

Nestle India

STOCK INFO.	BLOOMBERG
BSE Sensex: 11,835	NEST IN
	REUTERS CODE
S&P CNX: 3,508	NEST.BO

27 April 2006

Neutral
Previous Recommendation: Neutral
Rs1,329

		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
Equity Shares (m)	96.4	12/05A	24,769	3,293	34.1	17.2	38.9	36.1	92.8	135.8	5.1	24.2
52-Week Range	1,348/646	12/06E	27,304	3,693	38.3	12.1	34.7	32.5	93.6	139.8	4.6	21.3
1,6,12 Rel. Perf. (%)	4/0/14	12/07E	30,233	4,543	47.1	23.0	28.2	27.6	97.9	141.9	4.1	17.7
M.Cap. (Rs b)	128.2											
M.Cap. (US\$ b)	2.9											

* excluding extraordinary items and provisions

Nestle's 1QCY06 results were marginally below our expectations, mainly on account of lower operating margins. Revenues for the quarter grew 10% YoY to Rs7.2b, driven by 13.5% growth in domestic revenues. Export revenues continued to be adversely impacted due to lower sales (down 21.7% YoY) to Russia and Japan.

EBITDA margins declined by 240bp on YoY basis, as the company continues to face cost price inflation on account of high prices of milk solids and green coffee. Operating margins were further impacted by higher fuel costs.

The company has written back provision for contingencies amounting to Rs125m during the quarter. PAT (excluding extraordinary items) declined 11% YoY to Rs760m, primarily due to lower operating margins and higher tax provisioning.

High prices of milk, sugar and coffee would continue to put pressure on operating margins in the short to medium term. We are maintaining our CY06 and CY07 EPS estimates at Rs38.3 and Rs47.1, respectively. The stock currently trades at 34.7x CY06E and 28.2x CY07E earnings. We maintain our **Neutral** recommendation.

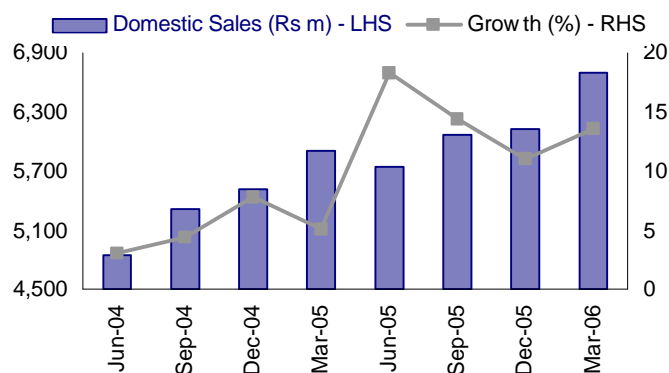
QUARTERLY PERFORMANCE										(RS MILLION)
Y/E DECEMBER	CY05				CY06				CY05	CY06E
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Gross Sales (incl Excise)	6,554	6,526	6,679	6,680	7,210	7,027	7,252	7,260	26,439	28,681
YoY Change (%)	5.7	19.9	12.0	9.1	10.0	7.7	8.6	8.7	11.3	8.5
Less: Excise	-419	-368	-431	-452	-451	-351	-348	-226	-1,670	-1,377
Net Sales	6,135	6,158	6,248	6,228	6,759	6,676	6,904	7,034	24,769	27,304
Total Exp	-4,748	-4,778	-4,970	-5,047	-5,394	-5,234	-5,375	-5,393	-19,549	-21,396
EBITDA	1,387	1,380	1,278	1,181	1,365	1,442	1,529	1,640	5,221	5,908
Margins (%)	22.6	22.4	20.5	19.0	20.2	21.6	22.2	22.6	19.7	20.6
Depreciation	-126	-149	-156	-154	-157	-145	-145	-138	-568	-585
Interest	-1	0	0	0	0	0	0	0	0	0
Other income	69	80	57	58	50	45	50	43	235	188
PBT	1,329	1,311	1,179	1,085	1,258	1,342	1,434	1,545	4,887	5,511
Tax	-476	-428	-386	-305	-499	-443	-473	-404	-1,595	-1,819
Rate (%)	35.8	32.6	32.7	28.1	39.6	33.0	33.0	26.1	32.6	33.0
PAT	853	883	793	780	760	899	961	1,141	3,293	3,693
YoY Change (%)	9.7	80.8	23.3	-14.0	-11.0	1.8	21.2	46.4	17.2	12.1
Extraordinary Inc/(Exp)	-73	-55	-47	-38	127	0	0	0	-197	0
Reported PAT	781	828	746	742	886	899	961	1,141	3,096	3,693

E: MOST Estimates

Domestic revenues remain robust...

