

Nestlé India

Rs2865
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs276.3bn; US\$5.9bn

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Result: Q1CY10

Comment: Inflationary pressure!

Last report: 23 February 2010 (Price Rs2560; Recommendation: Outperformer)

Key valuation metrics

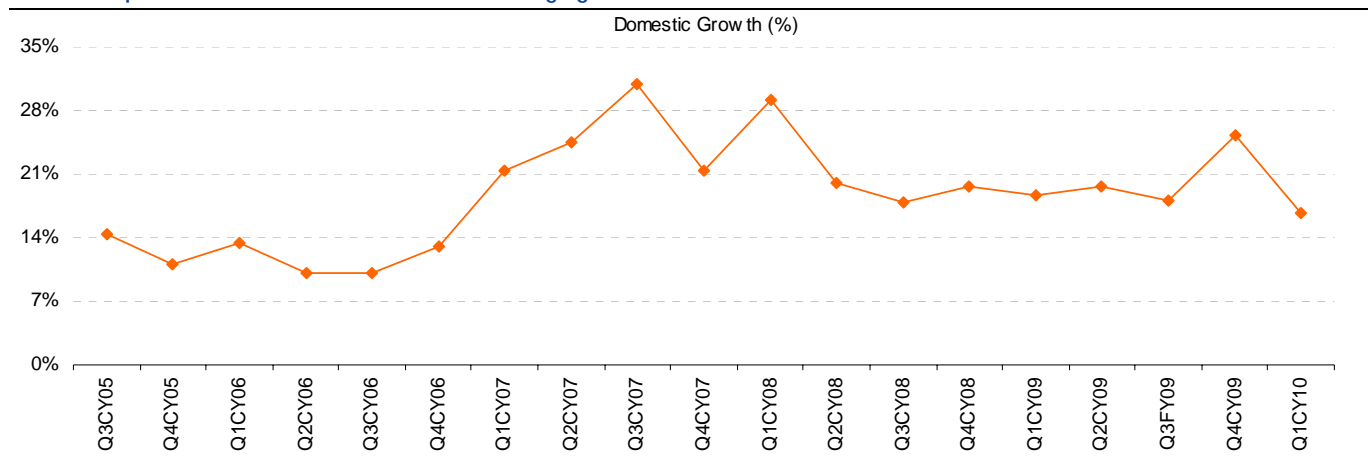
Year to Decemembr 31	Net revenues	yoy chg (%)	Net Profit	EPS	yoy chg (%)	EV/EBITDA	PER (x)
CY07	35,044	24.4	4,142	43.0	31.4	39.8	66.7
CY08	43,242	23.4	5,341	55.4	28.9	31.7	51.7
CY09E	51,294	18.6	6,551	67.9	22.7	26.5	42.2
CY10E	60,340	17.6	7,710	80.0	17.7	23.4	35.8
CY11E	70,470	16.8	9,639	100.0	25.0	18.6	28.7

KEY HIGHLIGHTS OF Q1CY10 RESULTS

- Lower than expectations, Nestle reported a revenue growth of 16.9% at Rs14.8bn (estimates of Rs15.4bn), EBITDA of Rs3.04bn (estimates of Rs3.36bn) and PAT growth of 2.3% at Rs2bn (estimates of Rs2.18bn)
- While the domestic business reported a growth of 16.7% at Rs13.9bn, exports business has reported 20.4% growth at Rs889m (could have been higher but for rupee appreciation).
- The growth was primarily volume led - this was the 18th consecutive quarter of high double digit growth in the domestic business. However, Nestle restrained from taking price increases given the pinch of food inflation (at near 20%) felt by consumers in the past few months
- No product prices increases and higher input cost pressure (milk, sugar and wheat – higher by 30%, 70% and 25% respectively) resulted in gross margin contraction of 263bp. Other expenses too reported a 145bp increase on the back of increase in fuel prices and higher ASP spends.
- EBITDA margins have contracted by 392bp at 20.5% (lower than our estimates of 21.9%).
- During the quarter, Nestle has done a write back of provision to the tune of Rs48m.
- PAT growth of 2.3% was also impacted by an increase in tax rates – up from 29.4% in Q1CY09 to 30% in Q1CY10.
- We believe that input cost pressure may continue for one more quarter before low priced inventory comes into use and a normal monsoon can further lead to softening of commodity prices. Sugar prices have already corrected to ~Rs30/kg from ~Rs50/kg. Also opening up of duty free import of SMP to the tune of 30,000 MT would help ease the pressure. Within Nestle's overall raw material portfolio, fresh milk continues to be a concern.

While Nestle continues to report its 18th consecutive quarter of strong double digit growth, Nestle faced pressure on front end pricing (food inflation) as well as back end (input cost inflation). While inflationary pressure would continue to be a pressure point in the near future, we remain upbeat about Nestle's sustainable double digit volume growth given the attractive categories that it operates in (suited to India consumerism story and organized retail boom) and increased focus on mass segment (through <Rs10 SKUs and deeper distribution). While the competitive intensity is increasing in few of the foods categories (HUL, ITC, GSK Consumer vying for noodles category), we believe that Nestle with few of the strongest consumer brands (Maggi, KitKat, Nescafe, Munch, Polo, Milkmaid, Everyday, etc) will sustain the growth momentum. While near term stock upside is limited given the inflationary pressure and valuations of 28.6x CY11E, we see merit in Nestle commanding the premium valuations in the long term and believe that any price dips on subdued results should be seen as a buying opportunity. Maintain Outperformer with a price target of Rs3000.

Domestic operations continue to see robust double digit growth



Cost Structures

Cost Structures as a % of sales	Q1CY10	Q1CY09	Change in bp
Raw Material	49.8	47.2	263
Employee expenses	6.7	6.9	(16)
Other expenses	22.9	21.4	145

Quarterly Results

(Rs M)	Q1CY09	Q2CY09	Q3CY09	Q4CY09	CY09	Q1CY10	CY10E	CY11E
Sales	12,659	12,095	13,022	13,518	51,294	14,798	60,340	70,470
% yoy	16.0	16.8	17.6	24.0	18.6	16.9	17.6	16.8
Total Expenditure	9,562	9,478	10,380	11,585	40,948	11,758	48,740	56,067
EBIDTA	3,097	2,618	2,642	1,933	10,346	3,040	11,599	14,403
Operating Margin (%)	24.5	21.6	20.3	14.3	20.2	20.5	19.2	20.4
Other Income	103	88	88	106	378	91	488	583
Interest	2	6	2	5	14	6	0	0
Depreciation	256	264	302	307	1113	310	1272	1418
PBT	2,943	2,436	2,427	1,727	9,597	2,816	10,815	13,568
Provisions and write offs	105	102	(60)	156	426	(48)	180	180
Current tax	864	654	659	442	2,620	845	2,925	3,749
Deferred tax	0	0	0	0		0		
Tax Rate (%)	29	27	27	26	27	30	27	28
PAT	1973	1680	1828	1129	6,551	2019	7,710	9,639
% yoy	23.2	33.8	38.7	-6.7	22.7	2.3	17.7	25.0

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2. Neutral: Within 0-5% to Index
3. Underperformer: Less than 5% to Index

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