

Supply chain constraints in April hit the sales

Nestlé India (NIL) reported muted revenue growth of 2% in Q2CY20 with manufacturing & supply chain operations remaining disrupted in April. The domestic sales growth was 2.6% while exports de-grew 9.3%. We believe supply in April was normal only for milk products & all other categories witnessed resumption of manufacturing in slow & gradual manner. The quarter witnessed a strong growth in 'Everyday', 'Nestlé a+' & 'Milkmaid' mainly due to very high sales in initial weeks of April. We believe the company anticipated large scale disruption in milk supply or shift in consumer demand from pouch to powder & UHT Milk. However, pouch milk supply disruption did not last longer than few weeks, resulting in piling up of 'Everyday' inventory at the end of distributors. We believe milk products would see inventory rationalisation at the distributor level given demand conditions from hotels, restaurants & airline remain muted. Operating profit saw growth of 7.2% with margins expanding 127 bps. The margin expansion was led by cost cutting measures & reduction in A&P spend (overhead spends down 487 bps) partially offset by the 193 bps contraction in gross margins. Given the reduction in corporate tax rate, net profit increased 11.1% to ₹ 486.6 crore (I-direct estimate : ₹ 502.7 crore). Notably, e-com channel sales grew by 122% contributing now 3.6% of sales.

Strong demand conditions in prepared foods

Though the supply & demand conditions for most categories are normalising, prepared dishes segment is having a different tale. One of the clear trends in the last four months has been increasing demand for convenient food. Maggi Noodles, ketchup, Masala magic witnessed strong demand conditions in the June quarter. However, the company could not supply the products in April given most manufacturing facilities either remain closed or are working on very low utilisation. Though manufacturing operations returned to normal in June-July, demand is still outpacing supply. We believe near term supply constrains in the noodles segment could potentially result in market share loss. However, on a long term perspective, we believe the company's product portfolio with strong growth opportunity in noodles, chocolate & UHT milk is likely to witness healthy growth. We expect 10.8% CAGR sales growth in CY19-21E.

Benign milk prices, cut in A&P spend to perk up margins

In Q2CY20, gross margins contracted 193 bps despite milk prices declining substantially. We believe the company would have been holding high SMP inventory in March in anticipation of elevated milk prices. We believe the company would see uptick in operating margins given lower milk prices, reduction in A&P spend (trade promotions have been lower than normal) & other cost cutting measures. We expect operating margins to expand 150 bps to 24.7% during CY20-22E.

Valuation & Outlook

From the average factory utilisation level of 75% in Q2CY20, manufacturing has returned to near normal currently. We remain positive on growth prospects driven by continued in-home consumption. The stock is trading at premium valuation multiples. We maintain our target price of ₹ 18000/share with a **HOLD** recommendation.

Key Financial Summary

Key Financials	CY17	CY18	CY19	CY20E	CY21E	CAGR (CY19-21E)
Net Sales	9952.5	11216.2	12295.3	13286.5	15103.2	10.8%
EBITDA	2248.3	2759.8	2864.3	3263.5	3748.7	14.4%
EBITDA Margin %	22.6	24.6	23.3	24.6	24.8	
Net Profit	1225.2	1606.9	1969.6	2220.4	2592.3	14.7%
EPS (₹)	127.07	166.66	204.27	230.29	268.85	
P/E	134.6	102.6	83.7	74.3	63.6	
RoNW %	37.5	45.6	101.9	114.2	123.6	
RoCE (%)	34.9	42.9	56.9	59.3	65.9	

Source: Company, ICICI Direct Research



Particulars

Particulars (₹ crore)	Amount
Market Capitalization	164869
Total Debt (CY19)	53.1
Cash & Investments (CY19)	2,315.5
EV	162,606.2
52 week H/L (₹)	18369 / 10120
Equity capital	96.4
Face value (₹)	10.0

