

FMCG

Target price Rs2,810

Earnings revision

(%)	CY10E	CY11E
Sales	↑ 0.8	↑ 1.1
EBITDA	↓ 6.4	↓ 6.4
EPS	↓ 6.1	↓ 5.9

Target price revision

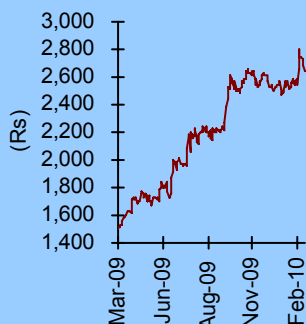
Rs2,810 from Rs2,718

Shareholding pattern

	Jun '09	Sep '09	Dec '09
Promoters	61.9	61.9	61.9
Institutional investors	19.9	19.9	19.8
MFs and UTI	4.6	4.3	3.6
Insurance Cos.	5.8	5.7	6.2
FIs	9.5	9.7	10.0
Others	18.3	18.2	18.3

Source: www.nseindia.com

Price chart



INDIA

Nestlé India

BUY

Maintained

Rs2,642

One-off costs pinch profits

Reason for report: Q4CY09 results review

Nestlé delivered yet another quarter of robust sales growth – sales grew 24% YoY vis-à-vis our 17.7% estimate. Headline PAT decline of 6.7% might come as a shocker but is not. This decline was owing to one-off expenses in the form of actuarial losses (staff costs rose 65% YoY) and higher advertising expenses due to new launches. Without considering actuarial losses, recurring PAT would have grown 13.7% YoY. At CY10E P/E of 30.4x, the stock is not cheap but deserves to trade at a premium to its FMCG peers owing to high growth potential, strong cashflows and parentage. We raise target price to Rs2,810, valuing Nestlé at CY11E P/E of 26.5x.

- **Domestic sales grew 25.3% YoY, much ahead of estimates.** Favourable weather conditions helped Nestlé's net domestic sales grow 25.3% YoY to Rs12.6bn (l-Sec: Rs11.9bn) in Q4CY09. Exports grew 8.5% YoY to Rs905mn. Nestlé continues to innovate – it is now pioneering affordable nutrition by launching *Maggi Rasile Chow* at attractive price point. It also launched *Maggi Pazzta* and *Munch Guru*.
- **Higher ad expenses, one-time staff costs & increased input costs led to 5% YoY dip in operating profits.** Rising commodity prices (especially sugar & milk) resulted in input costs-to-sales rising 105bps to 48.2%. Staff costs rose a huge 64.6% due to one-off actuarial losses. Due to higher advertising expenditure incurred for new launches, other expenses also rose sharply by 30% YoY. This across-the-board increase in costs led to 468bps YoY dip in operating profit margin (OPM) to 15%. Other income dipped sharply because of lower interest rates but was offset by lower tax rate (higher production at Pantnagar) resulting in recurring PAT declining 3.9% YoY. However, assuming normal growth in staff expenses, recurring PAT would have grown 13.7% YoY to Rs1.5bn in Q4CY09.
- **Maintain BUY; we raise target price to Rs2,810.** At CY10E P/E of 30.4x, the stock is not cheap and trades at a premium to its five-year historical median P/E of 24.6x. Given the higher input costs and lower other income (because of lower interest rates) we reduce CY10E & CY11E EPS estimates 6% each. We roll over estimates to CY11E and raise 12-month target price to Rs2,810 valuing Nestle at CY11E P/E of 26.5x. Maintain BUY.

