

# Nestle India

## Back to growth

NI's net sales grew 24.7% and EBITDA rose 31% in 1Q07. Its EBITDA margin had fallen in 2006 due to high commodity prices. Hence the 1Q07 margin expansion of 110bp is reassuring. We maintain our Buy rating and target price of Rs1,353.

### Key forecasts

	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue (Rsm)	26438.9	29437.2	34184.3	39310.0	45288.1
EBITDA (Rsm)	5601.6	5380.2	6943.0	7992.7	9207.8
Reported net profit (Rsm)	3476.8	3146.2	4358.6	5080.7	5900.7
Normalised net profit (Rsm) <sup>1</sup>	3673.6	3264.7	4438.6	5160.7	5980.7
Normalised EPS (Rs)	38.1	33.9	46.0	53.5	62.0
Dividend per share (Rs)	25.0	25.5	30.0 ▼	35.0	40.0
Dividend yield (%)	2.33	2.38	2.80	3.27	3.73
Normalised PE (x)	28.1	31.6	23.3 ▲	20.0	17.3
EV/EBITDA (x)	18.4	19.1	14.8	12.7	11.0
Price/book value (x)	28.4	25.3	20.1	16.2	13.1
ROIC (%)	104.9	91.1	118.7	99.2	111.1

1. Post-goodwill amortisation and pre-exceptional items  
Accounting Standard: Local GAAP  
Source: Company data, ABN AMRO forecasts

year to Dec, fully diluted

### Strong growth momentum in 1Q07

NI reported overall sales growth of 24.7%, with gross domestic sales growing 21.3% and exports growing 70%. Domestic sales growth was driven by strong double-digit volume growth in all categories - milk and nutrition, beverages, culinary products and chocolates and confectionery, and by the full impact of selective price hikes in 4Q06. Consequently, NI's EBITDA margins improved 110bp yoy, reversing the 190bp drop in 2006 EBITDA margins.

### NI dominates key product categories

The milk products and infant nutrition category contributes 44.8% to NI's sales, and the company is market leader in baby foods, infant formula and sweetened condensed milk. It is a strong No2 player in dairy whitener, and it is expanding its presence in fresh dairy business like yoghurt and milk. The beverages category contributes 19.7% to its sales and NI is the market leader in instant coffee. Culinary products account for 20% of sales, and NI is the market leader in instant noodles and ketchups, and a strong No2 player in healthy soups. The chocolates and confectionery business accounts for 15.5% of NI's sales. NI is the market leader in wafers, eclairs and chocolates and No2 in other range of chocolates.

### Entry barrier to NI's category is high; hence NI has good pricing power

The manufacturing process in most of NI's above product categories is more technology intensive than in most other FMCG categories. Hence, NI is less exposed to regional competition. NI's EBITDA margins have been 18.3% to 21.2% in the last five years compared to HLL's 13-19.65% in this period. NI's EBITDA CAGR has averaged 15% over the last 10 years, driven by domestic sales growth of 11%.

### We maintain Buy with a target price of Rs1,353

We have raised provision for contingencies in 2007, hence cut our 2007F earnings by 4.9% and raised 2008F by 1.3%, reflecting better sales growth momentum. NI trades at similar valuations to HLL, and we retain our DCF-based target price of Rs1,353.

## Buy

Absolute performance

n/a

Short term (0-60 days)

Neutral

Market relative to region

Food, Beverage & Tobacco

India

Price

Rs1071.15

Target price

Rs1353.00

Market capitalisation

Rs103.27bn (US\$2.51bn)

Avg (12mth) daily turnover

Rs28.03m (US\$0.63m)

Reuters

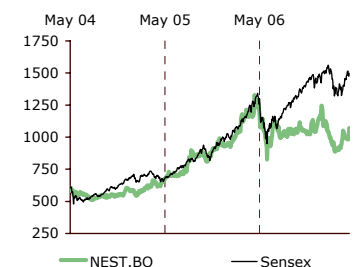
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Bloomberg

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### Price performance (1M) (3M) (12M)

	1M	3M	12M
Price (Rs)	973.8	1060.2	1275.5
Absolute %	10.0	1.0	-16.0
Rel market %	-1.4	3.4	-26.6
Rel sector %	6.1	-6.2	-31.3