Key Highlights

- Domestic sales increased by 2.6% impacted by manufacturing & supply chain disruptions in April
- Export sales declined by 9.3%
- Operating margins expanded by 127 bps with substantial reduction in A&P spends
- Maintain HOLD recommendation with target price of ₹ 18000/share

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Exhibit 1: Variance Analysis

Particulars (₹ crore)	Q2CY20	Q2CY20E	Q1CY19	YoY (%)	Q1CY20	QoQ (%)	Comments
Total Operating Income	3,050.5	3,188.8	3,000.9	1.7	3,325.3	-8.3	Net sales witnessed a growth of 2% impacted by manufacturing disruption in April
Operating Income	9.0	0.0	18.0	-49.9	19.5	-53.7	
Raw Material Expenses	1,331.9	1,320.2	1,252.2	6.4	1,453.3	-8.4	Gross margins contracted by 193 bps due to high milk prices. We believe the company would have been holding high inventory levels
Employee Expenses	369.6	325.5	314.6	17.5	358.4	3.1	
Other operating Expenses	601.4	755.7	736.8	-18.4	720.3	-16.5	Overhead spends were down by 18.4% with substantial reduction in A&P spends & cost cutting measures
EBITDA	747.6	787.3	697.3	7.2	793.3	-5.8	
EBITDA Margin (%)	24.5	24.7	23.2	127 bps	23.9	65 bps	Operating profit expanded by 127 bps led by lower A&P spends
Depreciation	92.4	83.6	80.8	14.4	91.4	1.2	
Interest	40.8	31.6	29.9	36.4	41.0	-0.4	
Other Income	37.9	0.0	72.6	-47.7	42.9	-11.5	
Exceptional Items	0.0	0.0	0.0	NA	0.0	NA	
PBT	652.3	672.1	659.2	-1.0	703.9	-7.3	
Tax Outgo	165.7	169.4	221.3	-25.1	178.4	-7.1	Net profit grew by 11.1% on account of reduction in tax rates in 2019
PAT	486.6	502.7	437.8	11.1	525.4	-7.4	
Adjusted PAT	486.6	502.7	437.8	11.1	525.4	-7.4	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	CY20E			CY21E			Comments
	Old	New	% Change	Old	New	% Change	
Net Sales	13,300.0	13,286.5	-0.1	15,115.9	15,103.2	-0.1	No major change in estimates
EBITDA	3271.3	3263.5	-0.2	3755.9	3748.7	-0.2	
EBITDA Margin(%)	24.6	24.6	-3 bps	24.8	24.8	-3 bps	
PAT	2226.3	2220.4	-0.3	2597.7	2592.3	-0.2	
EPS (₹)	230.9	230.3	-0.3	269.4	268.9	-0.2	