Market Cap	Rs255bn/US\$5.3bn
Reuters/Bloomberg	NEST.BO/NEST IN
Shares Outstanding (mn)	42.05
52-week Range (Rs)	3,244/1,409
Free Float (%)	38.1
FII (%)	10.0
Daily Volume (US\$/'000)	3,680
Absolute Return 3m (%)	1.1
Absolute Return 12m (%)	75.9
Sensex Return 3m (%)	(4.9)
Sensex Return 12m (%)	83.1

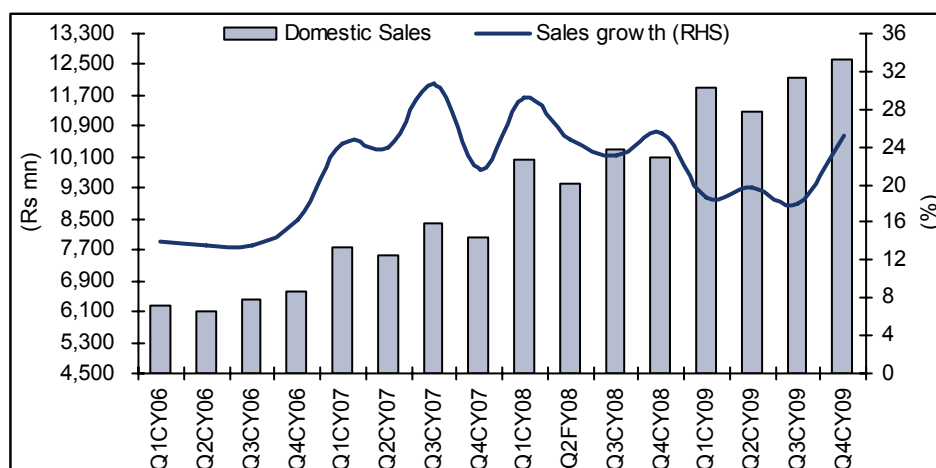
Year to Dec	CY08	CY09E	CY10E	CY11E
Revenue (Rs mn)	43,242	51,294	59,786	70,459
Net Income (Rs mn)	5,554	6,855	8,376	10,222
EPS (Rs)	57.6	71.1	86.9	106.0
% Chg YoY	30.6	23.4	22.2	22.0
P/E (x)	45.9	37.2	30.4	24.9
FCF per share	55.2	71.7	80.1	95.0
EV/E (x)	29.2	24.3	20.1	16.6
Dividend Yield (%)	1.6	1.8	2.3	2.8
RoCE (%)	115.8	121.5	121.1	120.8
RoE (%)	124.6	130.0	128.0	126.4

Sanjay Singh

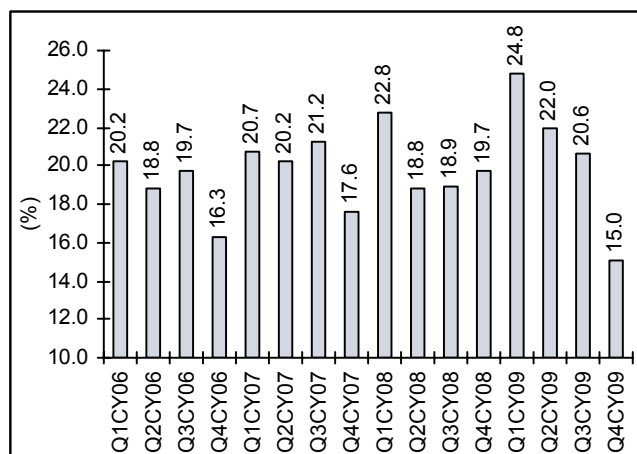
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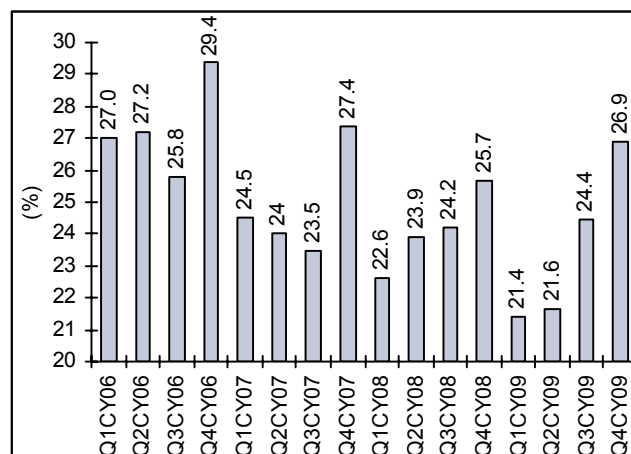
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Chart 1: Domestic sales growth at 25% in Q4CY09 surprises positively

