

Nestle India

29 July 2020

Reuters: NEST.BO; Bloomberg: NEST IN

Sales miss estimate; Operating margin surprises

Nestle India (NEST) saw deterioration in its sales growth rate in 2QCY20 from the performance it has been delivering over the last many quarters mainly due to the COVID-19 induced lockdown leading to production disruption across factories. On an average, factories were operating at 75% of capacity during 2QCY20. There was also severe demand impact on the out-of-home channel while in-home consumption categories (mainly milk based portfolio and Nescafe) did well during the quarter. After initial supply constraints, MAGGI also witnessed solid growth towards the end of the quarter. NEST's 2QCY20 revenue grew by just 1.7% YoY to Rs30.5bn (vs our est. 9% growth to Rs32.7bn). Domestic sales grew by 2.6% YoY to Rs29.1bn while exports (~4.4% of sales for the quarter) declined by 9.3% YoY to Rs1.3bn. Gross margin was down 190bps YoY a 56.3% (est. 56.5%) due to higher commodity prices, particularly in milk and its derivatives. Sharp savings in other expenses as a % of sales (-440bps YoY) were partially offset by higher staff costs as a % of sales (+170bps YoY). Employee benefit costs were higher due to production related incentives offered to limited available manpower. Other expenses decreased despite COVID related cost of ~Rs286mn in the quarter due to savings in marketing spend and reduction in other overheads (due to restricted operations). Consequently, EBITDA margin expanded by 80bps YoY to 24.9% (vs our est. 22.8%). EBITDA grew by 5.0% YoY to Rs7.6bn (vs our est. 5.4% growth to Rs7.5bn). Other income declined by 47.7% YoY due to lower yields and lower average liquidity. Lower tax rate of 25.0% vs 33.1% in the base quarter led to Adj. PAT growth of 11.1% YoY to Rs5bn (vs our est. 10.9% growth to Rs5bn). We believe that 2QCY20 is a small blip in the impressive volume growth turnaround the company has delivered over the last one and a half years. NEST has already built back the momentum by the end of the quarter and factories have been restored almost back to the pre-Covid levels. Over the next two years, we remain fairly confident that NEST will be able to sustain its healthy earnings growth (~18.9% over the next two years), primarily driven by volume and mix led topline growth and supported by better input prices compared to last year. The stock now trades at ~75x/58x CY20E/CY21E EPS. We maintain our Accumulate rating on the stock with a revised target price (TP) of Rs17,205 (based on P/E multiple of ~56x on March 2022 EPS; commands higher multiple for delivering ahead-of-the-market growth and having better return ratios), implying an upside of 1% from the current market price (CMP).

1HCY20 performance: Sales, EBITDA and Adj. PAT grew by 6.2%, 4.8% and 11.7% YoY, respectively. Gross margin was down 210bps YoY at 56.3% while EBITDA margin was down 30bps YoY at 24.5%.

Outlook and valuation: There is no major change to our earnings as the Adj. PAT was in-line with our estimate. The structural story for NEST remains strong in the fast-growing packaged food space in India. While there are short term hiccups for the sector, NEST can deliver strong growth going forward as well and will gain share in its core categories, led by distribution expansion, new product/variant launches, strong pipeline of products (can also leverage parents' vast brand portfolio) backed by R&D capabilities and faster growth in premium portfolio leading to better pricing power. With market leadership in ~80% of its categories, it has enough pricing power to further drive premiumization along with driving volume growth. This along with the company's recent initiative of localisation and clusterisation should keep it ahead of the market. We believe that it can easily deliver ~18.9% earnings growth over the next two years (over CY19-21), driven by volume and mix led topline growth. The stock trades at ~75x/58x CY20E/CY21E EPS. We maintain our Accumulate rating with a revised TP of Rs17,205 (based on P/E multiple of ~56x on March 2022 EPS).