Stock borrowing: n/a

Volatility (30-day): 28.49%

Volatility (6-month trend): ↑

52-week range: 1387.00-800.00

Sensex: 14078.21

BBG AP Food Prod & Proc: 202.66

Source: ABN AMRO, Bloomberg

Researched by

ABN AMRO Institutional  
Equities Team

[www.abnamrobroking.co.in](http://www.abnamrobroking.co.in)

**Table 1 : Earnings revision table**

	Old	New	Change
2007F	48.4	46.03	-4.9%
2008F	52.85	53.52	1.3%
2009F		62.03	

Source: ABN AMRO forecasts

**Table 2 : Quarterly results trend**

	1Q 2007	1Q 2006	Growth	4Q 06	4Q 05	Growth
Net sales	8994.1	7210.3	24.7%	7,688.80	6,680.30	15.1%
Exports	862.4	507.6	69.9%	760.10	555.40	37%
Domestic sales	8131.7	6702.7	21.3%	6,928.70	6,124.90	13.1%
Expenditure	7205.8	5844.9		6,486.20	5,499.20	
+/- stock-in-trade	-519.4	-229.4		-517.70	-264.00	
Raw Material	4600.2	3280.3		3,856.90	2,920.10	
Staff Cost	646.1	515.6		569.40	440.70	
Other Expenditure	2115.6	1827.3		2,577.60	2,402.40	
EBITDA	1788	1365.4	31.0%	1,202.60	1,181.10	2%
Margin	20%	18.9%		15.64%	17.68%	
Interest	1.9	0.3		1.40	0.40	
Depreciation	179.3	157.1		177.10	153.70	
Other income	69.5	50.4		73.00	57.50	
PBT	1676.6	1258.4	33.2%	1,097.10	1,084.50	
Ext (write-offs)/ write back	-29.6	126.6	-123.4%	163.40	25.00	
Tax	562.5	498.9	12.7%	303.20	305.20	
PAT	1084.5	886.1	22.4%	630.50	754.30	-16%
Exports to total	9.6%	7.0%		9.9%	8.3%	
Rm to net sales	45.4%	42.3%		43.4%	39.8%	

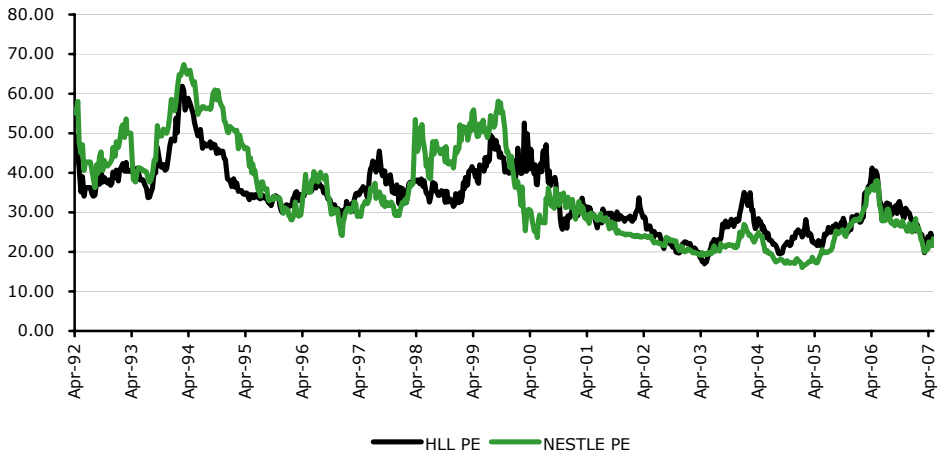
Source: Company releases

**Table 3 : Evolution of Nestle India over last 10 years**

(Rs m)	Domestic sales	Exports	EBITDA
1996	9,301	2,199	1365
1997	10,540	3,169	2005
1998	11,847	3,471	2051
1999	12,520	2,126	2265
2000	13,158	2,655	2732
2001	15,106	3,099	3144
2002	17,001	2,362	3990
2003	18,758	2,528	4327
2004	19,837	2,435	4580
2005	22,177	2,592	5602
2006	25,360	2,796	5380
CAGR-10 years	11%	2%	15%
CAGR-last 5 years	11%	4%	11%