Source: Company, ICICI Direct Research

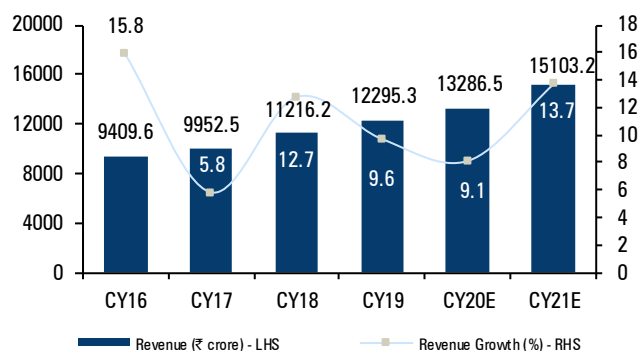
Exhibit 3: Assumptions

Exhibit 01: Assumptions									
	Current					Earlier			
	CY16	CY17	CY18	CY19E	CY20E	CY21E	CY20E	CY21E	Comments
Gross Sales (₹ crore)									
Milk Product and Nutrition	4,635.0	4,819.6	5,187.6	5,651.8	6,228.9	6,996.3	6,183.2	6,945.0	No major change in estimates
Beverages	1,286.1	1,387.0	1,522.6	1,501.8	1,516.8	1,687.3	1,679.3	1,868.1	
Prepared dishes	2,317.6	2,707.1	3,105.3	3,498.2	3,848.0	4,518.3	3,832.5	4,500.1	
Chocolate & confectionery	1,170.9	1,221.4	1,400.7	1,643.5	1,692.8	1,901.3	1,604.9	1,802.7	
Volume Growth (%)									
Overall Volume Growth	25.0	10.9	11.1	7.0	7.9	11.4	7.9	11.4	
Milk Product and Nutrition	-2.4	1.6	4.8	1.4	7.0	8.0	7.0	8.0	
Beverages	-0.2	10.6	10.6	-2.3	0.0	8.0	0.0	8.0	
Prepared dishes	71.5	19.0	14.5	9.6	10.0	14.0	10.0	14.0	
Chocolate & confectionery	6.7	4.3	14.7	16.2	3.0	8.0	3.0	8.0	

Source: Company, ICICI Direct Research

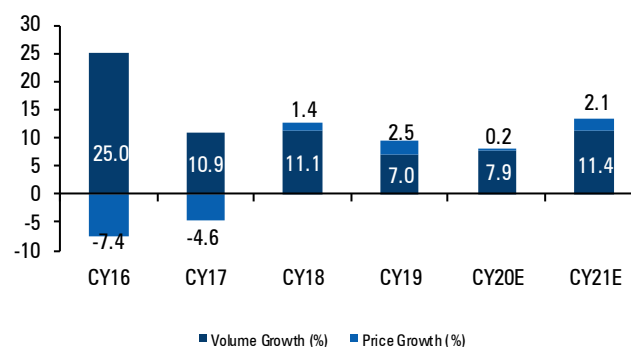
Key Metrics

Exhibit 4: Revenue growth trend



Source: Company, ICICI Direct Research

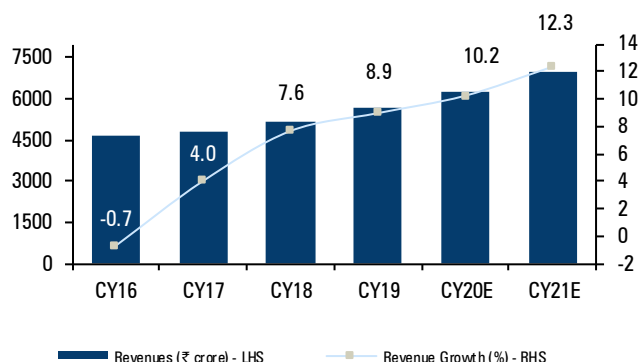
Exhibit 5: Volume growth to drive revenue



Source: Company, ICICI Direct Research

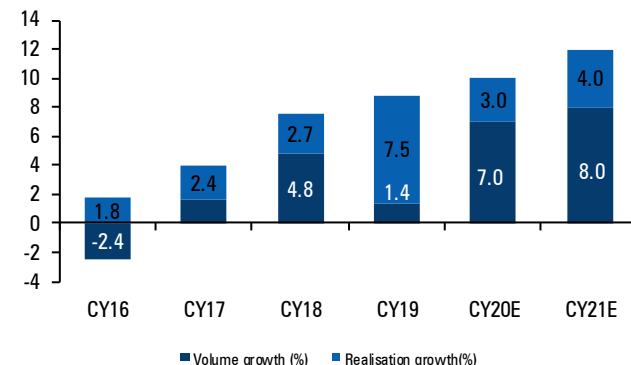
Milk products & nutrition

Exhibit 6: Revenue to grow at 11.3% CAGR over CY19-21E



Source: Company, ICICI Direct Research

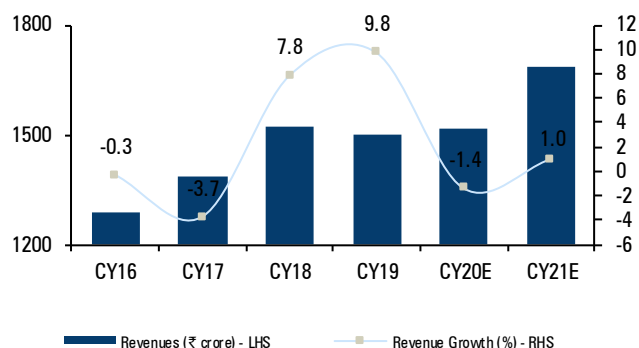
Exhibit 7: Revenue growth to be mix of volume & price growth