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ACCUMULATE

Sector: FMCG

CMP: Rs17,099

Target Price: Rs17,205

Upside: 1%

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Key Data

Current Shares O/S (mn)	96.4
Mkt Cap (Rsbn/US\$bn)	1,648.3/22
52 Wk H / L (Rs)	18,370/11,128
Daily Vol. (3M NSE Avg.)	160,346

Price Performance (%)

	1 M	6 M	1 Yr
Nestle India	2.5	10.9	49.4
Nifty Index	8.8	(6.3)	0.1

Source: Bloomberg

[CY19 Annual Report](#)
[2QCY20 Press Release](#)

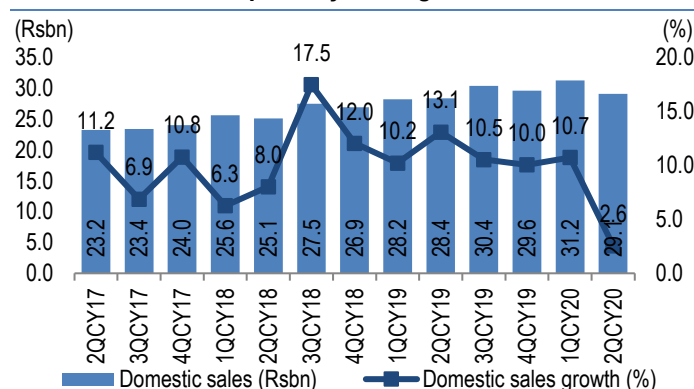
Y/E December (Rs mn)	2QCY19	1QCY20	2QCY20	YoY (%)	QoQ (%)	1HCY19	1HCY20	YoY (%)
Net Sales	30,009	33,253	30,505	1.7	-8.3	60,038	63,758	6.2
COGS	12,522	14,533	13,319	6.4	-8.4	24,975	27,852	11.5
Gross margin %	58.3	56.3	56.3	-1.9	0.0	58.4	56.3	-2.1
Employee costs	3,134	3,584	3,696	17.9	3.1	6,152	7,280	18.3
% of sales	10.4	10.8	12.1	1.7	1.3	10.2	11.4	1.2
Other expenses	7,126	7,130	5,906	-17.1	-17.2	14,040	13,036	-7.1
% of sales	23.7	21.4	19.4	-4.4	-2.1	23.4	20.4	-2.9
EBITDA	7,226	8,006	7,584	5.0	-5.3	14,871	15,590	4.8
EBITDA margin %	24.1	24.1	24.9	0.8	0.8	24.8	24.5	-0.3
Depreciation	941	914	924	-1.8	1.2	1,855	1,838	-0.9
EBIT	6,285	7,092	6,660	6.0	-6.1	13,016	13,752	5.7
EBIT margin %	20.9	21.3	21.8	0.9	0.5	21.7	21.6	-0.1
Interest expense	320	410	408	27.3	-0.4	659	818	24.0
Other income	726	429	379	-47.7	-11.5	1,458	808	-44.6
PBT	6,691	7,111	6,631	-0.9	-6.7	13,814	13,743	-0.5
Tax	2,213	1,784	1,657	-25.1	-7.1	4,592	3,441	-25.1
Effective tax rate %	33.1	25.1	25.0	-8.1	-0.1	33.2	25.0	-8.2
Adj. PAT	4,477	5,327	4,975	11.1	-6.6	9,222	10,302	11.7
Adj. PAT margin %	14.6	15.8	16.1	1.5	0.3	15.0	16.0	1.0
EPS	46.4	55.2	51.6	11.1	-6.6	95.6	106.8	11.7

