

Nestle

Performance Highlights

(₹ cr)	1QCY11	1QCY10	% yoy	Angel est.	% Diff.
Revenue	1,810.0	1,479.8	22.3	1,780.4	1.7
EBITDA	385.3	304.0	26.7	389.9	(1.2)
OPM (%)	21.3	20.5	74	21.9	(61)
PAT	255.7	201.9	26.7	251.9	1.5

Source: Company, Angel Research

Nestle reported strong set of numbers for 1QCY2011, beating our expectations by ~2% both on the top-line and earnings fronts. The company's top line grew by 22.3% yoy (largely driven by domestic volumes), while earnings grew by ~26.7% yoy (against our expectation of 24.8% yoy growth). During the quarter, Nestle's margin expanded on the back of cost rationalisation and robust top-line growth. Post 1QCY2011 results, we have tweaked our estimates. **We maintain our Reduce view on the stock with a target price of ₹3,483.**

Strong top line boosts results, gross margin recovers, though still under pressure:

Nestle registered robust top-line growth of 22.3% yoy to ₹1,810cr, driven by steady growth in its net domestic sales (up 23.1% yoy to ₹1,712cr, supported by steady volume growth and higher realisations across categories). Earnings (on a reported basis) registered 26.7% yoy growth to ₹255.7cr, aided by margin expansion. Gross margin expanded by 100bp yoy due to improved product/channel mix and discontinuing of free goods promotion by the company, despite higher cost inflation in milk and sugar prices.

Outlook and valuation: At the CMP, Nestle is trading at ~139% premium to the Sensex, significantly ahead of its five-year average historical premium of ~78%. We render caution on Nestle's high premium to the Sensex on account of 1) gross margin pressures due to rising input costs and 2) competition in the high-growth noodles category from HUL (*Knorr Soupy Noodles*), GSKCHL (*Horlicks Foodles*) and ITC (*Sunfeast Yipee*). Hence, we maintain our Reduce view on the stock with a revised target price of ₹3,483 (₹3,503).

Key financials

Y/E Dec. (₹ cr)	CY2009	CY2010	CY2011E	CY2012E
Net sales	5,129	6,255	7,277	8,435
% chg	18.6	21.9	16.3	15.9
Net profit	655	819	974	1,158
% chg	22.6	25.0	18.9	18.9
EBITDA (%)	20.2	20.0	20.1	20.7
EPS (₹)	67.9	84.9	101.0	120.1
P/E (x)	56.4	45.1	37.9	31.9
P/BV (x)	63.5	43.2	28.8	19.5
RoE (%)	124.2	114.0	91.1	72.9
RoCE (%)	164.3	149.4	120.4	97.6
EV/Sales (x)	7.1	5.9	5.0	4.3
EV/EBITDA (x)	35.5	29.3	24.6	20.4

Source: Company, Angel Research; Note: Price as on April 21, 2011

REDUCE

CMP	₹3,829
Target Price	₹3,483

Investment Period	12months
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Stock Info

Sector	FMCG
Market Cap (₹cr)	36,916
Beta	0.4
52 Week High / Low	4,199/2,570
Avg. Daily Volume	11,634
Face Value (Rs)	10
BSE Sensex	19,602
Nifty	5,885
Reuters Code	NEST.BO
Bloomberg Code	NEST@IN

Shareholding Pattern (%)

Promoters	62.8
MF / Banks / Indian Fls	10.2
FII / NRIs / OCBs	10.9
Indian Public / Others	16.1

Abs. (%)	3m	1yr	3yr
Sensex	3.1	12.2	17.1
Nestle	5.6	36.0	149.4

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Exhibit 1: Quarterly performance