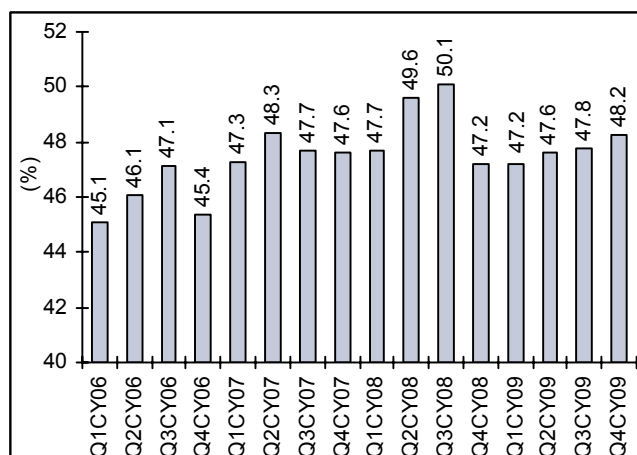
Source: Company data, I-Sec Research

Chart 2: EBITDA margin lower than expectations

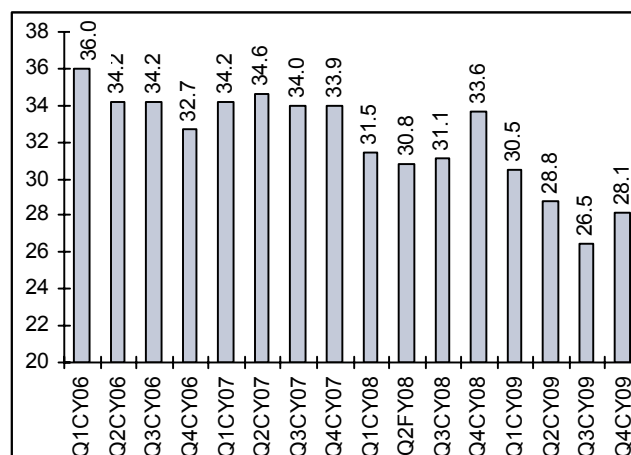
Source: Company data, I-Sec Research

Chart 3: Other expenses- to-sales rose due to higher advertising expenses

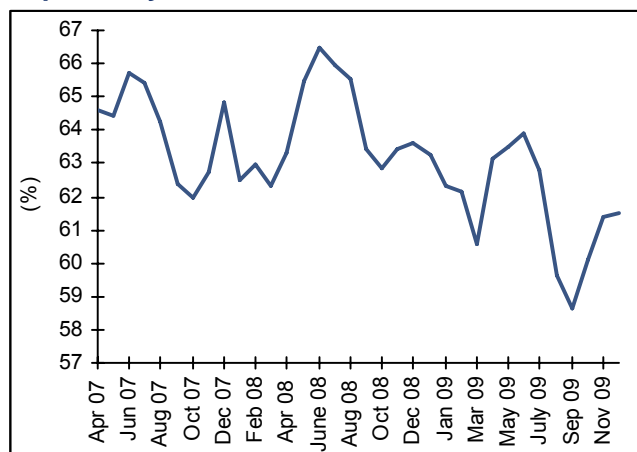
Source: Company data, I-Sec Research

Chart 4: Material cost-to-sales rose YoY