Source: Company, ICICI Direct Research

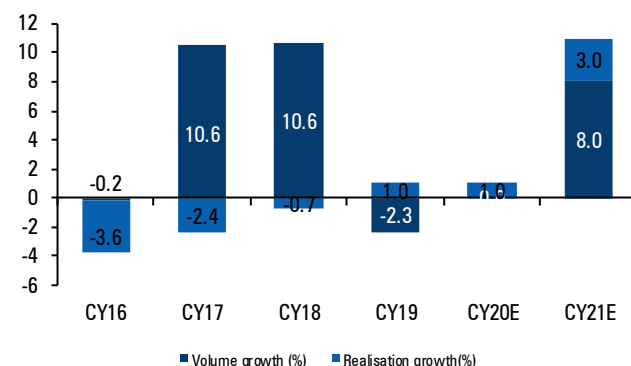
Beverages

Exhibit 8: Beverages revenue growth expected at 6% CAGR



Source: Company, ICICI Direct Research

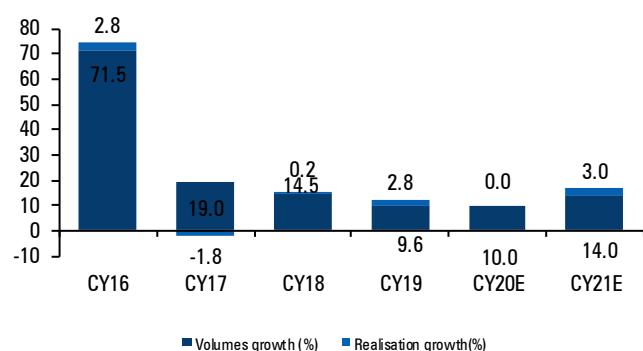
Exhibit 9: Volume growth to be impacted by lockdown



Source: Company, ICICI Direct Research

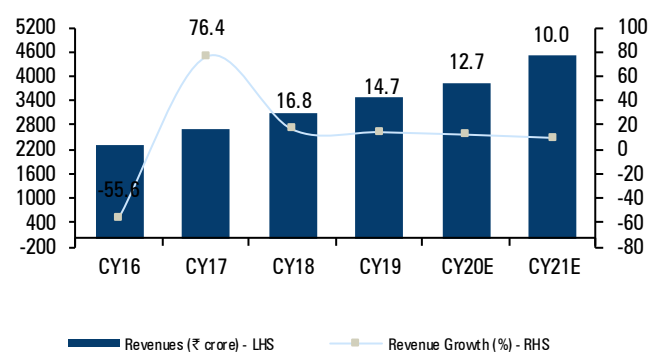
Prepared dishes

Exhibit 10: Volumes to grow with high in-home consumption



Source: Company, ICICI Direct Research

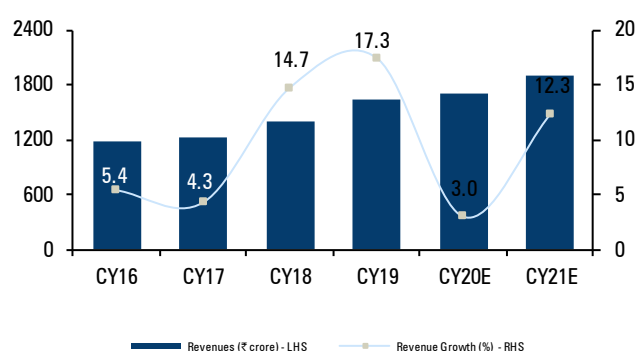
Exhibit 11: Growth aided by strong demand for convenient food



