

Q3CY13 Result Update/Rating change 15 Nov 2012

Volume growth under pressure

Nestle posted 7.8% YoY growth in revenue on the back of price hikes across products with volume growth expected to be negative. Gross margin expansion helped the company maintain operating margins of ~21% while high depreciation related to capex along with higher tax muted profitability growth to 2.4%. We have marginally reduced our volume growth estimates and downgrade our rating to Sell.

- **Results lower than expectations:** Nestle posted mere 7.8% YoY growth (lowest growth in last 30 quarters) in revenues to Rs21,156mn (3.8% below our expectations). Domestic net sales grew by 7.6% and exports by 10.5%. Operating profit was at Rs4,434mn (up 8.1% YoY) on the back of 6bps margin expansion while PAT was 7% below our expectations at Rs2,751mn (up 2.4% YoY).

Y/E Dec (Rsmn)	Q3CY12	Q3CY11	YoY (%)	Q2CY12	QoQ (%)	Q3CY12E	Var (%)
Net Sales	21,156	19,631	7.8	19,866	6.5	21,987	(3.8)
Employee cost	1,671	1,424	17.4	1,666	0.3	1,700	(1.7)
Raw Material	9,712	9,454	2.7	9,024	7.6	10,210	(4.9)
Admin & Other Exp	5,339	4,650	14.8	4,882	9.4	5,090	4.9
EBITDA	4,434	4,103	8.1	4,295	3.2	4,987	(11.1)
EBITDA margin (%)	21.0	20.9	6 bps	21.6	(66)bps	22.7	(172.2)
Depreciation	735	394		673		680	
Interest	(76)	12		220		150	
Other Income	173	121	43.1	113		110	57.3
PBT	3,870	3,745	3.3	3,545	9.2	4,267	(9.3)
Tax	1,197	1,134		1,085		1,306	
Adjusted PAT	2,673	2,685	2.4	2,429	13.2	2,961	(7.1)

Source: Company, Centrum Research Estimates

- **Sales growth lowest in 30 quarters:** Net domestic sales increased by 7.6% on the back of net realisations and product mix. Domestic sales growth during the quarter was adversely impacted by portfolio/channel optimization and pricing for value in certain products. Volume growth will be negative for the company against 1.1% growth for H1CY12. Sales growth during the quarter was the lowest in the last 30 quarters and we believe some pain is still remaining. While exports to Nestlé affiliates declined by 4.7%, to other third parties it grew by 29.7%. Rupee depreciation has favorably impacted total exports growth by 11.6%. Total exports grew by 10.5% to Rs949mn.
- **Margins continue to expand:** Gross margins of the company grew by 225bps to 54.1% due to higher realizations and product portfolio/channel mix, partially offset by higher input cost. We expect gross margin levels to remain firm. Employee cost grew by 17.4% due to an increase in headcount to support capacities for business expansion along with salary hikes during the quarter. Hence, operating margin expanded by mere 6bps to 20.96%.
- **Other highlights:** Total amount outstanding from the parent remains at \$192mn with no fresh drawdown during the quarter. Exchange differences amounting to Rs178mn (Rs33mn and Rs145mn for CY11 and H1CY12 respectively) spent in earlier periods were reversed in the current quarter and capitalized with the cost of the fixed assets. The one off favorable impact on net profit during the quarter was Rs120mn (net of tax). The company has completed its Rs25bn manufacturing expansion.
- **Downgrade to Sell:** We have lowered our CY12/CY13 earnings by 4% and 8% respectively as the management believed that some actions such as portfolio rationalisation, channel prioritization and focused innovations had started to yield results, while other corrective actions on demand generation in specific categories was taking time. The stock currently trades at 42.5x and 36.5x CY12E and CY13E PE. We value the stock at 33x CY13E EPS of Rs131.2 and arrive at a target price of Rs4,327 and downgrade our rating to Sell.

Y/E Dec (Rsmn)	Rev	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	EPS (Rs)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
CY10	62,547	21.9	12,497	20.0	8,370	20.0	86.8	116.5	107.5	55.1	36.6
CY11	74,908	19.8	15,528	20.7	10,188	21.7	105.7	95.7	62.1	45.3	30.1
CY12E	82,876	10.6	18,145	21.9	10,856	6.6	112.6	70.7	40.0	42.5	25.9
CY13E	97,332	17.4	21,678	22.3	12,645	16.5	131.2	62.9	41.0	36.5	21.5
CY14E	116,097	19.3	25,401	21.9	14,971	18.4	155.3	62.1	48.7	30.8	18.1

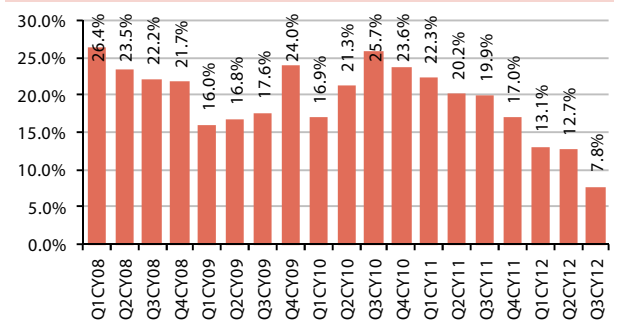
Source: Company, Centrum Research Estimates

