



## Nestle India

STOCK INFO.	BLOOMBERG
BSE Sensex: 12,907	NEST IN
	REUTERS CODE
S&P CNX: 3,739	NEST.BO

27 October 2006

Neutral

Previous Recommendation: Neutral

Rs1,049

Equity Shares (m)	96.4
52-Week Range	1,348/800
1,6,12 Rel. Perf. (%)	-5/-30/-46
M.Cap. (Rs b)	101.1
M.Cap. (US\$ b)	2.2

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
12/05A	24,770	3,289	34.1	17.1	35.8	21.0	58.6	84.9	4.7	22.3
12/06E	27,648	3,438	35.7	4.5	34.2	18.5	54.0	79.8	4.2	21.0
12/07E	30,745	4,244	44.0	23.5	27.7	16.2	58.4	82.1	3.8	17.7

\* excluding extraordinary items and provisions

- Results were in line with our expectations as adjusted PAT increased 9.9% compared with our estimate of 11.3%, mainly due to the higher tax rate versus our expectations.
- Overall revenues, for the quarter, were up 15.7% YoY to Rs7.2b. Strong 34.8% YoY increase in export revenues, from higher Beverage and Milk product exports to USA and South Asia drove this growth. Domestic sales growth at 10.1% was in line with our expectations.
- EBITDA margins for 3QCY06 declined 80bp YoY, as the company continues to face cost price inflation on account of high commodity prices of milk solids, sugar, fuel and freight, accentuated by costs of process improvement for Infant Foods.
- Management has indicated a positive outlook for domestic demand growth owing to the robust economy but we expect cost pressures to continue to impact the company in the medium term.
- Nestle India has provided for tax rates at 35.3% for 9m-CY06, which is higher than our estimates of 31.5%. We are increasing the tax rates for CY06 and CY07 based on rates for the 9m-CY06 period. Our revised tax rates would be 33.6% for CY06 and 30% for CY07 in comparison with our earlier estimates of 31.5% and 29%. Our EPS estimates for CY06 thereby stands reduced to Rs35.7 from Rs36.8; and for CY07 we are cutting it to Rs44 from Rs44.8 respectively. The stock currently trades at 34.2x CY06E and 27.7x CY07E earnings. We maintain **Neutral**.

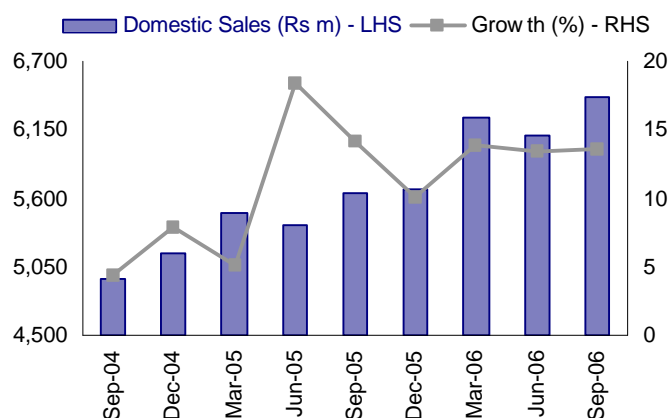
QUARTERLY PERFORMANCE										(RS MILLION)	
Y/E DECEMBER	CY05				CY06				CY05	CY06E	
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			
<b>Net Sales</b>	<b>6,135</b>	<b>6,158</b>	<b>6,248</b>	<b>6,228</b>	<b>6,759</b>	<b>6,812</b>	<b>7,227</b>	<b>6,849</b>	<b>24,769</b>	<b>27,647</b>	
Total Exp	-4,748	-4,778	-4,970	-5,047	-5,394	-5,530	-5,802	-5,424	-19,549	-22,150	
<b>EBITDA</b>	<b>1,387</b>	<b>1,380</b>	<b>1,278</b>	<b>1,181</b>	<b>1,365</b>	<b>1,282</b>	<b>1,425</b>	<b>1,425</b>	<b>5,220</b>	<b>5,497</b>	
Margins (%)	22.6	22.4	20.5	19.0	20.2	18.8	19.7	20.0	19.7	19.0	
Depreciation	-126	-149	-156	-154	-157	-161	-168	-145	-568	-630	
Interest	-1	0	-0.3	0	0	-2	-0.3	0	-2	-14	
Other income	69	80	57	58	50	146	47	80	237	323	
<b>PBT</b>	<b>1,329</b>	<b>1,311</b>	<b>1,179</b>	<b>1,085</b>	<b>1,258</b>	<b>1,265</b>	<b>1,303</b>	<b>1,360</b>	<b>4,887</b>	<b>5,176</b>	
Tax	-476	-428	-386	-305	-499	-421	-431	-388	-1,595	-1,739	
Rate (%)	35.8	32.6	32.7	28.1	39.6	33	33	29	32.6	33.6	
<b>Adjusted PAT</b>	<b>853</b>	<b>883</b>	<b>793</b>	<b>780</b>	<b>760</b>	<b>844</b>	<b>872</b>	<b>972</b>	<b>3,293</b>	<b>3,436</b>	
YoY Change (%)	9.7	80.8	23.3	-14.0	-11.0	-4.4	9.9	24.7	17.2	4.4	
Extraordinary Inc/(Exp)	-73	-55	-47	-38	127	-34	-42	-272	-197	-221	
<b>Reported PAT</b>	<b>781</b>	<b>828</b>	<b>746</b>	<b>742</b>	<b>886</b>	<b>810</b>	<b>830</b>	<b>700</b>	<b>3,096</b>	<b>3,215</b>	
YoY Change (%)	21.2	52.7	8.4	-3.0	13.5	-2.1	11.3	-5.6	22.9	3.9	