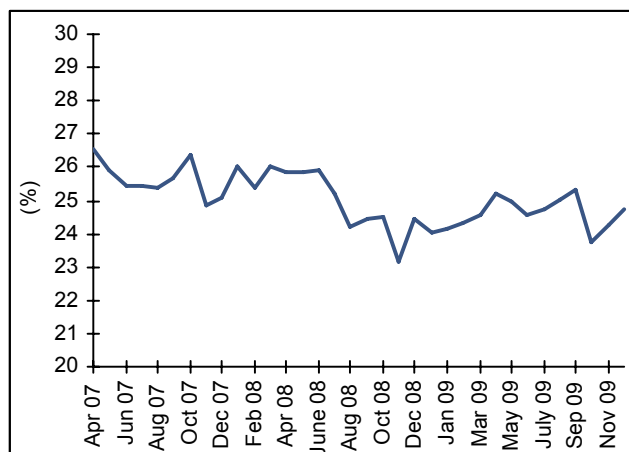
Source: Company data, I-Sec Research

Chart 5: Tax rates gradually tapering

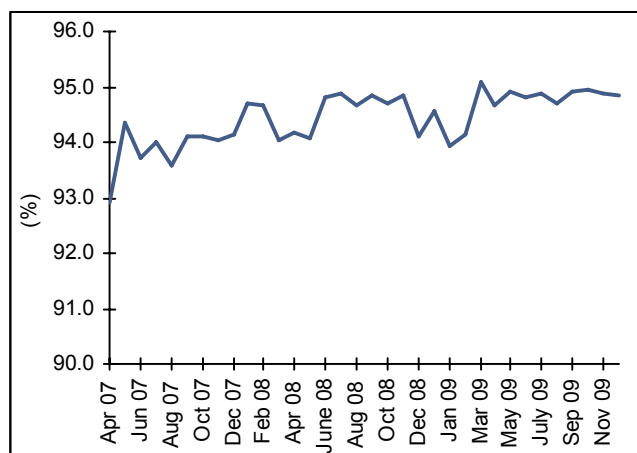
Source: Company data, I-Sec Research

Chart 6: Noodles – Market share improving sequentially

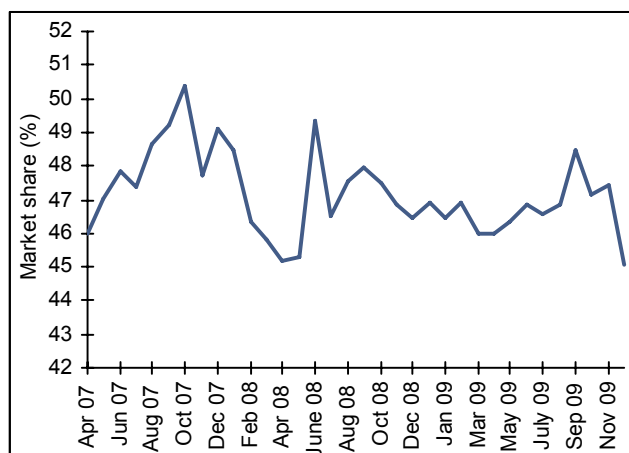
Source: Nielsen, I-Sec Research; Note:- As per Nielsen Noodles category includes vermicelli brands.