Source: Company, ICICI Direct Research

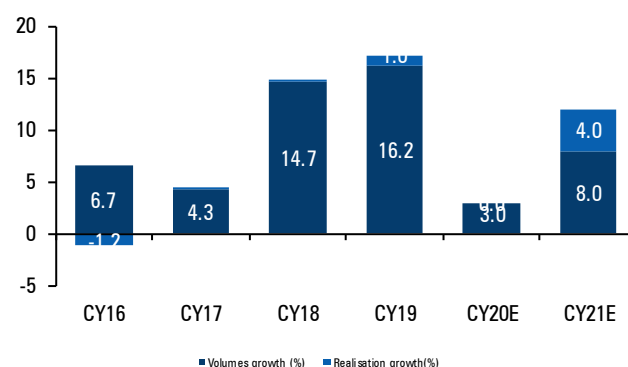
Chocolate & confectionery

Exhibit 12: Sales to gain traction, going forward



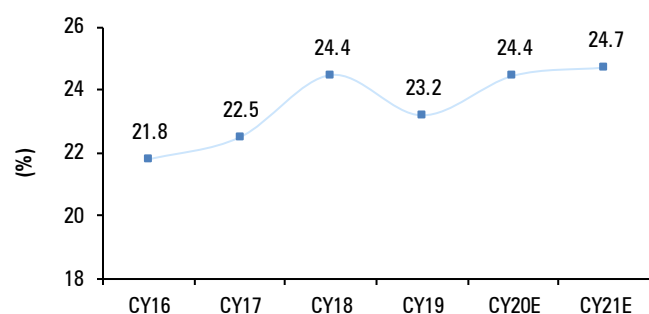
Source: Company, ICICI Direct Research

Exhibit 13: Volume growth to return in CY21E



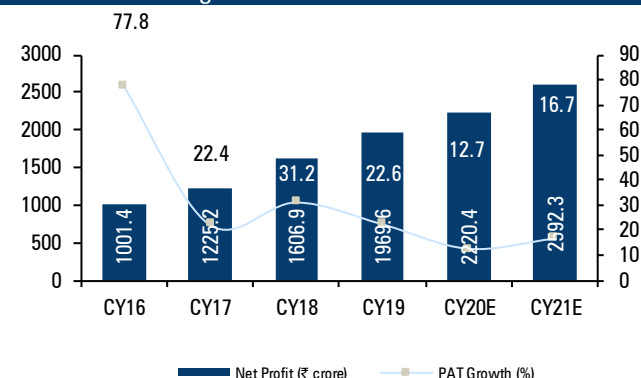
Source: Company, ICICI Direct Research

Exhibit 14: EBITDA margin to remain at elevated levels



Source: Company, ICICI Direct Research

Exhibit 15: PAT to grow at 14.7% CAGR over CY19-21E



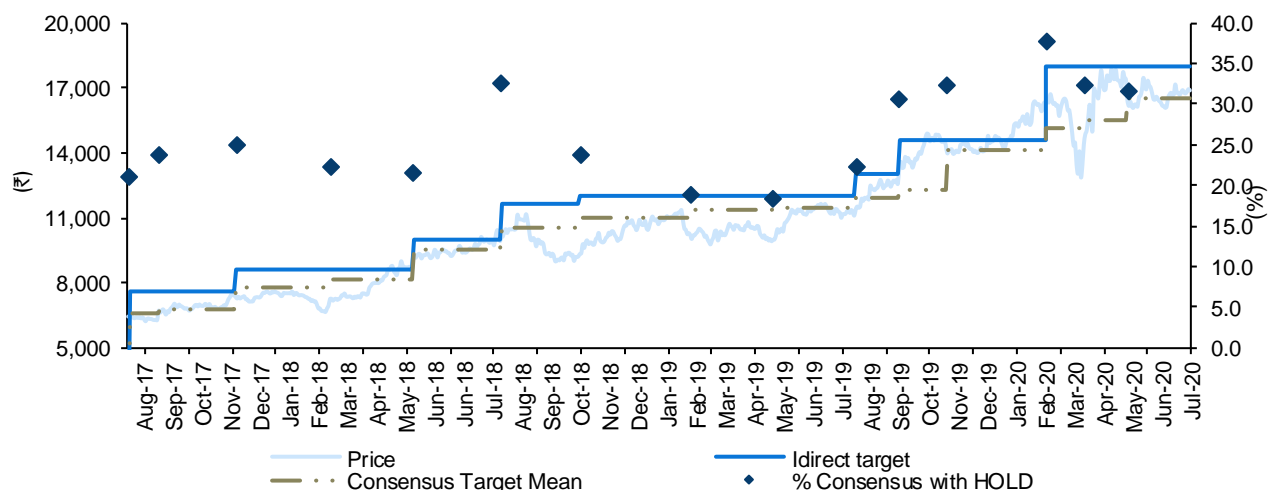
Source: Company, ICICI Direct Research

Exhibit 16: Valuation

	Sales	Growth	EPS	Growth	PE	EV/EBITDA	RoNW	RoCE
	(₹ cr)	(%)	(₹)	(%)	(x)	(x)	(%)	(%)
CY18	11216.2	12.7	166.7	31.2	102.6	59.2	45.6	42.9
CY19	12295.3	9.6	204.3	22.6	83.7	57.1	101.9	56.9
CY20E	13286.5	8.1	230.3	12.7	74.3	50.2	114.2	59.3
CY21E	15103.2	13.7	268.9	16.7	63.6	43.7	123.6	65.9

Source: Company, ICICI Direct Research

Exhibit 17: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 18: Top 10 Shareholders

Rank	Investor Name	Filing Date	% O/S	Position (m)	Change (m)
1	Nestle Sa	31-Mar-20	34.3	33.1	0.0
2	Maggi Enterprises Lt	31-Mar-20	28.5	27.5	0.0
3	Sbi Funds Management	30-Jun-20	8.9	8.6	7.1
4	Life Insurance Corp	31-Dec-19	3.0	2.9	0.1
5	50 Sbi-Etf Nifty	31-Dec-19	1.5	1.5	1.5
6	Axis Asset Managemen	31-May-20	1.3	1.3	0.1