Source: Company, Nirmal Bang Institutional Equities Research

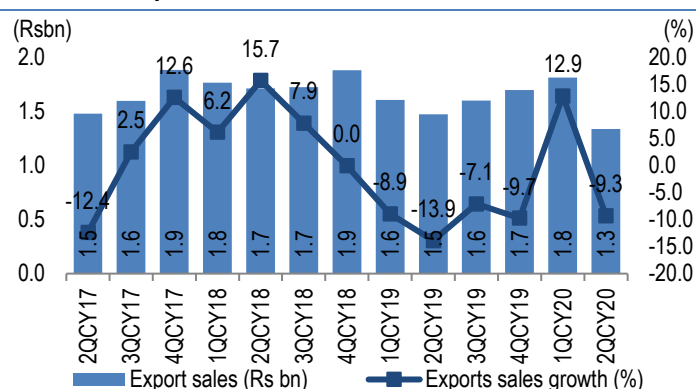
Exhibit 1: Financial summary

Y/E December (Rs mn)	CY17	CY18	CY19	CY20E	CY21E
Net revenues	1,00,096	1,12,923	1,23,689	1,35,492	1,53,783
YoY growth (%)	9.5	12.8	9.5	9.5	13.5
EBITDA	22,214	27,324	28,892	32,835	39,673
EBITDA margin (%)	22.2	24.2	23.4	24.2	25.8
PAT	13,500	17,217	19,944	21,907	28,214
EPS (Rs)	140.0	178.6	206.8	227.2	292.6
YoY growth (%)	13.2	27.5	15.8	9.8	28.8
RoCE (%)	41.7	50.2	73.2	112.3	131.4
RoE (%)	40.3	48.5	71.2	109.4	130.0
P/E (x)	122.1	95.8	82.7	75.3	58.4
P/BV (x)	48.2	44.9	85.3	79.5	72.7
EV/EBITDA (x)	72.7	58.8	56.0	49.2	40.5

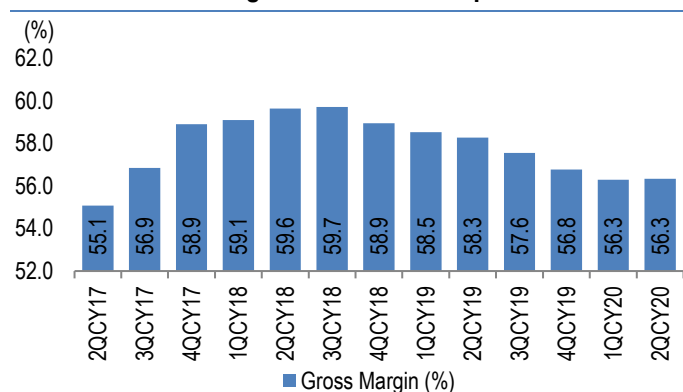
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Domestic quarterly sales grew 2.6% to Rs.29.1bn


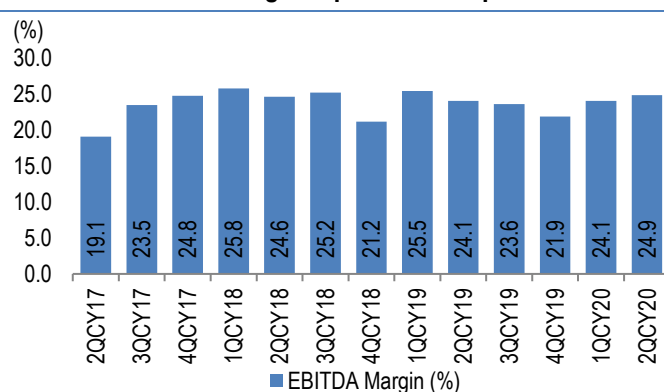
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Exports sales declined 9.3% to Rs1.3bn


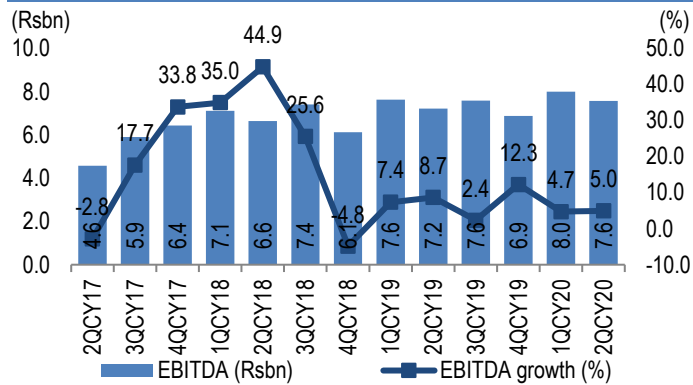
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Gross margin contracted 190bps YoY to 56.3%