Key Data

Target Price	Rs4,327	Bloomberg Code	NEST IN
CMP	Rs4,785*	Reuters Code	NEST.BO
Downside	10%	Current Shares O/S (mn)	96.4
Stock to Sector	Under perform	Diluted Shares O/S(mn)	96.4
Sector to Market	Neutral	Mkt Cap (Rsbn/USDbn)	463.1/8.4
Price Performance (%)*		52 Wk H / L (Rs)	5,429/3,925
	1M	6M	1Yr
NEST	2.3	3.8	8.6
NIFTY	(1.0)	14.0	8.7
		Daily Vol. (3M NSE Avg.)	25,464
		Face Value (Rs)	10
		1 USD = Rs55.0	

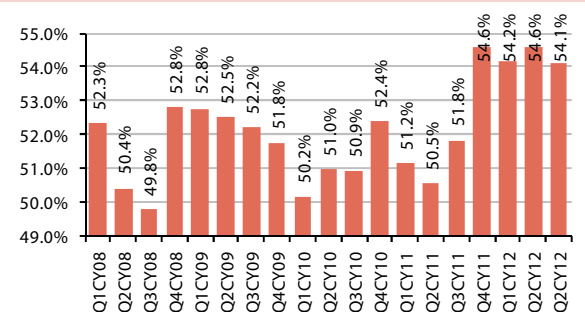
Source: Bloomberg, Centrum Research
*as on 12 November 2012

Moderating sales growth



Source: Company, Centrum Research

Gross margins expanding



Source: Company, Centrum Research

Revised earnings estimates

Particulars	CY12E			CY13E		
	Current	Earlier	Chg (%)	Current	Earlier	Chg (%)
Revenue	82,876	86,951	(4.7)	97,332	104,799	(7.1)
EBITDA	18,145	19,013	(4.6)	21,678	23,265	(6.8)
EBITDA margin (%)	21.9	21.9	2bps	22.3	22.2	7bps
Adj PAT	10,856	11,324	(4.1)	12,645	13,786	(8.3)
PAT margin (%)	13.1	13.0	7bps	13.0	13.2	-16bps

Source: Company, Centrum Research Estimates

Ankit Kedia

ankit.kedia@centrum.co.in
+91 22 4215 9634

Please refer to important disclosures/disclaimers inside

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Financials

Exhibit 1: Income Statement

Y/E Dec (Rsmn)	CY10	CY11	CY12E	CY13E	CY14E
Net Sales	62,547	74,908	82,876	97,332	116,097
Growth (%)	21.9	19.8	10.6	17.4	19.3
Employee Cost	4,334	5,465	5,967	7,008	8,359
% of Sales	6.9	7.3	7.2	7.2	7.2
Cost of Goods Sold	30,556	35,894	38,211	44,800	53,661
% of sales	48.9	47.9	46.1	46.0	46.2
Manufacturing Expenses	3,048	3,960	4,475	5,256	6,385
% of sales	4.9	5.3	5.4	5.4	5.5
Admin & other expenses	12,113	14,063	16,078	18,590	22,291
% of sales	19.4	18.8	19.4	19.1	19.2
EBIDTA	12,497	15,528	18,145	21,678	25,401
EBIDTA Margins (%)	20.0	20.7	21.9	22.3	21.9
Depreciation	1,278	1,533	2,531	3,432	3,942
Interest expenses	11	51	448	399	281
PBT for operations	11,208	13,943	15,166	17,846	21,177
Other income	427	509	545	613	679
Exceptional item	184	573	-	-	-
PBT	11,451	13,879	15,710	18,460	21,855
Provision for tax	3,264	4,264	4,854	5,815	6,884
Effective tax rate (%)	28.5	30.7	30.9	31.5	31.5
Net Profit	8,187	9,615	10,856	12,645	14,971
Adj Net Profit	8,370	10,188	10,856	12,645	14,971