7	Arisaig India Fund L	30-Jun-19	1.0	1.0	-0.1
8	Vanguard Group	30-Jun-20	0.9	0.8	0.0
9	Blackrock	13-Jul-20	0.8	0.8	0.0
10	Uti Asset Management	31-May-20	0.5	0.4	0.0

Source: Reuters, ICICI Direct Research

Exhibit 19: Shareholding Pattern

(in %)	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Promoter	62.8	62.8	62.8	62.76	62.76
FII	13.0	12.6	12.1	11.81	12.1
DII	7.5	8.5	8.9	9.12	8.7
Others	16.8	16.1	16.3	16.3	16.4

Source: Company, ICICI Direct Research

Financial summary

Exhibit 20: Profit and loss statement ₹ crore				
(Year-end December)	CY18	CY19	CY20E	CY21E
Total operating Income	11,292.3	12,368.9	13,367.5	15,192.3
Growth (%)	12.8	9.5	8.1	13.7
Raw Material Expenses	3,823.2	5,223.9	5,719.4	6,444.5
Employee Expenses	1,124.2	1,263.0	1,302.1	1,434.8
Marketing Expenses	1,285.2	0.0	0.0	0.0
Administrative Expenses	1,086.0	63.2	93.0	90.6
Other expenses	1,214.0	2,954.5	2,989.5	3,473.7
Total Operating Expenditure	8,532.5	9,504.6	10,104.0	11,443.6
EBITDA	2,759.8	2,864.3	3,263.5	3,748.7
Growth (%)	22.8	3.8	13.9	14.9
Depreciation	346.8	316.4	334.5	338.8
Interest	112.0	119.8	126.5	142.8
Other Income	258.9	246.9	166.0	198.6
PBT	2,532.6	2,675.0	2,968.5	3,465.6
Others	103.7	0.0	0.0	0.0
Total Tax	822.0	705.4	748.1	873.3
PAT	1,606.9	1,969.6	2,220.4	2,592.3
Growth (%)	31.2	22.6	12.7	16.7
EPS (₹)	166.7	204.3	230.3	268.9

