

Nestle India

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,752	NEST IN
	REUTERS CODE
S&P CNX: 3,148	NEST.BO

1 August 2006

Neutral
Previous Recommendation: Neutral
Rs998

Equity Shares (m)	96.4
52-Week Range	1,348/730
1,6,12 Rel. Perf. (%)	-1/-7/-14
M.Cap. (Rs b)	96.2
M.Cap. (US\$ b)	2.1

YEAR	NET SALES	PAT *	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
12/05A	24,770	3,289	34.1	17.1	29.3	21.0	58.6	84.9	4.7	22.3
12/06E	27,648	3,546	36.8	7.8	27.1	18.4	55.6	79.6	4.2	21.0
12/07E	30,745	4,305	44.7	21.4	22.4	16.1	59.1	81.8	3.8	17.7

* excluding extraordinary items and provisions

- Nestle's 2QCY06 results were below our expectations. Adjusted PAT declined 4.4% v/s our estimate of 1.4% increase, primarily due to a sharp increase in commodity price inputs.
- Revenues for the quarter grew 10.6% YoY to Rs6.8b, driven by strong growth in domestic revenues, which grew 13.5% YoY. Export revenues declined 9.2% YoY due to lower sales to Russia and Japan.
- EBITDA margins declined by 360bp YoY, as the company continued to face cost price inflation on account of high commodity prices of milk solids, sugar, fuel and freight, accentuated by cost of quality improvement in infant foods.
- The company had a writeback of Rs102.2m, which was included in other income. Nestle also commissioned the first phase of its Maggi Noodles facility at Uttaranchal. This unit is eligible for tax benefits and will boost profitability in future.
- We are increasing our sales growth estimates by 1.3% for CY06 and by 1.7% for CY07, due to higher domestic sales growth momentum. We are lowering our profit estimates for CY06 by 4% and for CY07 by 5% due to higher-than-expected commodity and material prices. Our revised CY06 and CY07 EPS estimates are Rs36.8 and Rs44.7 respectively. The stock currently trades at 27.1 CY06E and 22.4x CY07E earnings. Maintain **Neutral**.

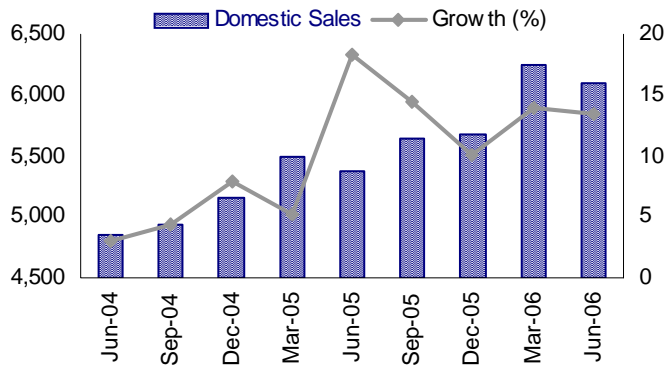
QUARTERLY PERFORMANCE										(RS MILLION)	
Y/E DECEMBER	CY05				CY06				CY05	CY06E	
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			
Domestic Sales	5,906	5,745	6,071	6,125	6,703	6,328	6,648	6,547	23,847	26,225	
YoY Change (%)	7.5	18.4	14.4	11.0	13.5	10.1	9.5	7.8	12.0	10.0	
Exports	648	781	607	555	508	709	550	890	2,592	2,657	
YoY Change (%)	6.0	32.2	-7.4	-8.1	-21.7	-9.2	-0.5	60.3	6.4	2.5	
Gross Sales (incl Excise)	6,554	6,526	6,679	6,680	7,210	7,037	7,198	7,437	26,439	28,882	
YoY Change (%)	5.7	19.9	12.0	9.1	10.0	7.8	7.8	11.3	11.3	9.2	
Less: Excise	-419	-368	-431	-452	-451	-225	-266	-293	-1,670	-1,236	
Net Sales	6,135	6,158	6,248	6,228	6,759	6,812	6,932	7,144	24,769	27,647	
Total Exp	-4,748	-4,778	-4,970	-5,047	-5,394	-5,530	-5,511	-5,715	-19,549	-22,150	
EBITDA	1,387	1,380	1,278	1,181	1,365	1,282	1,421	1,429	5,220	5,497	
Margins (%)	22.6	22.4	20.5	19.0	20.2	18.8	20.5	19.2	19.7	19.0	
Depreciation	-126	-149	-156	-154	-157	-161	-145	-168	-568	-630	
Interest	-1	0	0	0	0	-2	0	0	-2	-14	
Other income	69	80	57	58	50	146	50	77	237	323	
PBT	1,329	1,311	1,179	1,085	1,258	1,265	1,326	1,338	4,887	5,176	
Tax	-476	-428	-386	-305	-499	-421	-358	-353	-1,595	-1,631	
Rate (%)	35.8	32.6	32.7	28.1	39.6	33	27	26	32.6	31.5	
Adjusted PAT	853	883	793	780	760	844	968	985	3,293	3,545	
YoY Change (%)	9.7	80.8	23.3	-14.0	-11.0	-4.4	22.1	26.3	17.2	7.7	
Extraordinary Inc/(Exp)	-73	-55	-47	-38	127	-34	0	0	-197	-221	
Reported PAT	781	828	746	742	886	810	968	985	3,096	3,324	
YoY Change (%)	21.2	52.7	8.4	-3.0	13.5	-2.1	29.8	32.7	22.9	7.4	

