

Equities

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Nestle India (NEST.BO)

Alert: Analyst Meet Takeaways

- Plenty of positive takeaways...** — A combination of a) portfolio expansion and product innovation / renovation, b) market share gains (notably in Maggi), and c) pricing / mix benefits drive healthy revenue growth (>20% Y/Y). d) Volume growth appears steady (at ~9% Y/Y for 9MCY11) – mgmt noted that excluding discontinued products & channel rationalization initiatives, growth would be higher by ~400bps. Further, e) cost controls - initiatives under MM11 (Margin Management 2011) / Project Shark, along with, f) scale benefits (ex employee costs) support profit growth.
- ... and the negatives** — a) Input cost pressures remain as prices of fresh milk, MSK and coffee are all higher by ~19-20% Y/Y, with the company's commodity price basket being up by ~13% Y/Y. b) Mgmt noted there is a significant inflation in employee costs for both blue & white collar workers; c) High power & fuel costs remain a challenge – ~30bps negative impact on EBITDA margins in 9MCY11. d) Volatile currency movements and e) a higher taxation environment (VAT + excise + effective tax at Pantnagar) also need to be managed.
- Correcting supply-side issues is the key priority**— Investing in capacity remains a priority as mgmt attempts to match the growing demand. Capex during 9MCY11 was to the tune of Rs9.1bn with a continued increase in capital commitments (worth ~Rs11.4bn as of Sep 11). Current capex / net sales ratio is ~17% v/s. the last 10 yr average of ~4%. Mgmt noted that the Tahlilwal (HP) facility is expected to come on stream before Mar12 (required for the company to get income tax benefits). Additionally, mgmt has already announced another unit in Haryana (Samalkha), and more capacity at Goa (Ponda, Bicholim), Karnataka (Nanjangud) & Punjab (Moga).
- Distribution initiatives** — Over the past year, Nestle has aggressively expanded its distribution reach – now covering 3.6m outlets (i.e. ~40% direct + indirect reach of all food FMCG outlets in India). Mgmt noted that Nestle India's ~16% distribution growth is much higher than industry average growth (~5%), as per Nielson data. Additionally, there are efforts for trade modernization and strengthening front end. Recent initiative of providing the sales force / distributors with hand phones connected with GPRS is an attempt to enhance demand and improve visibility / go to market strategy.
- Business update** — a) Milk/Nutrition products (45% of revenues) growth has been driven by higher realizations, despite low volumes as mgmt phases out non strategic channels/products. b) Maggi (29% of revenues) continues to do well, unfazed by competition. c) Beverages (13% of revenues) volumes were flat as export sales to affiliates declined; domestic revenue growth has picked up well, post the high profile brand building initiatives. d) In chocolate/confectioneries (14% of revenues), reported volumes were muted as mgmt capped sales of non strategic, low margin SKUs.
- Maintain Sell on valuations** — Nestle India has strong fundamentals and is well positioned to benefit from the branded food & beverages growth opportunity. That said, the rich valuations adequately capture the growth prospects.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Company Update

Sell	3
Price (01 Dec 11)	Rs4,200.35
Target price	Rs3,964.00
Expected share price return	-5.6%
Expected dividend yield	1.4%
Expected total return	-4.3%
Market Cap	Rs404,980M
	US\$7,769M

Price Performance (RIC: NEST.BO, BB: NEST IN)



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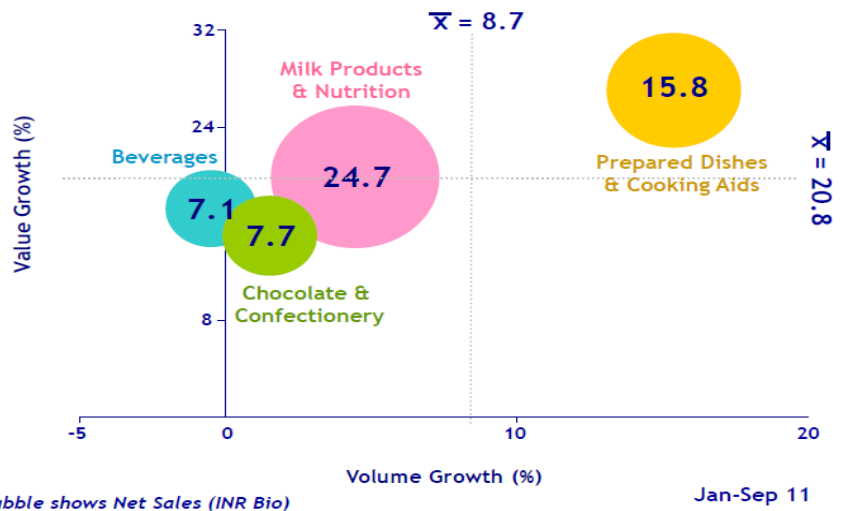
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Figure 1. Nestle India: Statistical Abstract

Year to 31-Dec	Net Profit (Rs Mn)	EPS (Rs)	EPS Growth (%)	P/E (x)	EV / EBITDA (x)	P / Book (x)	ROE (%)	ROCE (%)	Div. Yield (%)
2009	6,550	67.9	22.6%	61.8	39.0	69.7	124.2%	171.0%	1.2%
2010	8,187	84.9	25.0%	49.5	32.2	47.3	114.0%	155.1%	1.2%
2011E	9,982	103.5	21.9%	40.6	26.8	33.4	96.5%	105.7%	1.4%
2012E	12,152	126.0	21.7%	33.3	21.6	24.5	84.8%	92.7%	1.7%
2013E	14,500	150.4	19.3%	27.9	17.9	18.6	75.9%	99.8%	2.0%