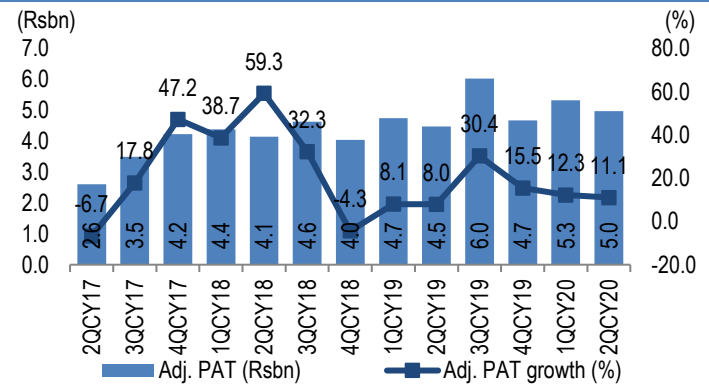
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: EBITDA margin expanded ~80bps YoY to 24.9%


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: EBITDA grew by 5.0% YoY to Rs7.6bn


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Adj. PAT grew by 11.1% YoY to Rs5.0bn


Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Our estimates versus actual performance

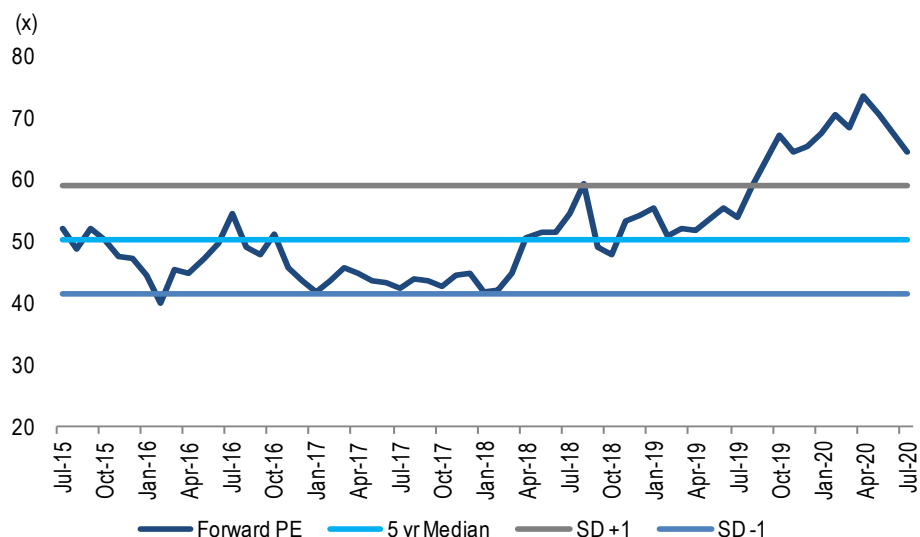
Y/E Dec. (Rs mn)	2QCY19	1QCY20	2QCY20	YoY (%)	QoQ (%)	NBIE estimate	Variation (%)
Net sales	30,009	33,253	30,505	1.7	-8.3	32,723	-6.8
EBITDA	7,226	8,006	7,584	5.0	-5.3	7,455	1.7
EBITDA margin (%)	24.1	24.1	24.9	0.8	0.8	22.8	2.1
Net income	4,477	5,327	4,975	11.1	-6.6	4,967	0.2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Change in our estimates

Y/E Dec (Rs mn)	Old estimates		New estimates		Change (%)	
	CY20E	CY21E	CY20E	CY21E	CY20E	CY21E
Net sales	1,37,836	1,56,075	1,35,492	1,53,783	-1.7	-1.5
EBITDA	32,719	39,656	32,835	39,673	0.4	0.0
EBITDA (%)	23.7	25.4	24.2	25.8	0.5	0.4
PAT	21,887	28,209	21,907	28,214	0.1	0.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: One year forward P/E


Source: Company, Nirmal Bang Institutional Equities Research

Financials (Standalone)

