	-249.7	0.0	0.0	0.0
Interest Expenses	4.1	1.7	162.9	171.1	179.6
Depreciation	335.7	316.4	366.5	372.0	377.6
Working Capital Change	412.8	163.2	57.4	137.1	140.5
Tax Paid	-881.3	-672.9	-718.0	-808.4	-913.5
OPERATING CASH FLOW (a)	**2052.5**	**2233.7**	**2695.6**	**3054.3**	**3380.6**
Capex	-166.0	-154.5	-420.0	-500.0	-500.0
Free Cash Flow	1886.5	2079.2	2275.6	2554.3	2880.6
Investments	0.0	0.0	0.0	0.0	0.0
Non-operating income	113.6	237.5	-9.9	-9.9	-9.9
INVESTING CASH FLOW (b)	**-52.4**	**83.0**	**-429.9**	**-509.9**	**-509.9**
Debt Issuance / (Repaid)	0.0	18.0	0.0	0.0	0.0
Interest Expenses	-4.1	-1.7	-162.9	-171.1	-179.6
FCFE	1882.4	2095.5	2112.7	2383.3	2701.0
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0
Dividend	-1313.4	-2950.5	-1889.8	-2082.7	-2449.1
Others	0.0	-6059.4	-3874.2	-4269.5	-5020.6
FINANCING CASH FLOW (c)	**-1317.4**	**-3540.1**	**-2440.2**	**-2680.7**	**-3130.7**
NET CASH FLOW (a+b+c)	**682.6**	**-1223.4**	**-174.4**	**-136.3**	**-260.0**

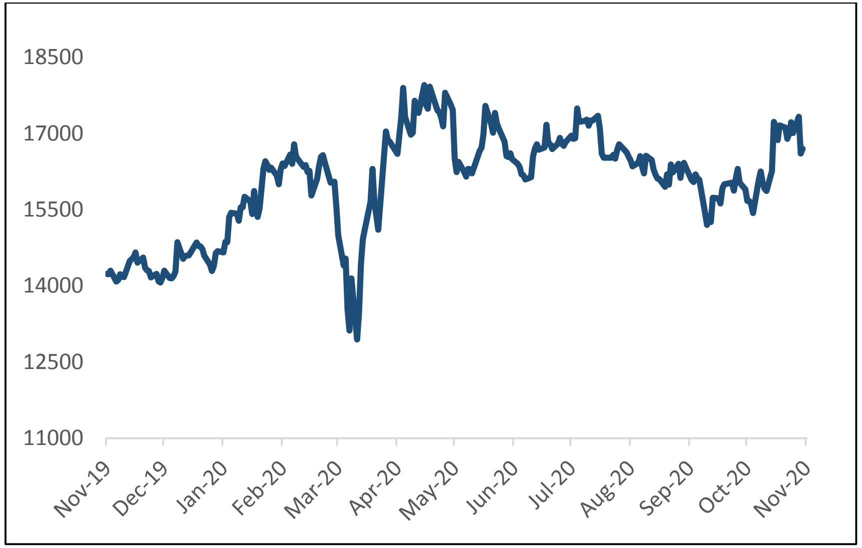
Key Ratios

(Rs Cr)	CY18	CY19	CY20E	CY21E	CY22E
EBITDA Margin	24.4	18.1	20.1	21.0	21.2
EBIT Margin	21.5	16.3	18.2	18.9	19.1
APAT Margin	14.9	12.7	14.2	14.5	15.2
RoE	47.4	33.7	34.6	34.6	37.7
RoCE	57.9	74.9	65.3	55.1	56.1
Solvency Ratio					
Net Debt/EBITDA (x)	(0.6)	(0.4)	(0.3)	(0.3)	(0.2)
Net D/E	(0.4)	(0.6)	(0.5)	(0.4)	(0.2)
PER SHARE DATA					
EPS	174.5	206.2	230.5	254.6	290.6
CEPS	209.4	238.8	271.0	312.8	363.5
BV	381.0	200.4	274.3	355.4	451.2
Dividend	113.0	306.0	196.0	216.0	254.0
Cash Conversion Cycle (days)	(17.5)	(15.3)	(11.4)	(7.2)	(4.1)
Debtor days	4.0	3.7	3.6	3.6	4.0
Inventory days	31.2	37.9	34.4	33.4	37.0
Creditors days	40.1	44.1	41.4	40.3	44.0
VALUATION					
P/E	101.9	86.3	77.2	69.9	61.2
P/BV	46.7	88.8	64.8	50.0	39.4
EV/EBITDA	61.6	58.2	51.8	47.7	42.7
EV / Revenues	15.0	13.8	12.7	11.5	10.4

(Source: Company, HDFC sec)

Nestle India Ltd.

One Year Price Chart



(Source: Company, HDFC sec)

Disclosure:

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Any holding in stock –No

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