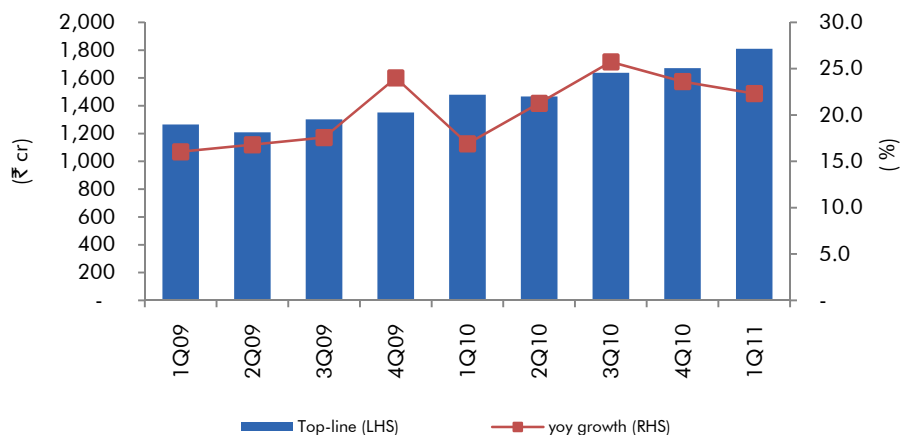
Y/E Dec. (₹ cr)	1QCY11	1QCY10	% yoy	CY2010	CY2009	% chg
Net Sales	1,810.0	1,479.8	22.3	6,254.8	5,129.4	21.9
Consumption of RM	884.1	737.6	19.9	3,055.6	2,448.4	24.8
(% of Sales)	48.8	49.8		48.9	47.7	
Staff Costs	120.5	99.8	20.7	433.4	432.4	0.2
(% of Sales)	6.7	6.7		6.9	8.4	
Other Expenses	420.1	338.4	24.1	1,516.1	1,214.2	24.9
(% of Sales)	23.2	22.9		24.2	23.7	
Total Expenditure	1,424.7	1,175.8	21.2	5,005.1	4,095.0	22.2
Operating Profit	385.3	304.0	26.7	1,249.7	1,034.4	20.8
OPM (%)	21.3	20.5		20.0	20.2	
Interest	0.1	0.6		1.1	1.4	(23.6)
Depreciation	32.7	31.0	5.6	127.8	111.3	14.8
Other Income	12.8	9.1	39.6	42.7	37.9	12.6
PBT (excl. Extr. Items)	365.3	281.6	29.7	1,163.5	959.6	21.2
Extr. Income/(Expense)	6.9	(4.8)		18.4	42.6	
PBT (incl. Extr. Items)	358.4	286.4	25.1	1,145.1	917.0	24.9
(% of Sales)	19.8	19.4		18.3	17.9	
Provision for Taxation	102.7	84.5	21.5	326.5	262.0	24.6
(% of PBT)	28.1	30.0		28.1	27.3	
Recurring PAT	255.7	201.9	26.7	818.7	655.0	25.0
PATM	14.1	13.6		13.1	12.8	
Reported PAT	262.6	197.1	33.3	837.0	697.6	20.0
Equity shares (cr)	9.6	9.6		9.6	9.6	
EPS (₹)	26.5	20.9		84.9	67.9	

Source: Company, Angel Research

Robust top-line growth aided by volumes, despite high commodity prices

Nestle registered robust top-line growth of 22.3% yoy to ₹1,810cr (₹1,480cr), ahead of our estimates, driven by steady growth in its net domestic sales (up 23.1% yoy to ₹1,712cr supported by steady volume growth and higher realisations across categories). Exports also registered growth of 10.2% yoy to ₹98cr during the quarter.