Chart 7: Chocolate – Market share steady

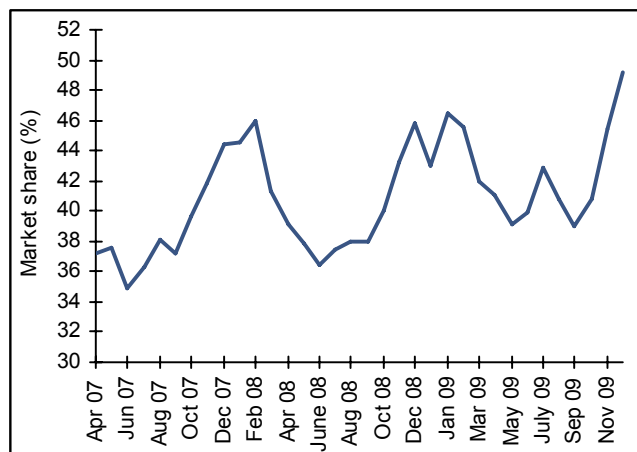
Source: Nielsen, I-Sec Research

Chart 8: Baby Food – Market share on the rise

Source: Nielsen, I-Sec Research

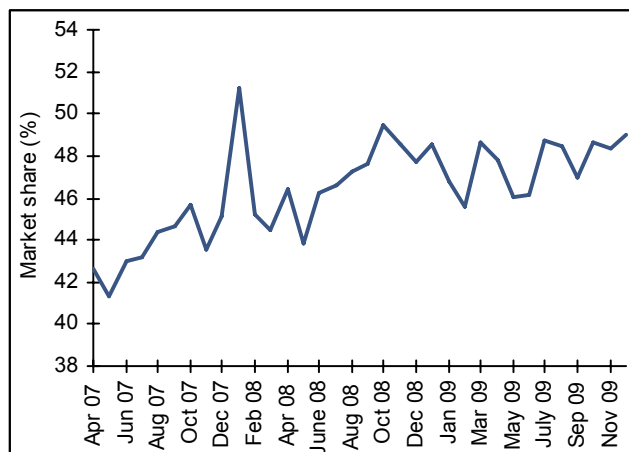
Chart 9: Milk Food – Market share declines

Source: Nielsen, I-Sec Research

Chart 10: Coffee – Market share improving

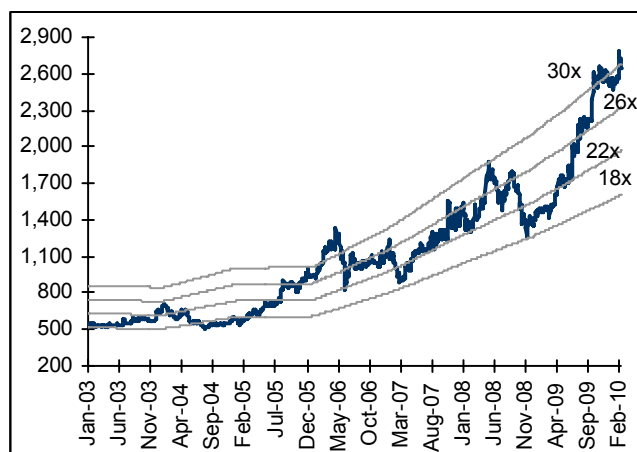
Source: Nielsen, I-Sec Research

Note – Coffee market shares are volatile because of seasonality

Chart 11: Milk Powder – Market share inching up

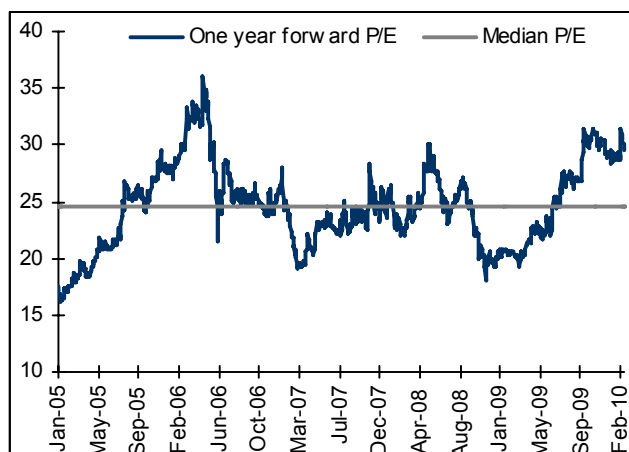
Source: Nielsen, I-Sec Research

Chart 12: P/E bands



Source: Company data, I-Sec Research

Chart 13: One-year forward P/E bands



Source: Company data, I-Sec Research

Table 1: Q4CY09 results review

(Rs mn, year ending December 31)