Source: Company accounts

**Chart 1 : Hindustan Lever & Nestle India PER trend**



Source: ABN AMRO

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## NESTLE INDIA: KEY FINANCIAL DATA

### Income statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Revenue	26438.9	29437.2	34184.3	39310.0	45288.1
Cost of sales	-10876	-13201	-14904	-17139	-19746
Operating costs	-9961.8	-10856	-12337	-14178	-16335
<b>EBITDA</b>	<b>5601.6</b>	<b>5380.2</b>	<b>6943.0</b>	<b>7992.7</b>	<b>9207.8</b>
DDA & Impairment (ex gw)	-568.4	-662.8	-687.1	-749.1	-842.1
<b>EBITA</b>	<b>5033.2</b>	<b>4717.3</b>	<b>6255.8</b>	<b>7243.6</b>	<b>8365.7</b>
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
<b>EBIT</b>	<b>5033.2</b>	<b>4717.3</b>	<b>6255.8</b>	<b>7243.6</b>	<b>8365.7</b>
Net interest	-2.10	-4.41	-1.00	-11.1	-9.26
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	237.4	206.1	370.0	470.0	570.0
<b>Reported PTP</b>	<b>5268.5</b>	<b>4919.0</b>	<b>6624.8</b>	<b>7702.5</b>	<b>8926.4</b>
Taxation	-1594.9	-1654.3	-2186.2	-2541.8	-2945.7
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	-196.8	-118.5	-80.0	-80.0	-80.0
Other post-tax items	0.00	0.00	0.00	0.00	0.00
<b>Reported net profit</b>	<b>3476.8</b>	<b>3146.2</b>	<b>4358.6</b>	<b>5080.7</b>	<b>5900.7</b>
Normalised Items Excl. GW	-196.8	-118.5	-80.0	-80.0	-80.0
<b>Normalised net profit</b>	<b>3673.6</b>	<b>3264.7</b>	<b>4438.6</b>	<b>5160.7</b>	<b>5980.7</b>

Source: Company data, ABN AMRO forecasts

year to Dec

### Balance sheet

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
Cash & market secs (1)	366.5	763.6	500.0	1500.0	2500.0
Other current assets	4260.5	4590.2	3992.4	4528.4	5154.8
Tangible fixed assets	4966.0	5800.4	5383.8	5635.7	6294.6
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	1044.3	777.7	2700.0	2700.0	2700.0
<b>Total assets</b>	<b>10637.2</b>	<b>11931.8</b>	<b>12576.3</b>	<b>14364.1</b>	<b>16649.4</b>
Short term debt (2)	0.00	0.00	0.00	0.00	0.00
Trade & oth current liab	6853.3	7688.7	7256.1	7893.6	8638.5
Long term debt (3)	143.0	162.7	179.4	97.0	134.5
Oth non-current liab	0.00	0.00	0.00	0.00	0.00
<b>Total liabilities</b>	<b>6996.3</b>	<b>7851.4</b>	<b>7435.5</b>	<b>7990.7</b>	<b>8772.9</b>
Total equity (incl min)	3640.9	4080.4	5140.8	6373.5	7876.5
<b>Total liab &amp; sh equity</b>	<b>10637.2</b>	<b>11931.8</b>	<b>12576.3</b>	<b>14364.1</b>	<b>16649.4</b>
Net debt (2+3-1)	-223.4	-600.9	-320.6	-1403.0	-2365.5