Exhibit 2: Top-line growth at 22.3% yoy, driven by volume and value

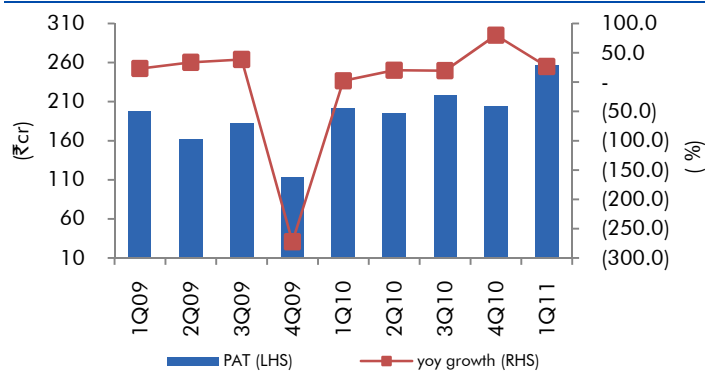


Source: Company, Angel Research

Cost rationalisation helps Nestle sail through inflationary pressures

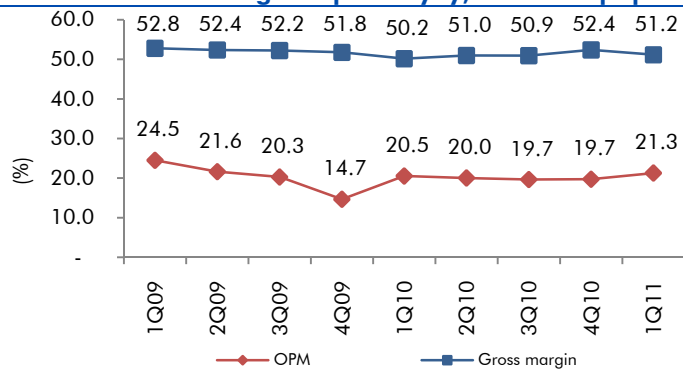
Nestle's earnings (on a reported basis) registered 26.7% yoy growth to ₹255.7cr (₹201.9cr), aided by margin expansion. At the operating front, gross margin expanded by 100bp yoy on account of improved product/channel mix and discontinuing of free goods promotion by the company, despite higher cost inflation in milk and sugar prices. Staff cost during the quarter was maintained as a percentage of sales, while other expenses marginally increased by 34bp yoy. Hence, EBITDA registered healthy growth of 26.7% yoy during the quarter.

Exhibit 3: Earnings led by healthy top-line growth



Source: Company, Angel Research

Exhibit 4: Gross margin expands yoy, declines qoq



Source: Company, Angel Research

Investment concerns

- Key raw-material prices to continue pressurising margins:** Although Nestle has reported an expansion in its operating margin on a yoy basis, it was largely in line with our expectations. While we do not expect raw-material prices of key commodities such as milk, sugar and wheat flour to show a steep increase from the current levels on account of the onset of normal monsoon (according to IMD forecast, April 2011), we do expect prices of these commodities to remain firm. Milk prices in particular are currently trading 10–11% higher than the average milk price in 4QFY2011 (Source: Bloomberg, as on 18/04/2011).
- However, valuations at 139% premium to the Sensex capture the full potential:** At the CMP, Nestle is trading at ~139% premium to the Sensex, significantly ahead of its five-year average historical premium of ~78%. While Nestle has been able to maintain these premium valuations on account of strong parentage, dominant brands, high RoEs and OPMs, we believe current valuations capture the full potential of near-term growth. We remain cautious in terms of Nestle being able to maintain this triple-digit premium to the Sensex on account of 1) gross margin pressures due to rising input costs and 2) competition in the high-growth noodles category from HUL (*Knorr Soupy Noodles*), GSKCHL (*Horlicks Foodles*) and ITC (*Sunfeast Yipee*)

Outlook and valuation

Post 1QCY2011 results, we have tweaked our estimates. We have factored in higher depreciation as the company undertakes heavy capex.