Source: Company, ICICI Direct Research

Exhibit 21: Cash flow statement ₹ crore				
(Year-end December)	CY18	CY19	CY20E	CY21E
Profit after Tax	1,606.9	1,969.6	2,220.4	2,592.3
Add: Depreciation	346.8	316.4	334.5	338.8
(Inc)/dec in Current Assets	-646.9	617.8	-548.6	-587.8
Inc/(dec) in CL	362.2	292.6	109.4	267.2
CF from operating activities	1,669.0	3,196.2	2,115.7	2,610.6
(Inc)/dec in LT loans & adv	6.2	-6.8	47.0	0.0
(Inc)/dec in other investments	-148.1	-10.2	-20.0	-20.0
(Inc)/dec in Fixed Assets	-142.2	-180.6	-477.6	-320.0
Others	110.1	401.0	299.6	100.0
CF from investing activities	-162.6	194.8	-70.6	-240.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	0.0	18.0	0.0	0.0
Dividend paid & dividend tax	-1,313.4	-3,957.1	-2,207.5	-2,439.3
Inc/(dec) in Sec. premium	0.0	0.0	0.0	0.0
Others	-40.4	246.0	0.0	0.0
CF from financing activities	-1,353.7	-3,693.0	-2,207.5	-2,439.3
Net Cash flow	152.7	-302.0	-162.4	-68.8
Opening Cash	1,457.4	1,610.1	1,308.1	1,145.7
Closing Cash	1,610.1	1,308.1	1,145.7	1,076.9

Source: Company, ICICI Direct Research

Exhibit 22: Balance sheet ₹ crore				
(Year-end December)	CY18	CY19	CY20E	CY21E
Liabilities				
Equity Capital	96.4	96.4	96.4	96.4
Reserve and Surplus	3,577.3	1,835.8	1,848.7	2,001.7
Total Shareholders funds	3,673.8	1,932.3	1,945.2	2,098.1
Total Debt	35.1	53.1	53.1	53.1
Deferred Tax Liability	58.8	18.0	18.0	18.0
Long Term Provisions	2,464.9	2,906.9	3,206.9	3,306.9
Total Liabilities	6,233.1	4,910.7	5,223.2	5,476.1
Assets				
Gross Block	3,485.4	3,785.4	4,085.4	4,385.4
Less: Acc Depreciation	1,084.8	1,401.2	1,735.7	2,074.5
Net Block	2,400.6	2,226.7	2,349.7	2,310.9
Capital WIP	105.2	143.3	163.3	183.3
Total Fixed Assets	2,505.8	2,370.0	2,513.0	2,494.2
LT Loans & Advances	40.1	47.0	0.0	0.0
Inventory	965.6	1,283.1	1,383.2	1,655.1
Debtors	124.6	124.3	127.4	144.8
Loans and Advances	17.9	12.5	145.6	165.5
Current Investments	2,018.9	1,089.3	1,401.4	1,680.0
Cash	1,610.1	1,308.1	1,145.7	1,076.9
Total Current Assets	4,737.0	3,817.2	4,203.4	4,722.4
Creditors	1,240.4	1,494.7	1,456.1	1,655.1
Provisions	157.3	85.5	254.8	248.3
Other Current Liabilities	457.3	567.4	546.0	620.7
Total Current Liabilities	1,855.0	2,147.5	2,256.9	2,524.1
Net Current Assets	2,882.0	1,669.7	1,946.5	2,198.3
Application of Funds	6,233.1	4,910.7	5,223.2	5,476.1