E: M0St Estimates

### Domestic revenues maintain steady growth

Nestlé’s net domestic revenues maintained steady growth with 13.6% increase on a YoY basis, aided by excise reduction on Maggi Noodles, as the gross sales increased by 10.1%. Domestic revenues grew 13.6% YoY for the quarter supported by strong volume growth across product segments. Excise duty has gone down sharply owing to reduction in excise levies for Maggi Noodles. Management has given positive guidance for domestic sales growth due to favorable business and upbeat consumer confidence in the country. Long term prospects appear encouraging due to low penetration of products in the rural areas and attempts by the company to launch new and affordable pack sizes to improve product affordability and increase penetration.

TREND IN DOMESTIC SALES AND GROWTH

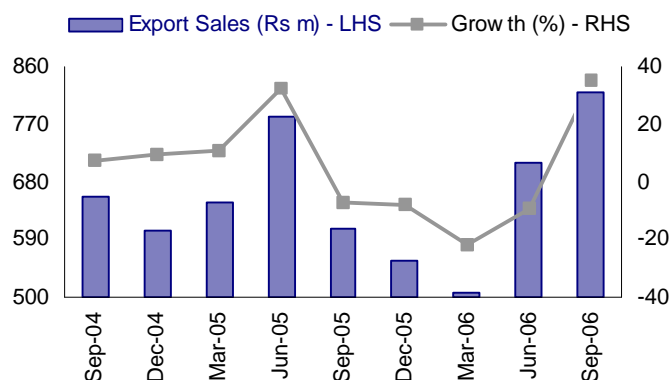


Source: Company/ Motilal Oswal Securities

### Export revenues jump sharply

Export revenues jumped by 34.8% on YoY basis due to strong beverage exports to USA and Milk product exports to South Asia. While the increase in exports is encouraging, we are skeptical of the company maintaining the growth momentum as USA has not been the traditional export market for the company.

TREND IN EXPORT SALES AND GROWTH

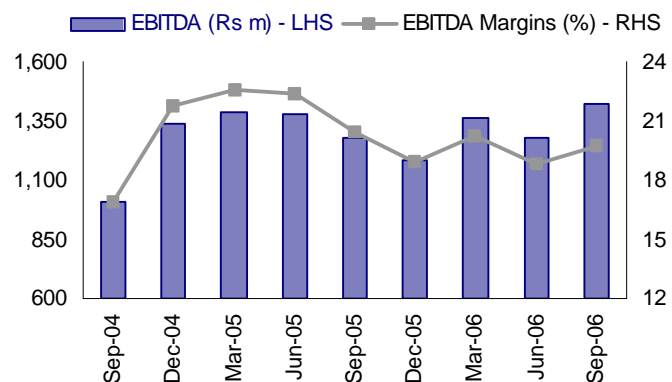


Source: Company/ Motilal Oswal Securities

### High commodity prices continue to impact operating margins

Operating margins declined 80bp on a YoY basis impacted by high commodity prices. Prices of commodities such as milk, sugar, wheat and fuel have been increasing steeply. This has impacted operating profits of the company over the last few quarters. In addition, the process and quality improvement initiatives in Infant Foods also impacted profitability. Although the company has resorted to selective price increases to counter the impact of commodity price inflation, we believe profit margins will continue to be impacted in the medium term, although base effect will become favorable from 4QCY06.

TREND IN EBITDA



Source: Company/ Motilal Oswal Securities

**Nestle continues to drive new product innovations**

New product launches have managed to drive strong domestic volume growth, with Nestle intent on increasing its share in rural areas by offering products at affordable price points. The company has launched Maggi Teekha Masala Sauce, Maggi Tiffin pack of ketchups and Nestle FUNBAR Éclairs. In addition the company also started NAN starter formula in infant nutrition products, which aims at achieving nutritional immunity for infants through a unique combination of nutrients.