Exhibit 5: Change in estimates

₹ cr)	Old estimates		New estimates		% chg	
	CY11E	CY12E	CY11E	CY12E	CY11E	CY12E
Revenue	7,267	8,420	7,277	8,435	0.1	0.2
OPM (%)	20.1	20.7	20.1	20.7	(1bp)	(4bp)
EPS (₹)	101.3	120.8	101.0	120.1	(0.3)	(0.6)

Source: Company, Angel Research

At the CMP of ₹3,829, the stock is trading higher to its three-year average P/E of 28.9x CY2012E EPS of ₹120.1. **Hence, we maintain our Reduce view on the stock with a revised target price of ₹3,483 (₹3,503).**

Exhibit 6: Key assumptions

Sales (₹ cr)	CY2009	CY2010	CY2011E	CY2012E	#CY09-12E
Total milk products	2,311	2,776	3,095	3,448	14.3
Beverages	804	899	1,022	1,157	12.9
Prepared dishes & cooking aids	1,335	1,725	2,132	2,613	25.1
Chocolates & confectionaries	772	976	1,176	1,389	21.6
Total gross revenue	5,222	6,377	7,426	8,607	18.1
Yoy growth (%)					
Total milk products	19.2	20.1	11.5	11.4	
Beverages	0.4	11.8	13.7	13.2	
Prepared dishes & cooking aids	26.9	29.2	23.6	22.6	
Chocolates & confectionaries	13.6	26.4	20.5	18.1	
Total gross revenue	16.8	22.1	16.5	15.9	
Volume growth (%)					
Total milk products	13.1	7.6	7.2	7.1	
Beverages	(3.1)	13.2	12.0	11.5	
Prepared dishes & cooking aids	21.7	24.4	20.0	19.0	
Chocolates & confectionaries	9.7	21.2	17.0	14.6	
Total gross revenue	14.9	17.0	14.7	17.0	
Realisation growth (%)					
Total milk products	5.4	11.6	4.0	11.6	
Beverages	3.6	(1.2)	1.5	(1.2)	
Prepared dishes & cooking aids	4.3	3.9	3.0	3.9	
Chocolates & confectionaries	3.5	4.3	3.0	4.3	

Source: Company, Angel Research ; #Note: Denotes CAGR

Exhibit 7: Peer valuation

Company	Reco.	Mcap (₹ cr)	CMP (₹)	TP* (₹)	Upside (%)	P/E (x)		EV/Sales (x)		RoE (%)		CAGR #	
						FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	Sales	PAT
Asian Paints	Accumulate	24,811	2,587	2,767	7.0	24.7	20.6	2.6	2.2	39.9	37.6	17.1	19.7
Britannia	Buy	4,541	380	458	20.5	26.6	18.3	0.9	0.8	35.7	44.5	14.2	11.1
Colgate	Reduce	12,293	904	837	(7.4)	26.6	23.8	4.6	4.1	100.1	87.2	13.5	11.8
Dabur	Buy	17,961	103	123	19.2	23.0	20.1	3.3	2.8	53.1	46.4	23.2	24.8
GSKCHL	Reduce	9,714	2,310	2,144	(7.2)	27.9	23.7	3.2	2.7	32.6	31.5	17.4	17.0
GCPL	Buy	11,824	365	431	17.9	21.3	18.7	3.1	2.8	35.1	26.2	15.2	23.0
HUL	Accumulate	63,007	289	304	5.3	25.5	21.8	2.7	2.4	75.9	77.9	13.2	16.1
ITC	Accumulate	147,102	190	205	8.1	25.1	22.2	5.7	5.0	31.9	30.6	13.5	14.2
Marico	Neutral	8,594	140	145	3.3	28.8	22.3	2.6	2.3	35.9	29.6	11.9	26.0
Nestle	Reduce	36,916	3,829	3,483	(9.0)	37.9	31.9	5.0	4.3	91.1	72.9	16.1	18.9