Source: Company, ICICI Direct Research

Exhibit 23: Key ratios ₹ crore				
(Year-end December)	CY18	CY19	CY20E	CY21E
Per share data (₹)				
EPS	166.7	204.3	230.3	268.9
Cash EPS	202.6	237.1	265.0	304.0
BV	381.0	200.4	201.7	217.6
DPS	113.0	342.0	190.0	210.0
Cash Per Share	112.5	145.3	180.0	215.2
Operating Ratios (%)				
EBITDA Margin	24.4	23.2	24.4	24.7
PBT / Net Sales	21.7	21.8	22.3	22.9
PAT Margin	14.3	16.0	16.7	17.2
Inventory days	31.4	38.1	38.0	40.0
Debtor days	4.1	3.7	3.5	3.5
Creditor days	40.4	44.4	40.0	40.0
Return Ratios (%)				
RoE	45.6	101.9	114.2	123.6
RoCE	42.9	56.9	59.3	65.9
RoIC	53.4	70.4	74.8	80.9
Valuation Ratios (x)				
P/E	102.6	83.7	74.3	63.6
EV / EBITDA	59.2	57.1	50.2	43.7
EV / Net Sales	14.6	13.3	12.3	10.8
Market Cap / Sales	14.7	13.4	12.4	10.9
Price to Book Value	44.9	85.3	84.8	78.6
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	1.7	1.2	1.4	1.4
Quick Ratio	1.2	0.6	0.7	0.8

Source: Company, ICICI Direct Research

Exhibit 24: ICICI Direct coverage universe (FMCG)

Sector / Company	CMP	TP	Rating	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)		(₹ Cr)	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY21E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Colgate (COLPAL)	1,392	1,350	Hold	37,620	30.0	29.3	33.6	46.4	47.4	41.4	8.4	8.2	7.5	60.7	66.2	77.5	51.2	50.8	59.5
Dabur India (DABIND)	475	520	Buy	83,283	8.2	8.8	10.3	58.0	53.9	46.3	9.6	9.5	8.2	26.1	25.7	28.3	21.9	22.5	24.8
Hindustan Unilever (HINLEV)	2,243	2,410	Hold	519,159	31.2	32.4	40.1	71.9	69.2	55.9	13.6	12.2	10.6	89.5	26.7	33.0	85.7	20.3	25.4
ITC Limited (ITC)	195	250	Buy	245,475	12.5	11.7	13.0	15.7	16.6	15.0	5.3	5.2	4.6	29.4	28.3	36.1	23.8	21.7	27.7
Jyothy Lab (JYOLAB)	121	115	Hold	4,535	4.3	4.1	5.7	28.2	29.3	21.0	2.7	2.9	2.4	24.3	23.3	28.8	21.7	18.8	23.8
Marico (MARLIM)	362	380	Hold	45,286	8.1	8.5	9.6	44.8	42.6	37.8	6.2	6.1	5.5	41.0	42.3	46.2	34.5	35.6	39.5
Nestle (NESIND)	17,099	18,000	Hold	164,869	204.3	230.3	268.9	83.7	74.3	63.6	13.4	12.4	10.9	56.9	59.3	65.9	101.9	114.2	123.6
Tata Consumer Products (TATGLO)	413	440	Buy	37,667	5.0	8.7	10.9	82.7	47.6	37.9	3.9	3.7	3.4	6.9	7.9	8.8	4.6	5.9	7.1
VST Industries (VSTIND)	3,202	4,000	Buy	4,942	196.9	124.8	216.3	16.3	25.7	14.8	4.0	4.5	3.5	52.1	32.9	45.6	38.6	24.3	33.7
Varun Beverage (VARBEV)	702	571	Reduce	20,122	16.4	9.7	17.8	42.9	72.1	39.4	2.8	3.3	2.7	15.5	11.3	16.3	14.2	8.8	14.2
Zydus Wellness (ZYDWEL)	1,624	1,530	Buy	9,445	24.6	31.6	50.3	66.1	51.3	32.3	5.3	5.7	4.6	5.9	5.7	7.4	5.4	5.1	7.5

Source: Company, ICICI Direct Research

RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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