



Nestle India

STOCK INFO. BLOOMBERG
BSE SENSEX: 19,633 NEST IN
REUTERS CODE
S&P CNX: 5,908 NEST.BO

19 November 2007

Buy

Rs1,447

Previous Recommendation: Buy

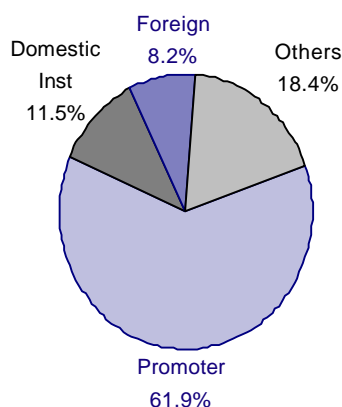
Equity Shares (m)	96.4
52-Week Range	1,663/876
1,6,12 Rel. Perf. (%)	4/-9/-6
M.Cap. (Rs b)	139.5
M.Cap. (US\$ b)	3.5

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
12/06A	28,161	3,269	33.9	-0.6	42.7	23.0	53.8	79.0	4.9	25.6
12/07E	34,976	4,416	45.8	35.1	31.6	20.4	64.5	95.6	3.9	19.2
12/08E	41,236	5,555	57.6	25.8	25.1	18.2	72.5	107.7	3.3	15.3

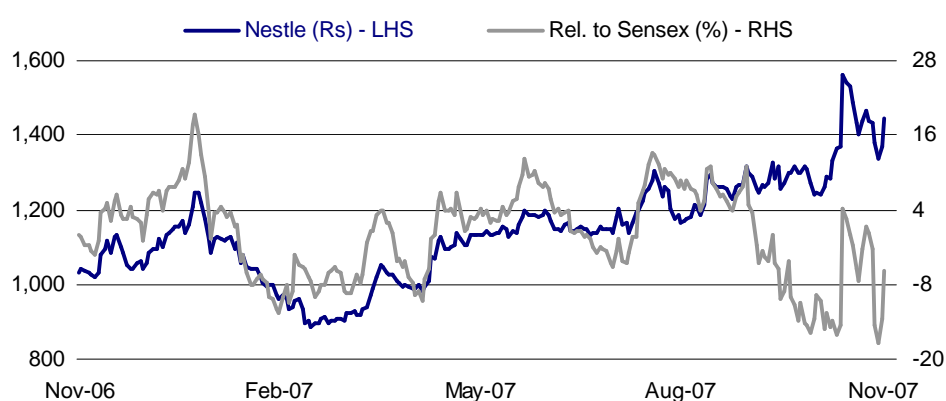
* Excluding extraordinary items and provisions

- We interacted with the management of Nestle India at the recently organized analyst meet. The management is confident in sustaining growth rates exhibited in the past few quarters and we believe that the momentum can further pick from here. Nestle believes that growing middle class and rising consumer confidence is resulting in consumers looking at improving the quality of life. Nestle is uniquely placed to tap this potential due to strong brands, R&D support of the parent and SBU focus.
- Domestic volume and value growth during 9MCY07 was 15.5% and 25.6%. Exports grew volumes and value by 2.4% and 16.3%. Exports were impacted by ban on milk exports, rupee appreciation and lower coffee export volumes. The growth rates compare favorably with 9% sales CAGR in past five years. Prepared Dishes and Chocolates & Confectionary grew volumes by 27.8% and 18.6% while domestic instant coffee volumes grew 13.2% for 9MCY07.
- Raw material costs continue to be a concern as prices of all major inputs like wheat flour, coffee, milk etc are strong. 9mCY07 price increase of Milk, Coffee and Wheat was 25%, 35% and 15%. The company has successfully demonstrated its brand strength by undertaking more than 10% price increase in Milk products and coffee. Launch of value added products and economies of scale has enabled it to improve EBITDA margins by 110bp.
- The company continued to focus on innovation and renovation which has enabled it to launch new products like Milkmaid Funshake, Polo Zero, Cerelac Multigrain, Orange and lemonade Juice Drinks concentrate and Nescafe Mild Coffee in the past few months. Success of Nescafe Mild can significantly increase beverage growth rates.
- We believe that Nestle is one of the best plays on huge growth potential in food processing sector in India due to resurgent urban India and rising affordability in tier II and tier III cities. Strong brands and launch of new products and variants would enable the company post sales and PAT growth of 17.2% and 24% over CY07-09. The stock trades at 25.1x CY08E and 20.5x CY09E earnings. Maintain **Buy** with target price of Rs1,768, a 22% upside.