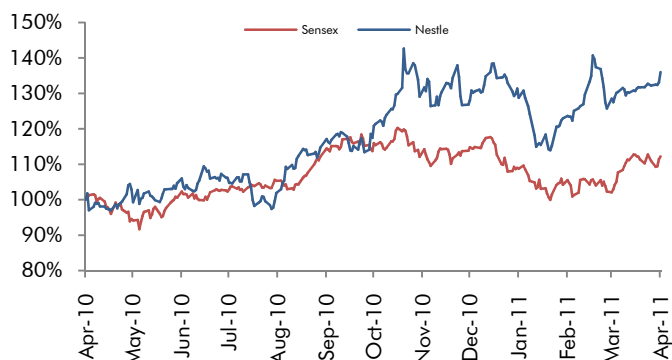
Source: Company, Angel Research, Note: # CAGR for FY2010-12E, * In case of Neutral recommendation, TP = Fair value, \$estimates for CY11 and CY12

Exhibit 8: Angel vs. consensus estimates

Top line (₹ cr)	CY2011E	CY2012E	EPS (₹)	CY2011E	CY2012E
Angel estimates	7,277	8,435	Angel estimates	101.0	120.1
Consensus	7,496	9,018	Consensus	93.5	112.2
Diff (%)	(2.9)	(6.5)	Diff (%)	8.0	7.0