Source: Company data, ABN AMRO forecasts

year ended Dec

### Cash flow statement

Rsm	FY05A	FY06A	FY07F	FY08F	FY09F
EBITDA	5601.6	5380.2	6943.0	7992.7	9207.8
Change in working capital	-102.3	505.8	165.2	101.5	118.4
Net interest (pd) / rec	-2.10	-4.41	-1.00	-11.1	-9.26
Taxes paid	-1594.9	-1654.3	-2186.2	-2541.8	-2945.7
Other oper cash items	237.4	206.1	370.0	470.0	570.0
<b>Cash flow from ops (1)</b>	<b>4139.7</b>	<b>4433.3</b>	<b>5290.9</b>	<b>6011.3</b>	<b>6941.3</b>
Capex (2)	-1221.3	-1497.3	-270.6	-1001.0	-1501.0
Disposals/(acquisitions)	0.00	0.00	0.00	-80.0	-80.0
Other investing cash flow	504.4	266.5	-1922.3	0.00	0.00
<b>Cash flow from invest (3)</b>	<b>-716.9</b>	<b>-1230.7</b>	<b>-2192.9</b>	<b>-1081.0</b>	<b>-1581.0</b>
Incr / (decr) in equity	-342.4	96.8	0.00	0.00	0.00
Incr / (decr) in debt	64.0	19.6	16.7	-82.3	37.4
Ordinary dividend paid	-2675.7	-2803.4	-3298.3	-3848.0	-4397.7
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	-196.8	-118.5	-80.0	0.00	0.00
<b>Cash flow from fin (5)</b>	<b>-3150.8</b>	<b>-2805.5</b>	<b>-3361.6</b>	<b>-3930.3</b>	<b>-4360.3</b>
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
<b>Incr/(decr) cash (1+3+5+6)</b>	<b>272.0</b>	<b>397.1</b>	<b>-263.6</b>	<b>1000.0</b>	<b>1000.0</b>
Equity FCF (1+2+4)	2918.4	2936.1	5020.3	5010.3	5440.3

Lines in bold can be derived from the immediately preceding lines.  
Source: Company data, ABN AMRO forecasts

year to Dec

## NESTLE INDIA: PERFORMANCE AND VALUATION

Standard ratios	Nestle India					Hindustan Lever			Nestle R		
Performance	FY05A	FY06A	FY07F	FY08F	FY09F	FY06F	FY07F	FY08F	FY07F	FY08F	FY09F
Sales growth (%)	11.4	11.3	16.1	15.0	15.2	9.43	12.0	13.0	7.34	8.08	5.41
EBITDA growth (%)	22.3	-3.95	29.0	15.1	15.2	14.2	24.0	18.8	9.13	9.36	7.56
EBIT growth (%)	23.1	-6.28	32.6	15.8	15.5	15.1	24.9	19.4	10.5	10.7	8.49
Normalised EPS growth (%)	30.8	-11.1	36.0	16.3	15.9	17.5	22.9	17.4	10.3	9.78	9.53
EBITDA margin (%)	21.2	18.3	20.3	20.3	20.3	13.6	15.1	15.9	16.4	16.6	16.9
EBIT margin (%)	19.0	16.0	18.3	18.4	18.5	12.5	14.0	14.8	13.4	13.7	14.1
Net profit margin (%)	13.9	11.1	13.0	13.1	13.2	12.7	14.0	14.5	9.35	9.51	9.89
Return on avg assets (%)	36.6	29.0	36.2	38.4	38.6	23.5	26.2	28.0	10.9	11.8	12.7
Return on avg equity (%)	107.7	84.6	96.3	89.6	83.9	60.9	65.9	70.2	18.3	18.1	17.8
ROIC (%)	104.9	91.1	118.7	99.2	111.1	84.9	86.4	97.2	9.95	9.84	10.4
ROIC - WACC (%)	93.0	79.2	106.8	87.3	99.2	73.4	74.9	85.7	2.83	2.72	3.25
				<i>year to Dec</i>			<i>year to Dec</i>			<i>year to Dec</i>	
<b>Valuation</b>											
EV/sales (x)	3.90	3.49	3.01	2.59	2.23	3.53	3.15	2.77	1.84	1.71	1.69
EV/EBITDA (x)	18.4	19.1	14.8	12.7	11.0	25.9	20.9	17.5	11.3	10.4	11.8
EV/EBITDA @ tgt price (x)	23.2	24.1	18.7	16.1	13.9	34.0	27.4	22.9	12.4	11.4	12.9
EV/EBIT (x)	20.5	21.8	16.5	14.1	12.1	28.2	22.5	18.7	13.8	12.5	12.0
EV/invested capital (x)	30.2	29.5	21.4	20.5	18.3	19.5	18.3	17.5	1.70	1.67	1.71
Price/book value (x)	28.4	25.3	20.1	16.2	13.1	15.7	14.4	12.9	3.31	2.97	2.67
Equity FCF yield (%)	2.83	2.84	4.86	4.85	5.27	3.09	4.54	5.40	3.80	4.44	5.18
Normalised PE (x)	28.1	31.6	23.3	20.0	17.3	28.0	22.8	19.4	18.8	17.1	15.6
Norm PE @tgt price (x)	35.5	40.0	29.4	25.3	21.8	36.6	29.8	25.4	20.8	18.9	17.3
Dividend yield (%)	2.33	2.38	2.80	3.27	3.73	3.27	3.83	4.36	2.37	2.60	2.86
				<i>year to Dec</i>			<i>year to Dec</i>			<i>year to Dec</i>	
<b>Per share data</b>	<b>FY05A</b>	<b>FY06A</b>	<b>FY07F</b>	<b>FY08F</b>	<b>FY09F</b>	<b>Solvency</b>	<b>FY05A</b>	<b>FY06A</b>	<b>FY07F</b>	<b>FY08F</b>	<b>FY09F</b>
Tot adj dil sh, ave (m)	96.4	96.4	96.4	96.4	96.4	Net debt to equity (%)	-6.14	-14.7	-6.24	-22.0	-30.0
Reported EPS (INR)	36.1	32.6	45.2	52.7	61.2	Net debt to tot ass (%)	-2.10	-5.04	-2.55	-9.77	-14.2
Normalised EPS (INR)	38.1	33.9	46.0	53.5	62.0	Net debt to EBITDA	-0.04	-0.11	-0.05	-0.18	-0.26
Dividend per share (INR)	25.0	25.5	30.0	35.0	40.0	Current ratio (x)	0.68	0.70	0.62	0.76	0.89
Equity FCF per share (INR)	30.3	30.5	52.1	52.0	56.4	Operating CF int cov (x)	2731.8	1382.0	7478.1	774.7	1068.8
Book value per sh (INR)	37.8	42.3	53.3	66.1	81.7	Dividend cover (x)	1.37	1.16	1.35	1.34	1.36
				<i>year to Dec</i>						<i>year to Dec</i>	