Nestlé’s domestic revenues have been driving overall revenue growth. Domestic revenues grew 13.5% YoY in 1QCY06, backed by strong volume growth and better price realizations. New product launches have been a major growth driver for the domestic business and the company is focusing on increasing penetration of its categories by launching new products at affordable price points, supported by advertising spends.

GROWING DOMESTIC BUSINESS

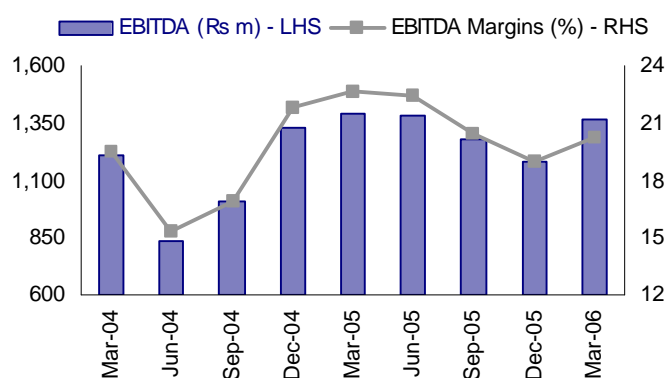


Source: Company/Motilal Oswal Securities

High commodity prices impact operating margins

Operating margins declined 240bp on a YoY basis, impacted by high commodity prices. Prices of milk, sugar and coffee have been rising steeply, which has impacted the company’s operating profits over the last few quarters. Gross margins for the quarter declined 210bp to 54.9% due to high commodity prices. Higher fuel cost has also resulted in higher other expenses, which has further impacted operating margins.

EBITDA MARGIN TREND

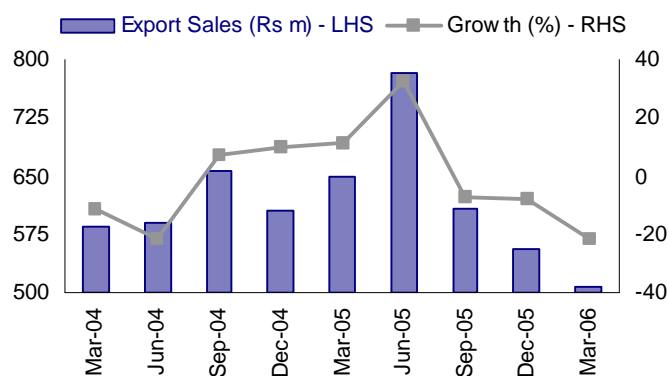


Source: Company/Motilal Oswal Securities

...while export revenues continue to decline

Export revenues declined 21.7% YoY in 1QCY06, primarily due to lower sales of beverages to Russia and Japan. Nestlé’s parent company has set up a plant in Russia to cater to local demand, which has impacted the company’s export revenues. The company continues to focus on domestic business and we believe that export revenues will continue to decline as exports to parent company decline.

DECLINING EXPORT REVENUES



Source: Company/Motilal Oswal Securities

Nestle continues to drive new product innovations

New product launches have been driving strong domestic volume growth, with Nestle intent on increasing market penetration in rural areas by offering products at affordable price points. The company renovated *LACTOGEN 1* infant food in line with scientific research to provide nutrition and greater comfort to infants. The company also launched *POLO Powermint* and *NESTLE MILKYBAR* with calcium rich recipe.

Valuation and view

Domestic demand growth continues to be buoyant, given the strong FMCG environment and new product launches by the company. Export revenues are likely to continue declining, as demand from the parent is waning. We believe that operating margins will continue to decline, given high commodity prices, particularly of milk, sugar and coffee. We are maintaining our CY06 and CY07 EPS estimates at Rs38.3 and Rs47.1, respectively. The stock trades at 34.7x CY06E and 28.2x CY07E earnings. We maintain **Neutral**.

Nestle India: an investment profile

Company description

Nestle India is a subsidiary of Nestle SA- one of the largest food product companies in the world. In India, Nestle is present primarily in weaning foods, chocolates & confectionary, beverages (tea, coffee) and cooking preparations. Nestle has been an urban-focused company but is now reorienting itself to expand its reach.