E: MOST Estimates

Revenues continue to be driven by strong domestic revenues

Nestlé’s domestic revenues have been driving overall revenue growth driven by buoyant FMCG environment and new variants. Domestic revenues grew 13.5% YoY for the quarter backed by strong volume growth and better price realizations. Excise duty has to consumers with price reductions. We expect strong sales growth in the coming quarters due to focus on increasing penetration of products by launching small sizes at affordable price points. We have increased our CY06 and CY07 sales growth estimates by 1.3% and 1.7% respectively.

TREND IN DOMESTIC SALES AND GROWTH

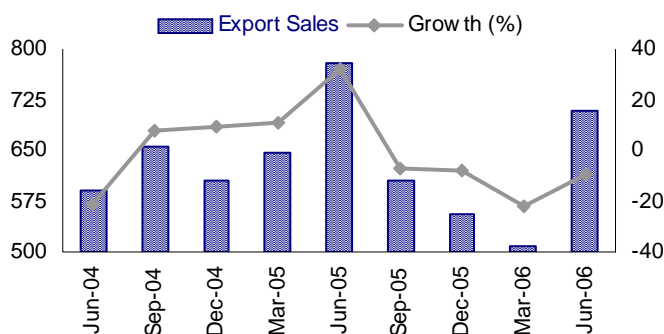


Source: Company/ Motilal Oswal Securities

Export revenues continue to decline

Export revenues declined 9.1% YoY in 2QCY06 primarily due to lower sales of beverages to Russia and Japan. The parent has set up a plant in Russia to cater to local demand which has impacted the company’s export revenues. The company continues to focus on domestic business and we believe export revenues will continue to decline as exports to the parent company declines.

TREND IN EXPORT SALES AND GROWTH

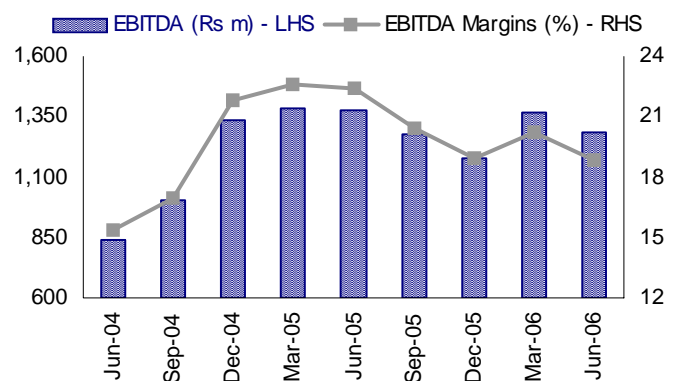


Source: Company/ Motilal Oswal Securities

High commodity prices continue to impact operating margins

Operating margins declined 360bp on a YoY basis for the quarter impacted by high commodity prices. Prices of commodities like milk, sugar and fuel have been increasing steeply. This has impacted operating profits of the company over the last few quarters. In addition the quality improvement initiatives in Infant foods also impacted the profitability. Although the company has resorted to selective price increases to ward off the impact of commodity price inflation, we believe that the profit margins will continue to be impacted in the medium term.

TREND IN EBITDA



Source: Company/ Motilal Oswal Securities

Nestle continues to drive new product innovations

New product launches have managed to drive strong domestic volume growth, with Nestle intent on increasing share in rural areas by offering products at affordable price points. The company has launched Maggi Dal Atta Noodles and Milo with Actigen during the quarter. In addition, the company also undertook quality improvement program for infant food to further improve the quality.