	Q4CY09	Q4CY08	YoY (%)	CY09	CY08	YoY (%)
Net domestic sales	12,612	10,066	25.3	48,008	39,859	20.4
Export sales	906	835	8.5	3,286	3,384	(2.9)
Total net sales	13,518	10,901	24.0	51,294	43,242	18.6
Other operating income	59	32	85.2	206	111	86.5
Total income	13,577	10,933	24.2	51,500	43,353	18.8
Material costs	6,522	5,145	26.8	24,484	21,041	16.4
Staff costs	1,376	836	64.6	4,324	3,146	37.4
Other expenditure	3,639	2,797	30.1	12,142	10,420	16.5
Total expenditure	11,537	8,778	31.4	40,950	34,607	18.3
Operating profit	2,040	2,155	(5.3)	10,550	8,746	20.6
Other income	47	97	(51.8)	173	230	(24.9)
Interest	5	2		14	16	(14.6)
Depreciation	307	257	19.4	1,113	924	20.5
PBT	1,775	1,994	(11.0)	9,596	8,036	19.4
Provision for taxation	442	614	(27.9)	2,620	2,387	9.7
Extraordinary expenses	204	169	20.4	426	308	38.4
Reported profit	1,129	1,211	(6.7)	6,550	5,341	22.6
Recurring PAT	1,276	1,328	(3.9)	6,844	5,553	23.2
			YoY			YoY
			(bps)			(bps)
OPM (%)	15.0	19.7	(468)	20.5	20.2	31
NPM (%)	9.4	12.2	(276)	13.3	12.8	48
Effective tax rate (%)	28.1	33.6	(548)	28.6	30.9	(232)
Material cost-to-sales (%)	48.2	47.2	105	47.7	48.7	(93)
Staff cost-to-sales (%)	10.2	7.7	251	8.4	7.3	115
Other expenditure-to-sales (%)	26.9	25.7	126	23.7	24.1	(42)

Source: Company data, I-Sec Research

Financial summary

Table 2: Profit & Loss statement

(Rs mn, year ending December 31)

	CY08	CY09	CY10E	CY11E
Net Sales	43,242	51,294	59,786	70,459
of which Exports	3,384	3,286	3,513	3,716
of which Domestic	39,859	48,008	56,273	66,743
Raw materials cost	21,041	24,484	28,888	33,973
Gross Profit	22,201	26,810	30,898	36,485
Gross Margin (%)	51.3	52.3	51.7	51.8
Total Operating Expenses	34,605	40,949	47,349	55,489
EBITDA	8,637	10,345	12,438	14,970
% growth	24.1	19.8	20.2	20.4
% margins	20.0	20.2	20.8	21.2
Depreciation & Amortisation	924	1,113	1,234	1,383
Gross Interest	16	14	3	3
Other Income	339	378	464	574
Recurring PBT	8,036	9,596	11,665	14,158
Add: Extraordinaries	(308)	(426)	(200)	(200)
Less: Taxes	2,387	2,620	3,233	3,880
Net Income (Reported)	5,341	6,550	8,232	10,078
Recurring Net Income	5,554	6,855	8,376	10,222
% growth	30.6	23.4	22.2	22.0
% margins	12.7	13.3	13.9	14.4

Source: Company data, I-Sec Research

Table 3: Balance sheet

(Rs mn, year ending December 31)

	CY08	CY09E	CY10E	CY11E
Assets				
Total Current Assets	7,980	10,188	12,342	14,955
of which cash equivalents	1,937	3,144	4,322	5,129
Current Liabilities & Prov	11,840	13,618	15,473	17,585
Net Current Assets	(3,860)	(3,430)	(3,132)	(2,631)
Investments	349	500	500	500
Of which Strategic	0	0	0	0
Of which Other Marketable	349	500	500	500
Net Fixed Assets	8,622	9,117	10,283	11,400
Of which Capital WIP	1,092	900	1,000	1,000
Total Assets	5,110	6,187	7,651	9,269
Liabilities				
Equity Share Capital	964	964	964	964
Reserves & Surplus	3,769	4,848	6,312	7,930
Net Worth	4,733	5,812	7,276	8,894
Borrowings	8	25	25	25
Deferred Tax Liability	369	350	350	350
Total Liabilities	5,110	6,187	7,651	9,269