Priced as follows: NEST.BO - Rs1071.15; HLL.BO - Rs195.80; NESZn.VX - SFr486.50  
Source: Company data, ABN AMRO forecasts

## NESTLE INDIA: VALUATION METHODOLOGY

Economic Profit Valuation			Discounted Cash Flow Valuation		
	Rs m	%		Rs m	%
Adjusted Opening Invested Capital	4204.8	3	Value of Phase 1: Explicit (2007 to 2010)	8022.3	6
NPV of Economic Profit During Explicit Period	8586.2	7	Value of Phase 2: Value Driver (2011 to 2013)	16496.0	13
NPV of Econ Profit of Remaining Business (1, 2)	42397.5	33	Value of Phase 3: Fade (2014 to 2046)	92656.9	73
NPV of Econ Profit of Net Inv (Grth Business) (1, 3)	72059.9	57	Terminal Value	10543.2	8
Enterprise Value	127248.4	100	Enterprise Value	127718.5	100
Plus: Other Assets	3200.0	3	FCF Grth Rate at end of Phs 1 implied by DCF Valuation		8.9
Less: Minorities	0.0	0	FCF Grth Rate at end of Phs 1 implied by Current Price		58.7
Less: Net Debt (as at 04 May 2007)	0.0	0			
Equity Value	130448.4	103			
No. Shares (millions)	96.4				
<b>Per Share Equity Value</b>	<b>1353.0</b>				
Current share price	1071.2				

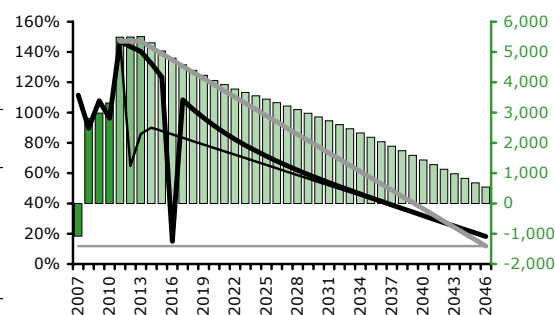
Sensitivity Table		No of Years in Fade Period				
		15	18	20	23	25
WACC	9.9%	960.40	1098.31	1193.79	1342.94	1446.62
	10.9%	864.71	976.91	1053.28	1170.55	1250.69
	11.9%	785.34	877.67	939.52	1032.96	1095.80
	12.9%	718.50	795.22	845.85	921.18	971.08
	13.9%	661.47	725.77	767.59	828.95	869.02