Key investment arguments

- ✍ Significant long-term potential in company's categories.
- ✍ Nestle is reorienting its product prices and distribution to expand consumer base.
- ✍ Likely rebound in earnings in CY05 after a weak CY04.
- ✍ Valuations at the upper end of the sector.

Key investment risks

- ✍ Parent setting up manufacturing in Russia could affect exports over the longer run.
- ✍ Increase in the commodity prices of milk, sugar, coffee and fuel can have substantial impact on margins.

COMPARATIVE VALUATIONS

		NESTLE	HLL	ITC
P/E (x)	CY06E	34.7	37.8	27.4
	CY07E	28.2	30.0	24.1
EV/EBITDA (x)	CY06E	21.3	32.8	16.9
	CY07E	17.7	25.6	14.3
EV/Sales (x)	CY06E	4.6	5.0	6.2
	CY07E	4.1	4.3	5.4
P/BV (x)	CY06E	32.5	27.3	6.9
	CY07E	27.6	23.8	5.9

SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	61.9	61.9	61.9
Domestic Institutions	10.2	10.6	9.5
FII/DFIs	8.2	7.8	8.5
Others	19.8	19.8	20.2

Recent developments

- ✍ Announced an investment of Rs1b in setting up manufacturing facility in Uttaranchal over next two to three years.
- ✍ Mr Martial Rolland, Chairman and Managing Director, Nestle India Ltd, awarded the Udyog Ratna Award for his contribution to the economic development of Punjab.

Valuation and view

- ✍ We forecast an earnings CAGR of 17.5% over CY05-07E.
- ✍ The stock currently trades at 28.2x CY07E earnings.
- ✍ Longer term potential and company's strong brands will prevent significant downside. We recommend **Neutral**.

Sector view

- ✍ We are positive on the sector. The sector is showing strong volume growth across product categories with improving pricing power for leading players.
- ✍ Companies with low competitive pressures and brought product portfolios will be able to better with stand any slowdown in a particular segment.
- ✍ Longer term prospects bright, given rising incomes and low penetration.

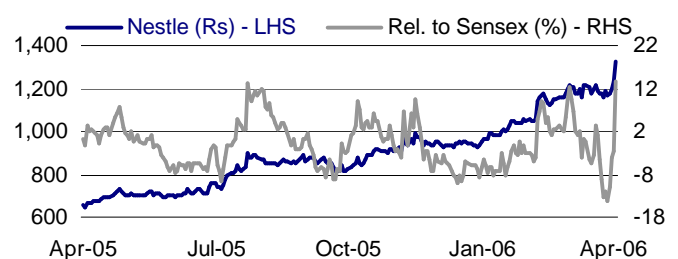
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY06	38.3	40.1	-4.4
CY07	47.1	47.1	-0.1