Exhibit 11: Income statement

Y/E December (Rsmn)	CY17	CY18	CY19	CY20E	CY21E
Net Sales	1,00,096	1,12,923	1,23,689	1,35,492	1,53,783
% Growth	9.5	12.8	9.5	9.5	13.5
COGS	43,269	45,902	52,239	58,051	62,243
Staff costs	10,577	11,732	13,036	14,818	16,362
Other expenses	24,037	27,965	29,522	29,787	35,505
Total expenses	77,882	85,599	94,797	1,02,657	1,14,110
EBITDA	22,214	27,324	28,892	32,835	39,673
% growth	9.4	23.0	5.7	13.6	20.8
EBITDA margin (%)	22.2	24.2	23.4	24.2	25.8
Other income	1,769	2,589	2,469	1,705	3,109
Interest costs	919	1,120	1,198	1,570	1,334
Depreciation	3,423	3,357	3,164	3,695	3,743
Profit before tax (before exceptional items)	19,641	25,437	26,999	29,276	37,705
Exceptional items	-1,248	-1,148	-249	-249	-249
Tax	6,141	8,220	7,054	7,369	9,490
Rate of Tax (%)	31.3	32.3	26.1	25.2	25.2
PAT	12,252	16,069	19,696	21,658	27,966
Adj PAT	13,500	17,217	19,944	21,907	28,214
Adj PAT margin (%)	13.3	14.9	15.8	16.0	18.0
% Growth	13.2	27.5	15.8	9.8	28.8

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Balance sheet

Y/E December (Rsmn)	CY17	CY18	CY19	CY20E	CY21E
Share capital	964	964	964	964	964
Reserves	33,242	35,773	18,358	19,769	21,701
Net worth	34,206	36,737	19,323	20,733	22,665
Total debt	351	351	531	531	531
Deferred tax liability	1,220	588	180	180	180
Total liabilities	35,777	37,677	20,034	21,444	23,376
Gross block	33,584	34,854	36,092	40,092	43,092
Depreciation	7,423	10,848	13,825	17,520	21,263
Net block	26,162	24,006	22,267	22,572	21,829
Capital work-in-progress	942	1,052	1,433	1,433	1,433
Investments	19,789	26,585	17,511	21,037	25,797
Inventories	9,025	9,656	12,831	13,927	14,911
Debtors	890	1,246	1,243	1,476	1,676
Cash	14,574	16,101	13,081	13,380	15,491
Loans & advances	2,245	2,236	2,217	3,006	3,433
Total current assets	26,734	29,238	29,371	31,789	35,510
Creditors	9,846	12,404	14,947	16,700	18,076
Other current liabilities & provisions	28,002	30,800	35,602	38,688	43,117
Total current liabilities	37,849	43,204	50,549	55,387	61,193
Net current assets	-11,115	-13,966	-21,177	-23,598	-25,683
Total assets	35,777	37,677	20,034	21,444	23,376

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Cash flow

Y/E December (Rsmn)	CY17	CY18	CY19	CY20E	CY21E
PAT	12,352	15,476	20,021	21,772	26,440
Depreciation	3,423	3,357	3,164	3,695	3,743
Other income	-1,353	-2,477	-2,497	-1,705	-3,109
Interest paid	7	41	17	1,570	1,334
(Inc.)/dec. in working capital	3,750	4,128	1,632	2,720	4,196
Cash flow from operations	18,178	20,525	22,337	28,051	32,605
Capital expenditure (-)	-1,959	-1,628	-1,522	-4,000	-3,000
Net cash after capex	16,219	18,897	20,815	24,051	29,605
Inc./(dec.) in invests/others	-479	-4,196	11,565	-1,934	-126
CF from investments	-2,438	-5,824	10,043	-5,934	-3,126
Dividends paid (-)	-8,292	-10,895	-29,503	-20,248	-26,033
Others	-1,674	-2,279	-5,896	-1,570	-1,334
CF from fin. activities	-9,966	-13,174	-35,400	-21,818	-27,368
Opening cash balance	8,800	14,574	16,101	13,081	13,380
Closing cash balance	14,574	16,101	13,081	13,380	15,491
Change in cash balance	5,774	1,526	-3,020	299	2,111