SHAREHOLDING PATTERN (SEP.07)



STOCK PERFORMANCE (1 YEAR)



Nestle best placed to tap huge opportunity in processed foods

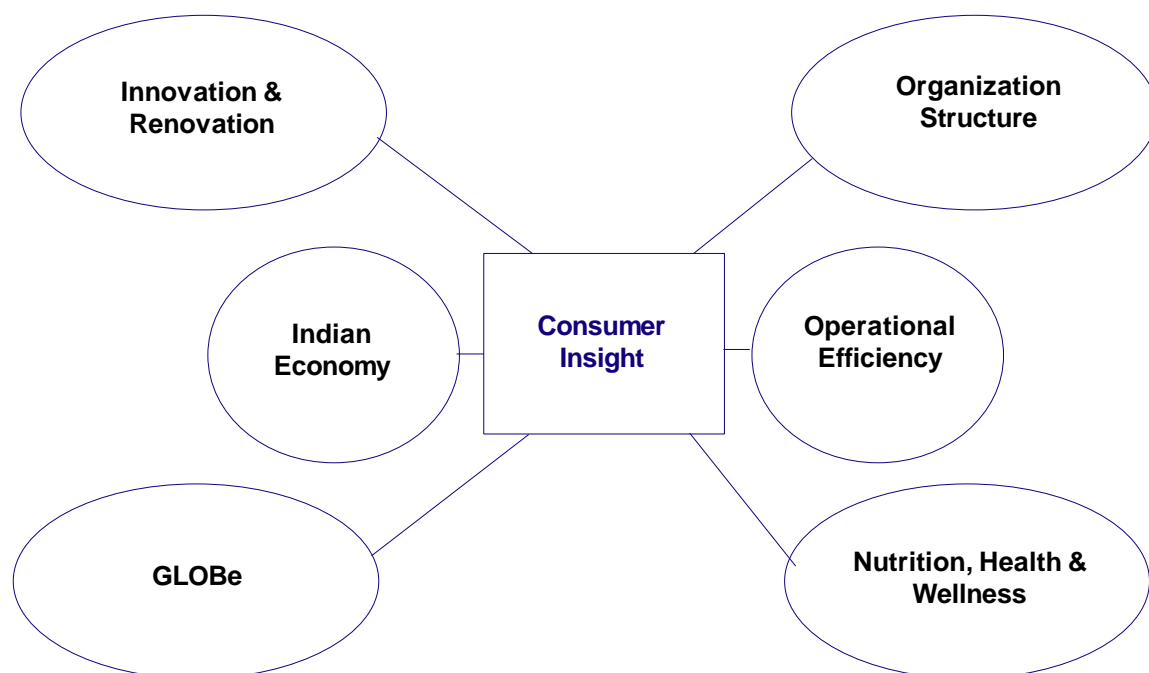
Growing middle class and consumer confidence is resulting in more consumers looking at improving the quality of life. Food processing is likely to emerge as one of the fastest growing areas due to changing lifestyles and trends. The company is uniquely placed to exploit this growth opportunity on account of strong brands, technology support from parent and ability to launch a variety of nutritional products. Nestle would be looking at leveraging its global strengths across verticals and entry into new product categories seems to be on a backseat as of now. Management seems more inclined at leveraging existing brands and launch of new variants and value added products in existing categories which it has exhibited successfully in Maggi Noodles, Soups, Infant food and chilled dairy products in the past one year.

SBU focus and Focused Management and access to its global R&D

Nestle has undergone mindset change in the organization with focus on external benchmarking rather than being more

inward looking organization; this coupled with innovation and renovation of products, Globe ERP initiative and SBU focus has pushed the company into a new growth trajectory. Further, Nestle India has access to global technology, brands and product development skills of the parent which spends US\$1.5b every year on R&D. The company continued to focus on innovation and renovation which has enabled it to launch new products like Milkmaid Funshake, Polo Zero, Cerelac Multigrain, Orange and lemonade Juice Drinks concentrate and Nescafe Mild Coffee in the past few months. The company has launched Maggi Rice Mania and Dal Atta Noodles, Variants in Ketchup and Soups in the culinary range in early 2007. The company has launched a whole lot of products across segments on health platform which include Slim Milk and Dahi, Probiotic Dahi, fruit Yogurts, sugar free chocolates and confectionary and drinks. We expect the company to focus on launch of new products and leverage the strong R&D focus of its parents, which would result in further pick up in growth rates.