Source: Company data, I-Sec Research

Table 6: Quarterly trend

(Rs mn, year ending December 31)

	Mar-09	Jun-09	Sep-09	Dec-09
Net sales	12,659	12,095	13,022	13,518
% growth (YoY)	16.0	16.8	17.6	24.0
EBITDA	3,146	2,672	2,692	2,040
Margin (%)	24.9	22.1	20.7	15.1
Recurring Net profit	2,047	1,735	1,795	1,276
- % growth (YoY)	25.9	40.8	35.7	(3.9)
Reported Net profit	1,973	1,620	1,828	1,129

Source: Company data, I-Sec Research

Table 4: Cash flow statement

(Rs mn, year ending December 31)

	CY08	CY09E	CY10E	CY11E
Operating Cash flow	6,049	7,711	9,202	11,087
Working Capital Changes	1,877	807	921	574
Capital Commitments	(2,605)	(1,608)	(2,400)	(2,500)
Free Cash Flow	5,320	6,910	7,724	9,161
Cash flow from Investing Activities	1,277	197	423	306
Issue of Share Capital	-	-	-	-
Buyback of shares	-	1	2	2
Inc (Dec) in Borrowings	(21)	17	-	-
Dividend paid	(4,794)	(5,471)	(6,768)	(8,460)
Extraordinary Items	(308)	(426)	(200)	(200)
Chg. in Cash & Bank balance	1,559	1,207	1,178	807

Source: Company data, I-Sec Research

Table 5: Key ratios

(Year ending December 31)

	CY08	CY09E	CY10E	CY11E
Per Share Data (in Rs.)				
Recurring EPS	57.6	71.1	86.9	106.0
Reported EPS	55.4	67.9	85.4	104.5
Dividend per share (DPS)	42.5	48.5	60.0	75.0
Book Value per share (BV)	49.1	60.3	75.5	92.2
FCF per share	55.2	71.7	80.1	95.0

Growth Ratios (%)

Net Sales	23.4	18.6	16.6	17.9
EBITDA	24.1	19.8	20.2	20.4
Recurring Net Income	30.6	23.4	22.2	22.0
Diluted Recurring EPS	30.6	23.4	22.2	22.0

Valuation Ratios (x)

P/E	45.9	37.2	30.4	24.9
P/BV	53.8	43.8	35.0	28.6
P/FCF	47.9	36.9	33.0	27.8
EV / EBITDA	29.2	24.3	20.1	16.6
EV / Net Sales	5.8	4.9	4.2	3.5

Operating Ratio

Raw Material/Sales (%)	48.7	47.7	48.3	48.2
SG&A/Sales (%)	14.3	14.3	14.3	14.2
Effective Tax Rate (%)	30.9	28.6	28.2	27.8
NWC / Total Assets (%)	(113.4)	(106.2)	(97.4)	(83.7)
Inventory Turnover (days)	59.6	57.7	56.5	56.9
Receivables (days)	4.0	3.6	3.7	3.7
Payables (days)	50.5	50.8	53.5	53.8
D/E Ratio (x)	0.1	0.1	0.1	0.0

Return/Profitability Ratio (%)

EBITDA Margins	20.0	20.2	20.8	21.2
Recurring Net Income Margins	12.7	13.3	13.9	14.4
RoCE	115.8	121.5	121.1	120.8
RoNW	124.6	130.0	128.0	126.4
Dividend Payout Ratio	89.8	83.5	82.2	83.9
Dividend Yield	1.6	1.8	2.3	2.8

Source: Company data, I-Sec Research

I-Sec investment ratings (all ratings relative to Sensex over next 12 months)

BUY: +10% outperformance; **HOLD:** -10% to +10% relative performance; **SELL:** +10% underperformance

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