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Key ratios

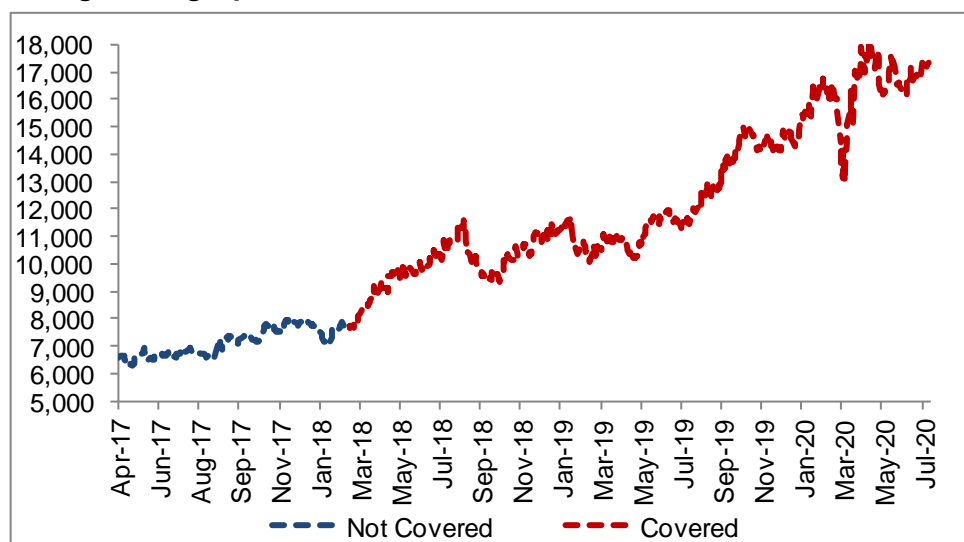
Y/E December	CY17	CY18	CY19	CY20E	CY21E
Per share (Rs)					
EPS	140.0	178.6	206.8	227.2	292.6
Book value	354.8	381.0	200.4	215.0	235.1
DPS	86.0	113.0	306.0	175.0	225.0
Valuation (x)					
EV/sales	16.1	14.2	13.1	11.9	10.5
EV/EBITDA	72.7	58.8	56.0	49.2	40.5
P/E	122.1	95.8	82.7	75.3	58.4
P/BV	48.2	44.9	85.3	79.5	72.7
Return ratios (%)					
RoCE	41.7	50.2	73.2	112.3	131.4
RoE	40.3	48.5	71.2	109.4	130.0
Profitability ratios (%)					
Gross margin	56.8	59.4	57.8	57.2	59.5
EBITDA margin	22.2	24.2	23.4	24.2	25.8
EBIT margin	18.8	21.2	20.8	21.5	23.4
PAT margin	13.3	14.9	15.8	16.0	18.0
Liquidity ratios (%)					
Current ratio	0.7	0.7	0.6	0.6	0.6
Quick ratio	0.5	0.5	0.3	0.3	0.3
Solvency ratio (%)					
Debt to Equity ratio	0.0	0.0	0.0	0.0	0.0
Turnover ratios					
Total asset turnover (x)	2.8	3.1	4.3	6.5	6.9
Fixed asset turnover (x)	3.8	4.7	5.6	6.0	7.0
Inventory days	76	77	90	88	87
Debtors days	3	4	4	4	4
Creditor days	83	99	104	105	106

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
13 March 2018	Buy	7,619	9,400
11 May 2018	Buy	8,981	10,700
6 August 2018	Buy	10,325	11,900
29 October 2018	Buy	9,569	11,200
19 February 2019	Buy	10,350	12,500
9 April 2019	Buy	10,878	12,500
15 May 2019	Buy	10,470	12,100
5 August 2019	Accumulate	11,411	12,350
23 September 2019	Accumulate	13,502	14,650
9 October 2019	Accumulate	13,600	14,520
11 November 2019	Accumulate	14,471	14,600
14 February 2020	Accumulate	16,418	15,985
30 March 2020	Accumulate	15,036	16,365
13 May 2020	Accumulate	17,455	16,855
29 July 2020	Accumulate	17,099	17,205

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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