KEY DRIVERS OF GROWTH MOMENTUM



Source: Company/Motilal Oswal Securities

Strong pickup in growth; trend likely to further pick up

Domestic volume and value growth during 9MCY07 was 15.5% and 25.6% respectively which reaffirms our bullish view. This compares favorably with 9% CAGR in sales in the past five years. Sustainance of this kind of growth is possible as it is broad based with positive trend. All the product categories for the company have witnessed strong growth during Jan-Sep 2007.

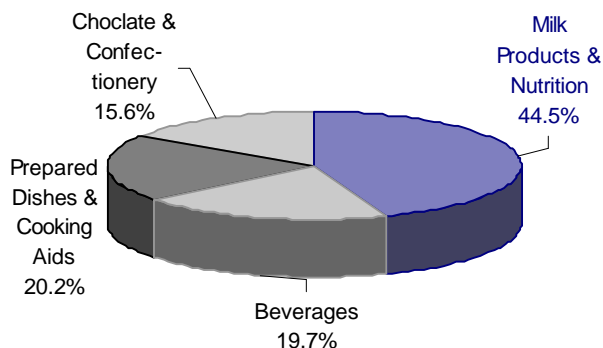
NESTLE INDIA – 9MCY07 GROWTH RATES (YOY)

	VOLUME	VALUE
	GR. (%)	GR. (%)
Prepared Dishes & Cooking Aids	27.8	33.2
Chocolates and Confectionary	18.6	27.4
Beverages	8.9	22.3
Milk Products	4.9	21.1

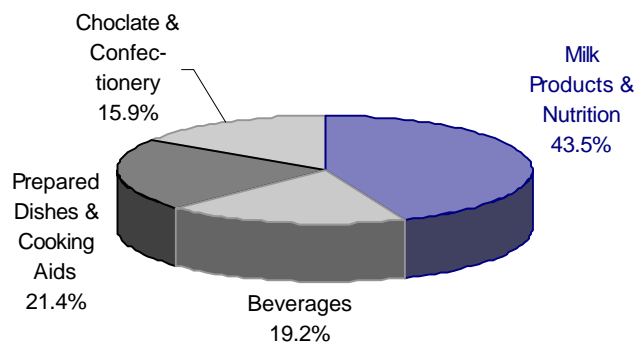
Source: Company/Motilal Oswal Securities

NESTLE INDIA: SALES MIX

9MCY06



9MCY07

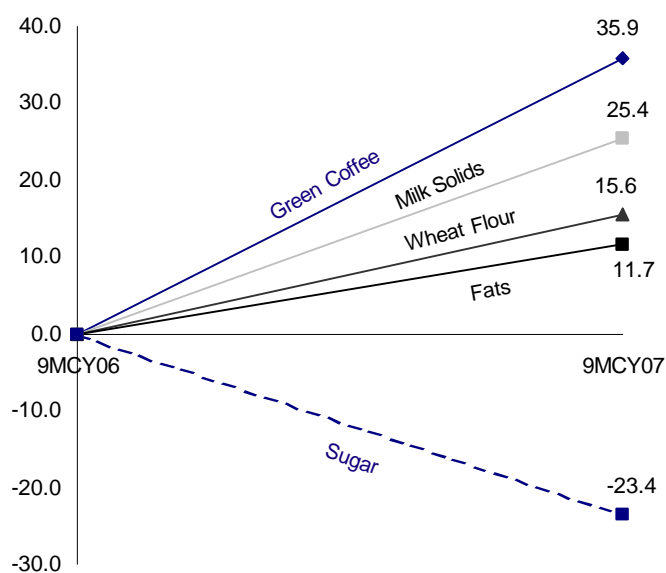


Source: Company/Motilal Oswal Securities

Raw Material price pressure continues

Prices of key raw material continue to remain firm. Milk and skimmed milk cost (47% of raw material cost) is up 25.4% YoY. Wheat and Green Coffee also witnessed steep increase in cost at 15.6% and 35.9% respectively. Sugar which account for 8% of the raw material decline by 23.4%. Nestle India has been undertaking selective price increase to pass on a part of the input price increase. Nestle has increased prices in double digits in Milk products and Coffee. The company has been able to report higher volume growth which indicates brands strength. The company has launched value-added variants of several products that are priced at a premium of 25-50% in competitive categories like Prepared Dishes and Confectionary. Strong focus on cost cutting and increase in scale of operations has enabled the company increase 110bp expansion in EBIDTA margins. We expect the raw material prices to hold strong in key categories like Wheat Flour, Milk Solids and Coffee. Nestle has increased the raw material inventory by Rs1b, which would enable the company in managing costs in a smooth manner.