Performance Summary				
	2007	2008	2009	Phase 2 Avg (2011 - 2013)
Invested Capital Growth (%)	16.0	12.1	25.4	15.0
Operating Margin (%)	21.2	18.3	20.3	20.8
Capital Turnover (x)	7.0	6.9	6.4	9.2

Source: ABN AMRO forecasts

- In periods following the Explicit Period i.e. Phase 2 and Phase 3
- Remaining Business is defined as Capital as at the end of Phase 1 and capex = depreciation thereafter
- Net Investment is defined as capex over and above depreciation after Phase 1

### Returns, WACC and NPV of Free Cash Flow

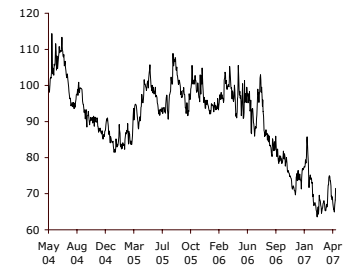


# Nestle India

**Company description**

Nestle India is a focused premium foods company with exposure to infant foods, milk products, chocolates and confectionery, beverages, whole range of culinary products like noodles, sauces etc, and dairy products like milk, yoghurt. It holds a dominant market share position in infant foods, culinary products and instant coffee segment.

**Buy Price relative to country**



**Strategic analysis**

**Average SWOT company score: 4**

**Strengths**

A comprehensive premium-foods portfolio with strong brands and dominating market shares in categories like infant foods (80%), noodles (80%) and instant coffee (44%).

**Weaknesses**

Prices of its raw materials (cocoa, coffee, milk and sugar) are influenced by commodity cycles. A sharp rise in cost can impact margins in the short term until price increases are effected.

**Opportunities**

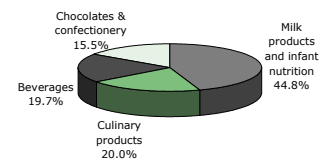
Key product categories - infant foods, culinary products, instant coffee, chocolates and confectionery - have very low urban penetration and even lower rural penetration.

**Threats**

Competition from highly integrated low-cost milk co-operative Amul in some categories like infant foods can impact NI's margins.

*Scoring range is 1-5 (high score is good)*

**Sales composition**



Source: Company

**Market data**

**Headquarters**  
Nestle House, Jacaranda Marg "m" Block, DLF City Phase II, Gurgaon- 122002 Haryana.

**Website**  
NULL

**Shares in issue**  
96.4m

**Freefloat**  
38%

**Majority shareholders**  
Nestle SA (62%), Indian Public (20%), FIIs (8%)

## India

**Country view**

**Neutral**

**Country rel to Asia Pacific**

The market looks expensive, but we believe it will remain supportive when regional funds seek a domestically-driven home with continuing robust earnings growth. The ABN AMRO Indian PMI suggests the economy is still powering ahead despite the global headwinds, thanks to its domestically-oriented economic structure. At the sector level, we still like autos, software and construction-related stocks.

*The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.*



**Competitive position**

**Average competitive score: 3-**

**Broker recommendations**

**Supplier power**

Milk is a very critical raw material for NI. Over the past few decades, NI has established very strong relationships with farmers at Moga, Punjab, which ensure availability and stability of pricing.

**Barriers to entry**

In certain categories like infant foods, NI's Cerelac and Lactogen have very strong brand loyalty. Also, there is a strong entry barrier since doctors prescribe these products for newborns.

**Customer power**

Most of NI's products have strong brand recognition, and in key categories it dominates the market with high market shares: infant foods - 80% market share; noodles - 80% market share.

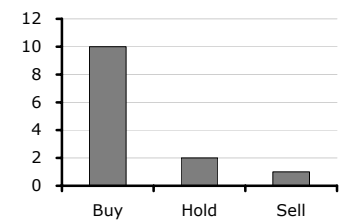
**Substitute products**

Since the penetration for NI's products is very low, we believe the threat from substitute products is low. For example, in beverages, half the consumers already consume tea.

**Rivalry**

NI has strong competitors, like HLL in beverages and others in culinary products. However, since the penetration of these products is low, we believe there is scope for growth for all players.

*Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse*



Source: Bloomberg