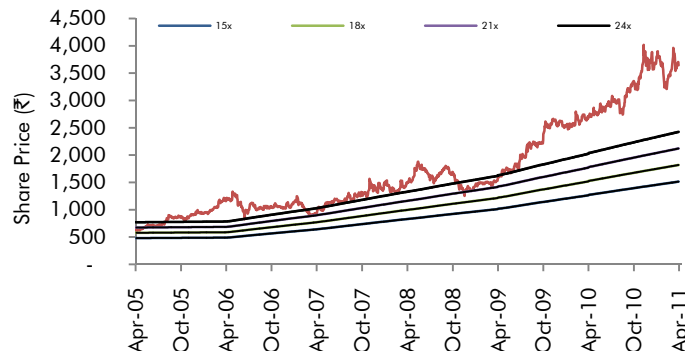
Source: Bloomberg, Angel Research

Exhibit 9: Absolute returns of Nestle vs. Sensex



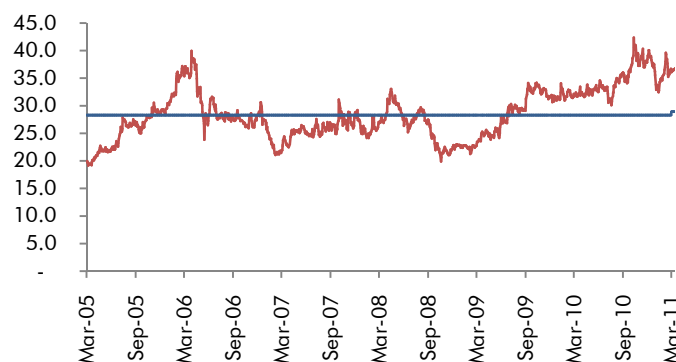
Source: Company, Angel Research

Exhibit 10: One-year forward P/E band



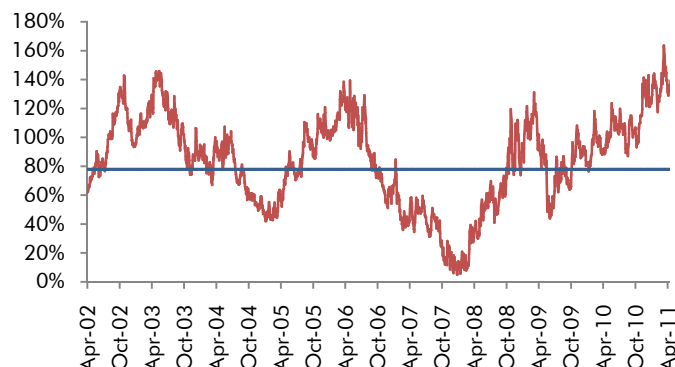
Source: Company, Angel Research

Exhibit 11: One-year forward P/E chart



Source: Company, Angel Research, Note: Blue-line indicates 5-year average

Exhibit 12: One-year forward Premium vs. Sensex chart



Source: Company, Angel Research, Note: Blue-line indicates 5-year average

Profit & loss statement

Y/E Dec (₹ cr)	CY07	CY08	CY09	CY10	CY11E	CY12E
Gross sales	3,647	4,471	5,222	6,377	7,426	8,607
Less: Excise duty	143	147	93	122	149	172
Net Sales	3,504	4,324	5,129	6,255	7,277	8,435
Total operating income	3,504	4,324	5,129	6,255	7,277	8,435
% chg	24.4	23.4	18.6	21.9	16.3	15.9
Total Expenditure	2,808	3,461	4,095	5,005	5,811	6,691
Cost of Materials	1,685	2,104	2,448	3,056	3,563	4,077
Advertising Exp	172	194	268	303	364	422
Personnel	263	307	432	433	509	590
Others	688	855	947	1,213	1,375	1,603
EBITDA	696	864	1,034	1,250	1,466	1,743
% chg	28.6	24.1	19.8	20.8	17.3	18.9
(% of Net Sales)	19.9	20.0	20.2	20.0	20.1	20.7
Depreciation & Amortisation	75	92	111	128	139	161
EBIT	622	771	923	1,122	1,327	1,582
% chg	30.8	24.1	19.7	21.5	18.3	19.2
(% of Net Sales)	17.7	17.8	18.0	17.9	18.2	18.8
Interest & other Charges	1	2	1	1	1	1
Other Income	25	34	38	43	47	55
(% of PBT)	3.9	4.2	3.9	3.7	3.4	3.4
Share in profit of Associates	0	0	0	0	0	0
Recurring PBT	646	804	960	1,163	1,373	1,636
% chg	30.4	24.4	19.4	21.2	18.0	19.1
Extraordinary Expense/(Inc.)	18	31	43	18	15	20
PBT (reported)	629	773	917	1,145	1,358	1,616
Tax	215	239	262	326	384	458
(% of PBT)	33.2	29.7	27.3	28.1	28.0	28.0
PAT (reported)	414	534	655	819	974	1,158
Add: Share of associates	0	0	0	0	0	0
Less: Minority interest (MI)	0	0	0	0	0	0
PAT after MI (reported)	414	534	655	819	974	1,158
ADJ. PAT	431	565	698	837	989	1,178
% chg	30.7	31.0	23.5	20.0	18.1	19.1
(% of Net Sales)	12.3	13.1	13.6	13.4	13.6	14.0
Basic EPS (₹)	42.9	55.4	67.9	84.9	101.0	120.1
Fully Diluted EPS (₹)	42.9	55.4	67.9	84.9	101.0	120.1
% chg	31.3	29.1	22.6	25.0	18.9	18.9

Balance sheet

Y/E Dec. (₹ cr)	CY07	CY08	CY09	CY10	CY11E	CY12E
SOURCES OF FUNDS						
Equity Share Capital	96	96	96	96	96	96
Preference Capital	-	-	-	-	-	-
Reserves & Surplus	322	377	485	759	1,185	1,796
Shareholders' Funds	418	473	581	855	1,282	1,893
Minority Interest	-	-	-	-	-	-
Total Loans	3	-	-	-	-	-
Deferred Tax Liability	29	37	32	33	33	33
Total Liabilities	450	510	613	889	1,315	1,926
APPLICATION OF FUNDS						
Gross Block	1,180	1,405	1,641	1,855	2,140	2,481
Less: Acc. Depreciation	578	652	745	842	981	1,142
Net Block	602	753	896	1,013	1,159	1,338
Capital Work-in-Progress	74	109	80	349	107	124
Goodwill	-	-	-	-	-	-
Investments	94	35	203	151	151	151
Current Assets	638	798	857	1,046	1,747	2,385
Cash	38	194	156	255	815	1,301
Loans & Advances	145	124	138	151	167	194
Other	455	481	563	639	765	890
Current liabilities	958	1,185	1,422	1,670	1,849	2,072
Net Current Assets	(320)	(387)	(566)	(624)	(102)	313
Misc Exp. not written off	-	-	-	-	-	-
Total Assets	450	510	613	889	1,315	1,926