PRICE CHANGE IN KEY RAW MATERIALS (% YOY)

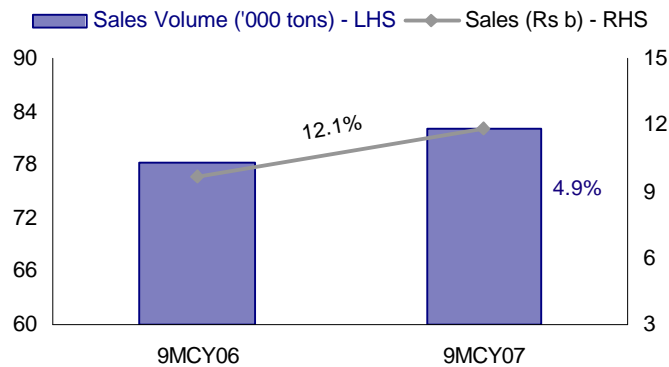


Source: Company/Motilal Oswal Securities

Milk Products and Nutrition

- 4.9% volume growth and 21.1% value growth during 9mCY07 YoY v/s 2.8% volume growth in last two years
- Low single digit volume growth due to ban on export of milk products in 3QCY07, adjusted volume growth in mid teens
- Double digit price increase in Infant formula and Baby foods; market leader in baby foods and close to being a leader in infant formula
- Launch of Cerelac Multigrain, Milkmaid Fun shakes, Nesvita Probiotic and Slim Dahi and fruit flavored Yogurts; market leadership in Probiotic products
- Chilled dairy growing in high double digits; albeit on a small base

SALES VOLUME ('000 TONS)

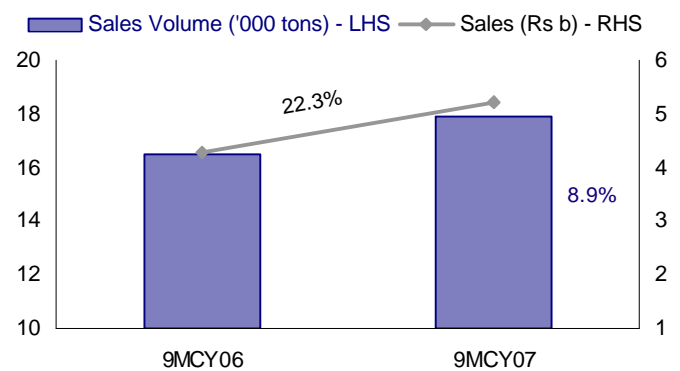


Source: Company/Motilal Oswal Securities

Beverages

- 8.9% increase in volumes and 22.3% increase in 9mCY07 sales YoY v/s 5% CAGR decline in volumes in last three years
- Low growth in US exports of coffee impact exports volumes; coffee exports share to the total exports declines to 64%
- 12.3% volume growth in domestic instant coffee volumes; 60bp increase in market share to 54.9%
- Launch of Nestle Orange and Lemonade juice concentrates and Nescafe Mild coffee
- Launch of Nescafe in small packs of Rs1,2 and Rs 5 aimed at increasing penetration
- Can emerge as next big growth driver in the domestic market

SALES VOLUME ('000 TONS)

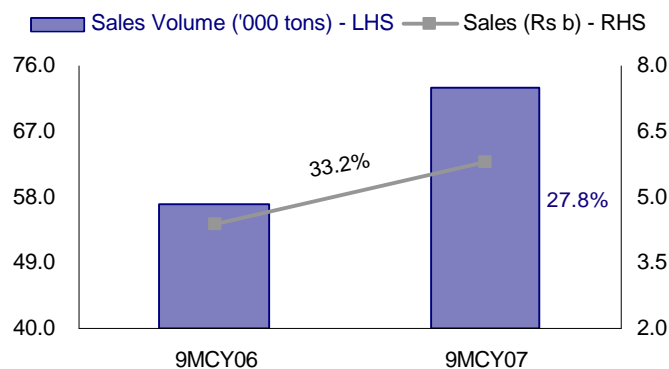


Source: Company/Motilal Oswal Securities

Prepared Dishes and Cooking Aids

- 27.8% increase in volumes and 33.2% increase in sales value for 9mCY07, led by Maggi Noodles and Soups, v/s 11% CAGR in volumes in last three years
- New variants of Maggi Noodles account for 10% of sales volume; enable increase in overall realizations
- Strong growth trend to continue in coming years