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,329	1,178	-11.4	Neutral

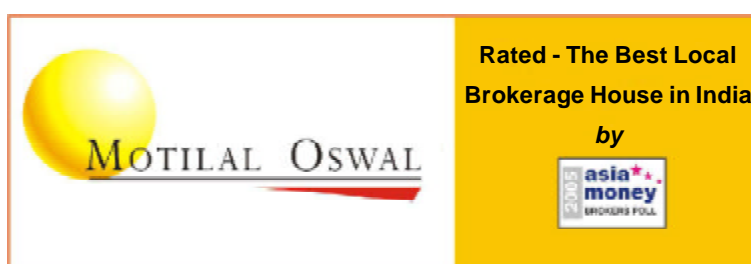
STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						RATIOS					
(RS MILLION)											
Y/E DECEMBER	2003	2004	2005	2006E	2007E	Y/E DECEMBER	2003	2004	2005	2006E	2007E
Domestic Sales	20,227	21,293	23,847	26,089	29,425	Basic (Rs)					
Export Sales	2,571	2,435	2,592	2,592	2,333	EPS	29.2	29.1	34.1	38.3	47.1
Net Sales	21,545	22,276	24,769	27,304	30,233	Cash EPS	34.0	34.2	40.0	44.4	54.0
Change (%)	11.3	3.4	11.2	10.2	10.7	BV/Share	34.7	33.1	36.8	40.9	48.1
Total Expenditure	-17,098	-17,766	-19,549	-21,396	-23,237	DPS	20.0	24.5	25.0	30.0	35.0
EBITDA	4,447	4,510	5,221	5,908	6,996	Payout %	68.5	84.1	73.2	78.3	74.3
Change (%)	11.4	1.4	16.7	13.2	18.4	Valuation (x)					
Margin (%)	19.5	19.0	19.7	20.6	22.0	P/E		45.6	38.9	34.7	28.2
Depreciation	-463	-491	-568	-585	-659	Cash P/E		38.8	33.2	30.0	24.6
Int. and Fin. Charges	-19	-8	0	0	0	EV/Sales		5.7	5.1	4.6	4.1
Other Income - Recurring	209	145	235	188	248	EV/EBITDA		28.1	24.2	21.3	17.7
Profit before Taxes	4,174	4,156	4,887	5,511	6,584	P/BV		40.1	36.1	32.5	27.6
Change (%)	2.4	-0.4	17.6	2.8	19.5	Dividend Yield (%)		1.8	1.9	2.3	2.6
Margin (%)	19.4	18.7	19.7	20.2	21.8	Return Ratios (%)					
Tax	-1,374	-1,463	-1,483	-1,819	-2,041	RoE	84.0	88.0	92.8	93.6	97.9
Deferred Tax	14	117	-112	0	0	RoCE	123.3	127.2	135.8	139.8	141.9
Tax Rate (%)	-32.6	-32.4	-32.6	-33.0	-31.0	Working Capital Ratios					
Profit after Taxes	2,813	2,810	3,293	3,693	4,543	Debtor (Days)	5	4	4	4	4
Change (%)	8.4	-0.1	17.2	2.1	23.0	Asset Turnover (x)	6.3	6.8	6.9	6.9	6.5
Margin (%)	13.1	12.6	13.3	13.5	15.0	Leverage Ratio					
Non-rec. (Exp)/Income	-182	-290	-197	0	0	Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0
Reported PAT	2,631	2,520	3,096	3,693	4,543						
BALANCE SHEET						CASH FLOW STATEMENT					
(RS MILLION)						(RS MILLION)					
Y/E DECEMBER	2003	2004	2005	2006E	2007E	Y/E DECEMBER	2003	2004	2005	2006E	2007E
Share Capital	964	964	964	964	964	OP/(loss) before Tax	3,984	4,019	4,652	5,323	6,337
Reserves	2,386	2,230	2,584	2,979	3,676	Int./Div. Received	209	145	235	188	248
Net Worth	3,350	3,195	3,549	3,944	4,640	Depreciation and Amort.	463	491	568	585	659
Loans	51	79	51	0	0	Interest Paid	-19	-8	0	0	0
Capital Employed	3,401	3,274	3,600	3,944	4,640	Direct Taxes Paid	-1,374	-1,463	-1,483	-1,819	-2,041
Gross Block	7,894	8,382	8,794	9,244	9,644	(Incr)/Decr in WC	662	1,349	-208	166	1,023
Less: Accum. Depn.	-3,981	-4,409	-4,978	-5,563	-6,222	CF from Operations	3,924	4,533	3,764	4,444	6,226
Net Fixed Assets	3,914	3,972	3,816	3,681	3,422	Extraordinary Items	47	-23	26	0	0
Capital WIP	139	341	341	341	341	(Incr)/Decr in FA	-362	-689	-412	-450	-400
Investments	736	1,549	1,823	2,469	4,447	(Pur)/Sale of Investments	-410	-812	-274	-646	-1,978
Curr. Assets, L&A	3,640	3,582	3,719	3,729	3,744	CF from Invest.	-725	-1,524	-660	-1,096	-2,378
Inventory	2,194	2,167	2,176	2,176	2,176	Issue of Shares	0	0	0	0	0
Account Receivables	317	262	278	287	303	(Incr)/Decr in Debt	-576	28	-28	-51	0
Cash and Bank Balance	63	94	94	94	94	Dividend Paid	-2,175	-2,675	-2,742	-3,297	-3,847
Others	1,066	1,059	1,172	1,172	1,172	Others	-443	-330	-175	1	-1
Curr. Liab. and Prov.	4,923	6,182	6,112	6,288	7,327	CF from Fin. Activity	-3,194	-2,977	-2,945	-3,347	-3,848
Account Payables	2,361	2,662	2,966	3,218	4,307	Incr/Decr of Cash	4	32	160	0	0
Other Liabilities	981	1,238	1,074	999	949	Add: Opening Balance	59	63	94	94	94
Provisions	1,582	2,282	2,072	2,072	2,072	Closing Balance	63	94	94	94	94
Net Current Assets	-1,283	-2,601	-2,393	-2,559	-3,583						
Deferred Tax Liability	-105	12	12	12	12						
Application of Funds	3,401	3,273	3,599	3,943	4,638						

E: MOST Estimates

N O T E S



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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 |

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