**Valuations and view**

We are increasing the tax rates for CY06 and CY07 based on rates for the 9m-CY06 period. Our revised tax rates would be 33.6% for CY06 and 30% for CY07 in comparison with our earlier estimates of 31.5% and 29%. Our EPS estimates for CY06 thereby stands reduced to Rs35.7 from Rs36.8; and for CY07 we are cutting it to Rs44 from Rs44.8 respectively. The stock currently trades at 34.2x CY06E and 27.7x 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.

### Recent developments

- ✍ Commissioned Rs1b manufacturing facility in Uttaranchal for Maggi noodles.
- ✍ 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 34.2x CY06E and 27.7x CY07E earnings. We maintain **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.

#### COMPARATIVE VALUATIONS

		NESTLE	HLL	ITC
P/E (x)	FY07E	34.2	31.3	25.0
	FY08E	27.7	25.2	21.2
EV/EBITDA (x)	FY07E	21.0	26.6	16.6
	FY08E	17.7	21.3	14.0
EV/Sales (x)	FY07E	4.2	3.8	5.6
	FY08E	3.8	3.4	4.7
P/BV	FY07E	18.5	18.3	6.6
	FY08E	16.2	15.6	5.6

#### SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoters	61.8	61.9	61.9
Domestic Institutions	9.8	10.1	9.5
FIs/FDIs	9.0	9.0	8.9
Others	19.4	19.0	19.7

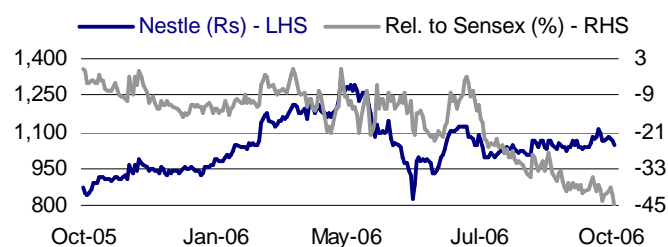
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
CY06	35.7	38.1	-6.4
CY07	44.0	45.5	-3.4

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
1,049	-	-	Neutral

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2004	2005	2006E	2007E	2008E
<b>Domestic Sales</b>	<b>21,397</b>	<b>23,930</b>	<b>26,225</b>	<b>29,142</b>	<b>32,698</b>
<b>Export Sales</b>	<b>2,331</b>	<b>2,509</b>	<b>2,657</b>	<b>2,882</b>	<b>3,155</b>
<b>Net Sales</b>	<b>22,279</b>	<b>24,770</b>	<b>27,648</b>	<b>30,745</b>	<b>34,420</b>
Change (%)	3.8	11.2	11.6	11.2	12.0
Total Expenditure	-17,766	-19,549	-22,150	-24,228	-26,606
<b>EBITDA</b>	<b>4,513</b>	<b>5,221</b>	<b>5,498</b>	<b>6,517</b>	<b>7,815</b>
Change (%)	0.2	15.7	5.3	18.5	19.9
Margin (%)	19.0	19.7	19.0	20.3	21.8
Depreciation	-491	-568	-630	-709	-794
Int. and Fin. Charges	-8	-2	-14	-14	-14
Other Income - Recurring	141	233	323	270	312
<b>Profit before Taxes</b>	<b>4,155</b>	<b>4,884</b>	<b>5,177</b>	<b>6,063</b>	<b>7,319</b>
Change (%)	-2.1	17.5	6.0	17.1	20.7
Margin (%)	18.7	19.7	18.7	19.7	21.3
Tax	-1,463	-1,483	-1,635	-1,674	-2,020
Deferred Tax	117	-112	-104	-146	-176
Tax Rate (%)	-32.4	-32.7	-33.6	-30.0	-30.0
<b>Adjusted PAT</b>	<b>2,809</b>	<b>3,289</b>	<b>3,438</b>	<b>4,244</b>	<b>5,123</b>
Change (%)	-2.5	17.1	4.5	23.5	20.7
Margin (%)	12.6	13.3	12.4	13.8	14.9
Non-rec. (Exp)/Income	-290	-197	-221	-246	-275
<b>Reported PAT</b>	<b>2,519</b>	<b>3,092</b>	<b>3,216</b>	<b>3,998</b>	<b>4,848</b>