SALES VOLUME ('000 TONS)

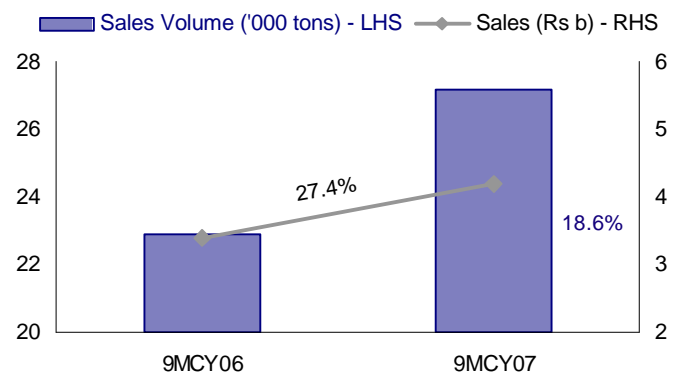


Source: Company/Motilal Oswal Securities

Chocolates and confectionary

- 18.6% increase in volumes and 27.4% increase in sales value for 9mCY07 v/s 12.3% volume CAGR in last three years
- Maintains market leadership in wafers, white chocolates and Éclairs (32.4% volume share)
- Launched Polo Sugar Free and Tang Eez

SALES VOLUME ('000 TONS)



Source: Company/Motilal Oswal Securities

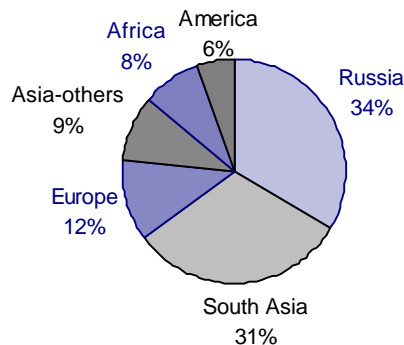
Lower dependence on Russia and Coffee exports is positive

Nestle has been diversifying its geographical spread of exports - Russia accounts for 34% while South Asia accounts for 31% of exports. Beverages continue to account for 64% of exports while Milk products contribute 27%. The company has been consciously reducing the exports dependence on coffee and Russian market as it had suffered in the past when the parent had set up an instant coffee facility over there. Decline in contribution of Russian coffee exports has considerably reduced the risks associated with exports to a single geography.

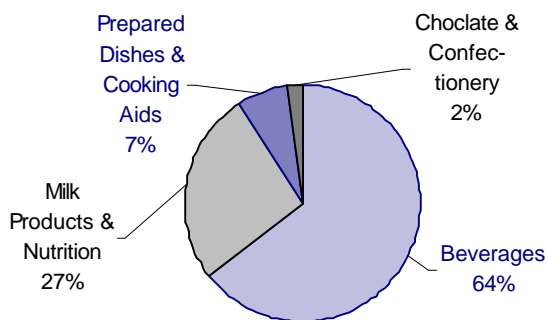
Valuation and view

We believe that Nestle is one of the best plays on huge growth potential in food processing sector in India due to resurgent urban India and rising affordability in tier II and tier III cities. Strong brands and launch of new products and variants would enable the company post sales and PAT growth of 17.2% and 24% over CY07-09. The stock trades at 25.1x CY08E and 20.5x CY09E earnings. **Maintain Buy** with target price of Rs1,768, a 22% upside.

GEOGRAPHICAL EXPORTS MIX (JAN-SEP 2007)



EXPORT MIX: PRODUCT CATEGORYWISE



Source: Company/Motilal Oswal Securities

INCOME STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2005	2006	2007E	2008E	2009E
Domestic Sales	23,930	26,646	33,314	39,442	46,026
Export Sales	2,509	2,796	3,095	3,430	3,867
Net Sales	24,770	28,161	34,976	41,236	48,053
Change (%)	11.2	13.7	24.2	17.9	16.5
Total Expenditure	-19,549	-22,776	-27,794	-32,302	-37,249
EBITDA	5,221	5,385	7,182	8,934	10,804
Change (%)	15.7	3.1	33.4	24.4	20.9
Margin (%)	21.1	19.1	20.5	21.7	22.5
Depreciation	-568	-663	-734	-820	-878
Int. and Fin. Ch.	-2	-4	-5	-5	-5
Other Inc.- Rec.	233	206	247	307	411
PBT	4,884	4,924	6,691	8,417	10,332
Change (%)	17.5	0.8	35.9	25.8	22.8
Margin (%)	19.7	17.5	19.1	20.4	21.5
Tax	-1,483	-1,562	-2,093	-2,633	-3,232
Deferred Tax	-112	-92	-182	-229	-281
Tax Rate (%)	-32.7	-33.6	-34.0	-34.0	-34.0
Adjusted PAT	3,289	3,269	4,416	5,555	6,819
Change (%)	17.1	-0.6	35.1	25.8	22.8
Margin (%)	13.3	11.6	12.6	13.5	14.2
Non-rec. (Exp)/Inc.	-197	-119	-280	-330	-384
Reported PAT	3,092	3,151	4,136	5,225	6,435