Valuations and view

We are increasing our sales growth estimates by 1.3% and 1.7% for CY06 and CY07, due to higher sales growth momentum in the domestic market. We are lowering our profit estimates for CY06 by 4% and for CY07 by 5% due

to higher-than-expected commodity and material prices. Our revised CY06 and CY07 EPS estimates are Rs36.8 and Rs44.7 respectively. The stock currently trades at 27.1x CY06E and 22.4x CY07E earnings. Maintain **Neutral** with reduced price target of Rs1,050.

Nestle India: an investment profile

Company description

Nestle India is a subsidiary of Nestle SA- one of the largest food product companies in the world. In India, Nestle is present primarily in weaning foods, chocolates & confectionary, beverages (tea, coffee) and cooking preparations. Nestle has been an urban-focused company but is now reorienting itself to expand its reach.

Key investment arguments

- Significant long-term potential in company's categories.
- Nestle is reorienting its product prices and distribution to expand consumer base.
- Likely rebound in earnings in CY05 after a weak CY04.
- Valuations at the upper end of the sector.

Key investment risks

- Parent setting up manufacturing in Russia could affect exports over the longer run.
- Increase in the commodity prices of milk, sugar, coffee and fuel can have substantial impact on margins.

Recent developments

- Commissioned Rs1b manufacturing facility in Uttaranchal for Maggi noodles.
- Mr Martial Rolland, Chairman and Managing Director, Nestle India Ltd, awarded the Udyog Ratna Award for his contribution to the economic development of Punjab.

Valuation and view

- We forecast an earnings CAGR of 17.5% over CY05-07E.
- The stock currently trades at 27.1 CY06E and 22.4x CY07E earnings. Maintain **Neutral**.

Sector view

- We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- Companies with low competitive pressures and brought product portfolios will be able to better with stand any slowdown in a particular segment.
- Longer term prospects bright, given rising incomes and low penetration.

COMPARATIVE VALUATIONS

		NESTLE	HLL	ITC
P/E (x)	FY06E	33.2	31.9	22.5
	FY07E	27.3	25.7	19.1
EV/EBITDA (x)	FY06E	21.0	27.2	14.8
	FY07E	17.7	21.8	12.5
EV/Sales (x)	FY06E	4.2	3.9	5.0
	FY07E	3.8	3.5	4.2
P/BV	FY06E	18.4	19.2	5.9
	FY07E	16.1	16.3	5.1

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	61.9	61.9	61.9
Domestic Institutions	10.1	10.2	9.3
FIs/FDIs	9.0	8.2	8.8
Others	19.0	19.8	20.0

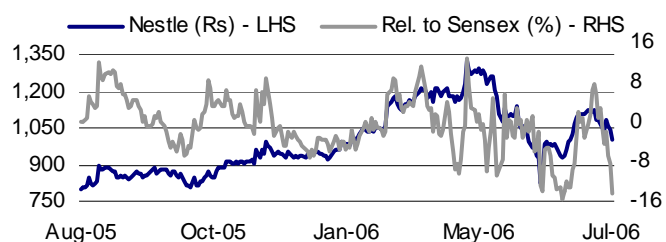
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY06	36.8	39.6	-7.0
CY07	44.7	47.1	-5.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
998	1,050	4.2	Neutral

STOCK PERFORMANCE (1 YEAR)



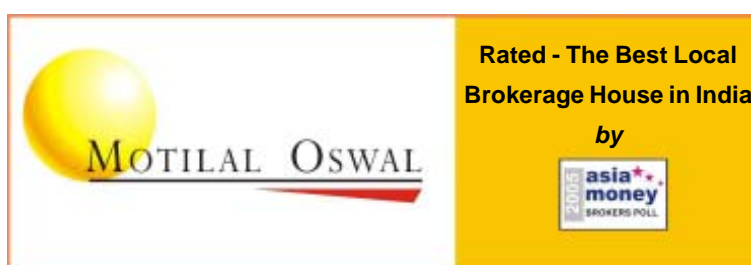
INCOME STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Domestic Sales	20,360	21,397	23,930	26,225	29,142
Export Sales	2,439	2,331	2,509	2,657	2,882
Net Sales	21,463	22,279	24,770	27,648	30,745
Change (%)	10.8	3.8	112	116	112
Total Expenditure	-16,959	-17,766	-19,549	-22,150	-24,228
EBITDA	4,504	4,513	5,221	5,498	6,517
Change (%)	12.9	0.2	15.7	5.3	18.5
Margin (%)	19.8	19.0	19.7	19.0	20.3
Depreciation	-463	-491	-568	-630	-709
Int. and Fin. Charges	-19	-8	-2	-14	-14
Other Income - Recurring	221	141	233	323	270
Profit before Taxes	4,243	4,155	4,884	5,177	6,063
Change (%)	14.2	-2.1	17.5	6.0	17.1
Margin (%)	19.8	18.7	19.7	18.7	19.7
Tax	-1,374	-1,463	-1,483	-1,533	-1,618
Deferred Tax	14	117	-112	-98	-141
Tax Rate (%)	-32.1	-32.4	-32.7	-31.5	-29.0
Adjusted PAT	2,883	2,809	3,289	3,546	4,305
Change (%)	11.1	-2.5	17.1	7.8	21.4
Margin (%)	13.4	12.6	13.3	12.8	14.0
Non-rec. (Exp)/Income	-252	-290	-197	-221	-246
Reported PAT	2,631	2,519	3,092	3,325	4,059