Cash flow statement

Y/E Dec. (₹ cr)	CY07	CY08	CY09	CY10	CY11E	CY12E
Profit before tax	629	773	917	1,145	1,358	1,616
Depreciation	75	92	111	128	139	161
Change in Working Cap	8	84	131	140	31	71
Interest / Dividend (Net)	(4)	(13)	(13)	(18)	(17)	(18)
Direct taxes paid	215	239	262	326	384	458
Others	22	21	(14)	(11)	7	1
Cash Flow from Operations	514	719	871	1,057	1,134	1,372
Inc./ (Dec.) in Fixed Assets	(157)	(261)	(206)	(483)	(44)	(357)
Inc./ (Dec.) in Investments	(17)	60	(168)	53	-	-
Cash Flow from Investing	(174)	(201)	(375)	(431)	(44)	(357)
Issue of Equity	-	-	-	-	-	-
Inc./ (Dec.) in loans	(13)	(3)	-	-	-	-
Dividend Paid (Incl. Tax)	370	372	547	545	547	547
Interest / Dividend (Net)	(4)	(13)	(13)	(18)	(17)	(18)
Cash Flow from Financing	(379)	(362)	(534)	(527)	(530)	(529)
Inc./ (Dec.) in Cash	(39)	156	(38)	100	560	486
Opening Cash balances	76	38	194	156	255	815
Closing Cash balances	38	194	156	255	815	1,301

Key ratios

Y/E Dec.	CY07	CY08	CY09	CY10	CY11E	CY12E
Valuation Ratio (x)						
P/E (on FDEPS)	89.2	69.1	56.4	45.1	37.9	31.9
P/CEPS	75.6	58.9	48.2	39.0	33.2	28.0
P/BV	88.2	78.0	63.5	43.2	28.8	19.5
Dividend yield (%)	0.9	1.1	1.3	1.3	1.3	1.3
EV/Sales	10.5	8.5	7.1	5.9	5.0	4.3
EV/EBITDA	53.0	42.5	35.5	29.3	24.6	20.4
EV / Total Assets	82.0	72.0	59.9	41.3	27.5	18.5
Per Share Data (₹)						
EPS (Basic)	42.9	55.4	67.9	84.9	101.0	120.1
EPS (fully diluted)	42.9	55.4	67.9	84.9	101.0	120.1
Cash EPS	50.7	65.0	79.5	98.2	115.4	136.8
DPS	33.0	42.5	48.5	48.5	48.5	48.5
Book Value	43.4	49.1	60.3	88.7	132.9	196.3
Returns (%)						
RoCE	142.2	160.7	164.3	149.4	120.4	97.6
Angel RoIC (Pre-tax)	141.1	180.9	250.4	219.0	229.6	276.5
RoE	102.5	119.8	124.2	114.0	91.1	72.9
Turnover ratios (x)						
Asset Turnover	3	3	3	3	3	3
Inventory / Sales (days)	42	37	35	34	34	34
Receivables (days)	6	4	5	4	5	5
Payables (days)	48	43	42	44	43	42
Net working capital (days)	(10)	(7)	(7)	(7)	(8)	(9)

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Note: Please refer to the important 'Stock Holding Disclosure' report on the Angel website (Research Section). Also, please refer to the latest update on respective stocks for the disclosure status in respect of those stocks. Angel Broking Limited and its affiliates may have investment positions in the stocks recommended in this report.

Disclosure of Interest Statement

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1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors.

Ratings (Returns) :	Buy (> 15%) Reduce (-5% to 15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)
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