Source: Company, Centrum Research Estimates

Exhibit 2: Balance Sheet

Y/E Dec (Rsmn)	CY10	CY11	CY12E	CY13E	CY14E
Share Capital	964	964	964	964	964
Reserves & Surplus	7,590	11,775	17,024	21,257	25,013
Total Shareholders Funds	8,554	12,740	17,988	22,222	25,977
Loan Funds	0	9709	12700	7249	4000
Deferred Tax Liabilities	333	435	435	435	435
Total Capital Employed	8,887	22,883	31,123	29,906	30,413
Fixed Asset					
Gross Block	18,547	25,522	42,522	51,022	57,522
Less:- Accumulated Dep.	8,420	9,765	12,295	15,728	19,670
Net Block	10,127	15,758	30,227	35,294	37,852
Capital WIP	3,489	14,186	8,500	4,250	3,250
Total fixed assets	13,616	29,944	38,727	39,544	41,102
Investments	1507	1344	1344	1075	1612
Inventory	5,760	7,340	7,951	9,305	11,126
Debtors	633	1,154	1,249	1,467	1,749
Loans & advances	1,514	1,964	2,486	2,920	3,483
Cash & bank balances	2,553	2,272	2,180	2,344	3,283
Other current assets	-	-	-	-	-
Total current assets	10,460	12,730	13,866	16,036	19,640
Current liabilities & provisions	16,696	21,135	22,814	26,749	31,942
Net current assets	(6,236)	(8,404)	(8,947)	(10,713)	(12,301)
Total	8,887	22,883	31,123	29,906	30,413

Source: Company, Centrum Research Estimates

Exhibit 3: Cash flow

Y/E Dec (Rsmn)	CY10	CY11	CY12E	CY13E	CY14E
CF from operations					
Profit before tax	11,451	13,879	15,710	18,460	21,855
Dep. & amortisation	1,278	1,533	2,531	3,432	3,942
Others	(704)	(544)	(97)	(214)	(397)
CF before WC changes	12,025	14,869	18,145	21,678	25,401
Working capital changes	1,575	1,887	451	1,930	2,526
Cash inflow from op	13,600	16,756	18,596	23,608	27,927
Income tax paid	3,264	4,264	4,854	5,815	6,884
Cash from Operations	10,335	12,492	13,741	17,793	21,042
Cash from investing					
Capex	(4,832)	(17,672)	(11,314)	(4,250)	(5,500)
Investments	526	163	0	269	(537)
Other Income	427	509	545	613	679
Cash from investing	(3,880)	(17,000)	(10,769)	(3,368)	(5,359)
Cash from financing					
Borrowings/ repayments	0	9,709	2,992	(5,451)	(3,249)
Dividend paid	(5,448)	(5,430)	(5,608)	(8,411)	(11,215)
Interest paid	(11)	(51)	(448)	(399)	(281)
Others	0	0	0	0	0
Cash from financing	(5,459)	4,228	(3,064)	(14,261)	(14,745)
Net change in cash	997	(281)	(92)	164	938

Source: Company, Centrum Research Estimates

Exhibit 4: Key Ratios

Y/E Dec	CY10	CY11	CY12E	CY13E	CY14E
Margin ratios (%)					
Gross Margins	51.1	52.1	53.9	54.0	53.8
EBIDTA Margins	20.0	20.7	21.9	22.3	21.9
PBIT Margins	17.9	18.7	18.8	18.7	18.5
PBT Margins	18.6	19.3	19.0	19.0	18.8
PAT Margins	13.1	12.8	13.1	13.0	12.9
Growth ratios (%)					
Revenues	21.9	19.8	10.6	17.4	19.3
EBIDTA	20.8	24.3	16.9	19.5	17.2
Adj Net Profit	20.0	21.7	6.6	16.5	18.4
Return Ratios (%)					
ROCE	107.5	62.1	40.0	41.0	48.7
RoNW	116.5	95.7	70.7	62.9	62.1
RoIC	232.4	72.6	56.6	68.9	84.1
Turnover Ratios (days)					
Inventory period	64	67	73	70	69
Collection period	4	4	5	5	5
Payment period	81	90	99	94	93
Working Capital Cycle	(13)	(19)	(21)	(18)	(18)
Per Share (Rs)					
EPS (Reported)	84.9	99.7	112.6	131.2	155.3
EPS (Adjusted)	86.8	105.7	112.6	131.2	155.3
CEPS	100.1	121.6	138.8	166.8	196.2
Book Value	88.7	132.1	186.6	230.5	269.4
Dividend	48.5	48.5	50.0	75.0	100.0
Valuations (x)					
PER	55.1	45.3	42.5	36.5	30.8
P/BV	53.9	36.2	25.6	20.8	17.8
EV/EBIDTA	36.6	30.1	25.9	21.5	18.1
EV/Sales	7.3	6.2	5.7	4.8	4.0
M-cap/Sales	7.4	6.2	5.6	4.7	4.0

Source: Company, Centrum Research Estimates

Appendix A

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Website: www.centrum.co.in

Investor Grievance Email ID: investor.grievances@centrum.co.in

Compliance Officer Details:

Mr. Praveen Malik; Tel: (022) 4215 9703; Email ID: compliance@centrum.co.in

Centrum Broking Limited

Registered Office Address

Bombay Mutual Building ,
2nd Floor,
Dr. D. N. Road,
Fort, Mumbai - 400 001

Correspondence Address

Centrum House
6th Floor, CST Road, Near Vidya Nagari Marg, Kalina,
Santacruz (E), Mumbai 400 098.
Tel: (022) 4215 9000