BALANCE SHEET					
(RS MILLION)					
Y/E DECEMBER	2005	2006	2007E	2008E	2009E
Share Capital	964	964	964	964	964
Reserves	4,649	5,111	5,880	6,696	7,516
Net Worth	5,613	6,075	6,844	7,660	8,481
Loans	143	163	163	163	163
Capital Employe	5,756	6,238	7,007	7,822	8,643
Gross Block	9,494	10,583	12,357	13,264	14,171
Less: Accum. Depn.	-4,757	-5,165	-5,899	-6,719	-7,597
Net Fixed Asset:	4,738	5,418	6,458	6,545	6,575
Capital WIP	228	382	402	422	443
Investments	1,044	778	1,180	2,071	3,308
Curr. Assets, L&	4,627	5,354	5,758	6,721	7,620
Inventory	2,531	2,762	3,135	3,566	4,083
Account Receivable	305	558	399	470	547
Cash and Bank Bal	366	764	549	714	694
Others	1,424	1,270	1,675	1,972	2,295
Curr. Liab. and F	4,781	5,502	6,418	7,335	8,419
Account Payables	3,165	3,697	4,588	5,180	5,912
Other Liabilities	34	39	55	64	75
Provisions	1,583	1,766	1,775	2,090	2,432
Net Curr. Assets	-155	-149	-659	-613	-799
Def. Tax Liability	-100	-192	-374	-602	-884
Appl. of Funds	5,756	6,238	7,007	7,822	8,643

E: MOST Estimates

RATIOS					
Y/E DECEMBER	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	34.1	33.9	45.8	57.6	70.7
Cash EPS	40.0	40.8	53.4	66.1	79.8
BV/Share	58.2	63.0	71.0	79.4	88.0
DPS	25.0	25.5	34.8	44.9	56.6
Payout %	73.3	75.2	76.0	78.0	80.0
Valuation (x)					
P/E		42.7	31.6	25.1	20.5
Cash P/E		35.5	27.1	21.9	18.1
EV/Sales		4.9	3.9	3.3	2.8
EV/EBITDA		25.6	19.2	15.3	12.6
P/BV		23.0	20.4	18.2	16.4
Dividend Yield (%)		1.8	2.4	3.1	3.9
Return Ratios (%)					
RoE	58.6	53.8	64.5	72.5	80.4
RoCE	84.9	79.0	95.6	107.7	119.6
Working Capital Ratios					
Debtor (Days)	4	7	4	4	4
Asset Turnover (x)	4.3	4.5	5.0	5.3	5.6
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2005	2006	2007E	2008E	2009E
OP/(loss) before Ta	4,653	4,722	6,448	8,114	9,926
Int./Div. Received	233	206	247	307	411
Depreciation and Ar	568	663	734	820	878
Interest Paid	-2	-4	-5	-5	-5
Direct Taxes Paid	-1,483	-1,562	-2,093	-2,633	-3,232
(Incr)/Decr in WC	-326	392	297	118	167
CF from Operati	3,643	4,416	5,629	6,722	8,145
Extraordinary Items	0	0	0	0	0
(Incr)/Decr in FA	-1,000	-1,242	-1,794	-927	-928
(Pur)/Sale of Investr	504	267	-402	-891	-1,237
CF from Invest.	-496	-976	-2,196	-1,818	-2,166
Issue of Shares	0	0	0	0	0
(Incr)/Decr in Debt	-64	-20	0	0	0
Dividend Paid	-2,748	-2,791	-3,927	-5,070	-6,383
Others	-63	-232	280	330	384
CF from Fin. Act	-2,875	-3,042	-3,647	-4,740	-5,999
Incr/Decr of Cas	272	398	-214	164	-20
Add: Opening Balan	94	366	764	549	714
Closing Balance	366	764	550	714	694

N O T E S



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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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