BALANCE SHEET					
(RS MILLION)					
Y/E DECEMBER	2003	2004	2005	2006	2007
Share Capital	964	964	964	964	964
Reserves	3,967	4,078	4,649	5,416	6,325
Net Worth	4,932	5,043	5,613	6,380	7,289
Loans	51	79	143	143	143
Capital Employed	4,983	5,122	5,756	6,523	7,432
Gross Block	7,894	8,382	9,494	10,207	11,960
Less: Accum. Depn.	-3,981	-4,409	-4,757	-5,387	-6,096
Net Fixed Assets	3,914	3,972	4,738	4,819	5,864
Capital WIP	139	341	228	240	252
Investments	736	1,549	1,044	2,181	2,077
Curr. Assets, L&A	3,640	3,582	4,627	4,463	4,851
Inventory	2,194	2,167	2,531	2,538	2,736
Account Receivables	317	262	305	317	351
Cash and Bank Balance	63	94	366	165	163
Others	1,066	1,059	1,424	1,444	1,601
Curr. Liab. and Prov.	3,342	4,334	4,781	4,983	5,273
Account Payables	2,361	2,662	3,165	3,641	3,841
Other Liabilities	29	31	34	43	48
Provisions	952	1,640	1,583	1,298	1,383
Net Current Assets	298	-752	-155	-519	-421
Deferred Tax Liability	-105	12	-100	-197	-338
Application of Funds	4,983	5,122	5,756	6,523	7,432

E: MOST Estimates

RATIOS					
Y/E DECEMBER	2003	2004	2005	2006E	2007E
Basic (Rs)					
EPS	29.9	29.1	34.1	36.8	44.7
Cash EPS	34.7	34.2	40.0	43.3	52.0
BV/Share	511	52.3	58.2	66.2	75.6
DPS	20.0	24.5	25.0	27.6	33.5
Payout %	66.9	84.1	73.3	75.0	75.0
Valuation (x)					
P/E	40.8	41.9	35.8	33.2	27.3
Cash P/E	35.2	35.6	30.5	28.2	23.5
EV/Sales	5.4	5.2	4.7	4.2	3.8
EV/EBITDA	26.0	25.7	22.3	21.0	17.7
P/BV	23.9	23.3	21.0	18.4	16.1
Dividend Yield (%)	16	2.0	2.0	2.3	2.7
Return Ratios (%)					
RoE	58.5	55.7	58.6	55.6	59.1
RoCE	85.5	81.3	84.9	79.6	81.8
Working Capital Ratios					
Debtor (Days)	5	4	4	4	4
Asset Turnover (x)	4.3	4.4	4.3	4.2	4.1
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2003	2004	2005	2006	2007
OP/(loss) before Tax	4,041	4,022	4,653	4,868	5,808
Int/Div. Received	221	141	233	323	270
Depreciation and Amort.	463	491	568	630	709
Interest Paid	-19	-8	-2	-14	-14
Direct Taxes Paid	-1,374	-1,463	-1,483	-1,533	-1,618
(Incr)/Decr in WC	-425	-1,019	869	-566	96
CF from Operations	2,907	2,165	4,838	3,709	5,251
Extraordinary Items	129	30	0	102	0
(Incr)/Decr in FA	-362	-689	-1,000	-723	-1,765
(Pur)/Sale of Investments	-40	-812	504	-1,137	104
CF from Invest.	-644	-1,471	-496	-1,758	-1,661
Issue of Shares	0	0	0	0	0
(Incr)/Decr in Debt	576	-28	-64	0	0
Dividend Paid	-2,175	-2,675	-2,748	-3,000	-3,642
Others	-660	2,040	-1,259	849	50
CF from Fin. Activity	-2,259	-663	-4,071	-2,151	-3,592
Incr/Decr of Cash	4	31	271	-201	-2
Add: Opening Balance	59	63	94	366	165
Closing Balance	63	94	366	165	163



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Disclosure of Interest Statement

Nestle India

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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