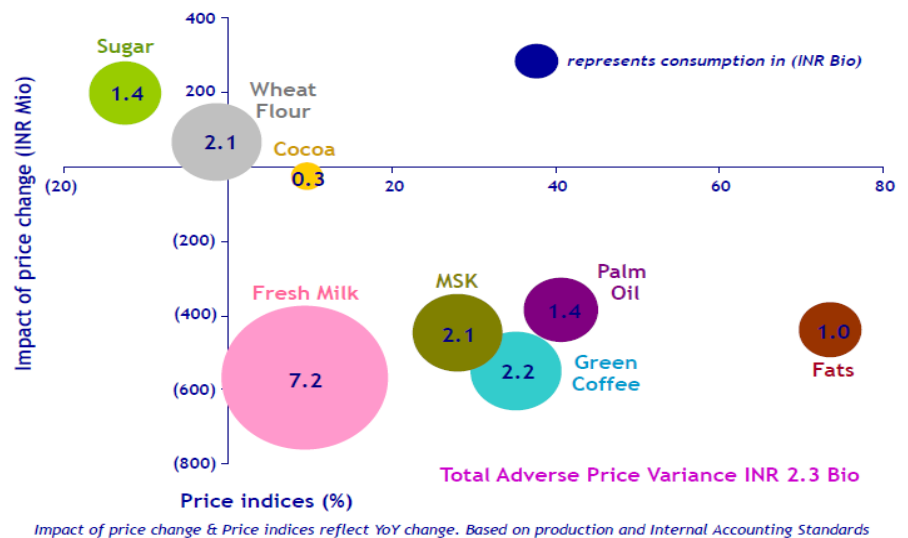
Source: Company Reports and CIRA Estimates

Figure 2. Nestle India: 9MCY11 Revenue Mix and Growth



Source: Company Reports

Figure 3. Nestle India: 9MCY11 Material Cost Mix & Impact of Price Movement



Source: Company Reports

Nestle India

Valuation

We value Nestle India using a P/E based methodology, given its steady growth characteristics and non cyclical revenue streams. Our target price of Rs3964 is based on a target P/E multiple to 30x Mar13E. We peg the target multiple at the middle of the current trading band. Our target multiple is at a premium to what we ascribe to Hindustan Unilever, given Nestle India's superior growth profile, benefiting from the recovery in urban consumption in India. The stock is trading at relative P/E of 2.9x vs. the broader market – highest in the last 10 years. At current valuations of ~37x one-year forward, Nestle is trading at a ~25% premium off its long-term P/E multiple; which we think is rich and leaves no room for disappointment.

Risks

The key upside risks that could sustain the shares above our target price include: (1) better-than-expected revenue growth; and (2) favorable agri-product prices could support profitability.

Key downside risks include: (1) fluctuations in commodity prices could affect profitability prospects; (2) supply constraints on raw materials, particularly milk solids, could stifle growth.

Appendix A-1

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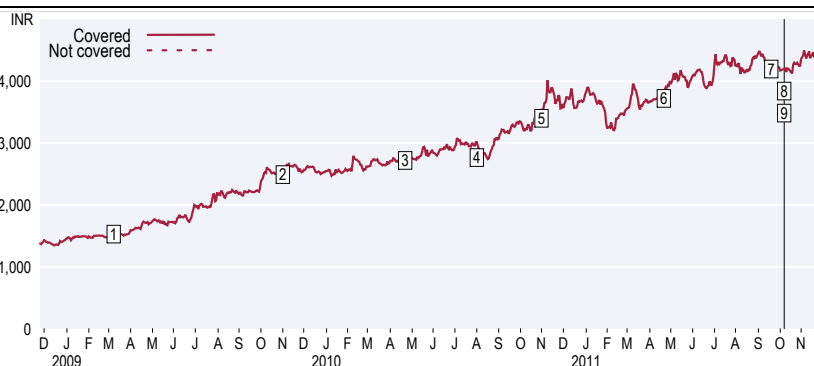
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Nestle India (NEST.BO)

Ratings and Target Price History

Fundamental Research

Analyst: Jamshed Dadabhoj



	Date	Rating	Target Price	Closing Price
1	8-Mar-09	3L	*1,395.00	1,417.25
2	1-Nov-09	3L	*2,306.00	2,573.45
3	22-Apr-10	3L	*2,441.00	2,865.05

	Date	Rating	Target Price	Closing Price
4	2-Aug-10	3L	*2,648.00	3,016.80
5	31-Oct-10	3L	*2,910.00	3,488.85
6	21-Apr-11	3L	*3,345.00	3,828.70

	Date	Rating	Target Price	Closing Price
7	20-Sep-11	3L	*3,964.00	4,245.10
8	7-Oct-11	Stock rating system changed		
9	7-Oct-11	*3	3,964.00	4,198.35

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Nestle India (NEST.BO)
Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Jamshed Dadabhoy



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