BALANCE SHEET					
(RS MILLION)					
Y/E DECEMBER	2004	2005	2006	2007	2008
Share Capital	964	964	964	964	964
Reserves	4,078	4,649	5,399	6,299	7,363
<b>Net Worth</b>	<b>5,043</b>	<b>5,613</b>	<b>6,364</b>	<b>7,263</b>	<b>8,328</b>
Loans	79	143	143	143	143
<b>Capital Employed</b>	<b>5,122</b>	<b>5,756</b>	<b>6,507</b>	<b>7,406</b>	<b>8,471</b>
Gross Block	8,382	9,494	10,207	11,960	12,844
Less: Accum. Depn.	-4,409	-4,757	-5,387	-6,096	-6,890
<b>Net Fixed Assets</b>	<b>3,972</b>	<b>4,738</b>	<b>4,819</b>	<b>5,864</b>	<b>5,954</b>
Capital WIP	341	228	240	252	264
Investments	1,549	1,044	2,181	2,077	3,187
<b>Curr. Assets, L&amp;A</b>	<b>3,582</b>	<b>4,627</b>	<b>4,453</b>	<b>4,836</b>	<b>5,292</b>
Inventory	2,167	2,531	2,538	2,736	2,951
Account Receivables	262	305	317	351	393
Cash and Bank Balance	94	366	155	148	156
Others	1,059	1,424	1,444	1,601	1,793
<b>Curr. Liab. and Prov.</b>	<b>4,334</b>	<b>4,781</b>	<b>4,983</b>	<b>5,273</b>	<b>5,702</b>
Account Payables	2,662	3,165	3,641	3,841	4,100
Other Liabilities	31	34	43	48	54
Provisions	1,640	1,583	1,298	1,383	1,549
<b>Net Current Assets</b>	<b>-752</b>	<b>-155</b>	<b>-530</b>	<b>-436</b>	<b>-410</b>
<b>Deferred Tax Liability</b>	<b>12</b>	<b>-100</b>	<b>-204</b>	<b>-349</b>	<b>-525</b>
<b>Application of Funds</b>	<b>5,122</b>	<b>5,756</b>	<b>6,507</b>	<b>7,406</b>	<b>8,471</b>

E: MOST Estimates

RATIOS					
Y/E DECEMBER	2004	2005	2006E	2007E	2008E
<b>Basic (Rs)</b>					
<b>EPS</b>	<b>29.1</b>	<b>34.1</b>	<b>35.7</b>	<b>44.0</b>	<b>53.1</b>
Cash EPS	34.2	40.0	42.2	51.4	61.4
BV/Share	52.3	58.2	66.0	75.3	86.4
DPS	24.5	25.0	26.7	33.0	39.9
Payout %	84.1	73.3	75.0	75.0	75.0
<b>Valuation (x)</b>					
P/E		35.8	34.2	27.7	23.0
Cash P/E		30.5	28.9	23.7	19.9
EV/Sales		4.7	4.2	3.8	3.3
EV/EBITDA		22.3	21.0	17.7	14.6
P/BV		21.0	18.5	16.2	14.1
Dividend Yield (%)		2.0	2.2	2.7	3.3
<b>Return Ratios (%)</b>					
RoE	55.7	58.6	54.0	58.4	61.5
RoCE	81.3	84.9	79.8	82.1	86.6
<b>Working Capital Ratios</b>					
Debtor (Days)	4	4	4	4	4
Asset Turnover (x)	4.4	4.3	4.2	4.2	4.1
<b>Leverage Ratio</b>					
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0

CASH FLOW STATEMENT					
(RS MILLION)					
Y/E DECEMBER	2004	2005	2006	2007	2008
OP/(loss) before Tax	4,022	4,653	4,868	5,808	7,021
Int./Div. Received	141	233	323	270	312
Depreciation and Amort.	491	568	630	709	794
Interest Paid	-8	-2	-14	-14	-14
Direct Taxes Paid	-1,463	-1,483	-1,635	-1,674	-2,020
(Incr)/Decr in WC	-1,019	869	-586	87	33
<b>CF from Operations</b>	<b>2,165</b>	<b>4,838</b>	<b>3,586</b>	<b>5,186</b>	<b>6,126</b>
Extraordinary Items	30	0	102	0	0
(Incr)/Decr in FA	-689	-1,000	-723	-1,765	-897
(Pur)/Sale of Investments	-812	504	-1,137	104	-1,110
<b>CF from Invest.</b>	<b>-1,471</b>	<b>-496</b>	<b>-1,758</b>	<b>-1,661</b>	<b>-2,007</b>
Issue of Shares	0	0	0	0	0
(Incr)/Decr in Debt	-28	-64	0	0	0
Dividend Paid	-2,675	-2,748	-2,908	-3,591	-4,334
Others	2,040	-1,259	869	59	223
<b>CF from Fin. Activity</b>	<b>-663</b>	<b>-4,071</b>	<b>-2,039</b>	<b>-3,532</b>	<b>-4,111</b>
<b>Incr/Decr of Cash</b>	<b>31</b>	<b>271</b>	<b>-211</b>	<b>-7</b>	<b>7</b>
Add: Opening Balance	63	94	366	155	148
<b>Closing Balance</b>	<b>94</b>	<b>366</b>	<b>155</b>	<b>148</b>	<b>156</b>

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<b>Disclosure of Interest Statement</b>	<b>Nestle India</b>
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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