



Nestle India

BSE SENSEX 17,563	S&P CNX 5,284	CMP: INR4,499	TP: INR3,994	Neutral								
Bloomberg Equity Shares (m)	NEST IN 96.4	YEAR	NET SALES	ADJ. PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EYI	EYI
52-Week Range (INR)	4,517/3,160	END	(INR M)	(INR M)	(INR)	YOY (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
1,6,12 Rel. Perf. (%)	-4/13/39	12/09A	51,294	6,976	72.4	23.5	-	-	132.3	167.8	-	-
M.Cap. (INR b)	433.7	12/10A	62,547	8,370	86.8	20.0	51.8	50.7	116.5	151.0	6.9	34.4
M.Cap. (USD b)	8.8	12/11E	75,638	10,169	105.5	21.5	42.7	34.4	96.0	110.0	5.7	28.0
		12/12E	92,549	12,033	124.8	18.3	36.0	25.3	80.9	86.5	4.7	23.0

Nestle India's (NEST) 3QCY11 results were above our estimates with adjusted PAT growing 23.5% to INR2.7b (against our estimate of INR2.5b).

- Domestic sales grew 20.7%, led by volume growth and price increases. Overall sales growth was 19.9% against our estimate of 22.8%. Exports grew 4.6% due to a ban on export of milk powder. Gross margins increased 90bp YoY and 130bp QoQ due to higher prices and an improved channel mix despite high milk and coffee prices. EBITDA increased 27% as lower other expenditure (120bp) more than neutralized the impact of higher staff costs (90bp).
- A 180bp increase in the tax rate (Pantnagar out of the 100% tax exemption bracket) restricted PAT growth to 23%.
- NEST availed debt of USD25m from its parent company (average rate 4.9%) for its ongoing expansion plans, taking total loans availed of to USD85m. NEST suffered an MTM loss of INR421.5m on USD85m drawn so far. In addition it has another loss of INR153.3m with respect of impending draw downs of USD46m. It has charged these (excluding income of INR8.8m) to reserves.
- We note that sales growth in the domestic business has been steady while the element of pricing has been increasing, indicating that volume growth slowed, which might be due to lack of capacity in a few segments. We expect volume growth to rebound as new capacities come on stream in the coming quarters.
- The input cost scenario remains challenging as milk prices continue to harden. In addition, depreciation of the rupee will increase costs in coming quarters.
- We are revising our estimates by 1-2%, which factors in gains from an improved channel mix and lower overheads. We remain positive on long-term growth opportunities for NEST in the Indian consumer space, although rising food inflation and input costs are a concern. We don't rule out a positive surprise on volume growth once new capacities come on stream. The stock trades at 42.7x CY11E EPS of INR105.5 and 36x CY12E EPS of INR124.8. Maintain **Neutral**.

Quarterly Performance

Y/E December	(INR Million)									
	CY10				CY11				CY10	CY11E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	14,798	14,667	16,373	16,710	18,100	17,631	19,631	20,277	62,547	75,638
YoY Change (%)	16.9	21.3	25.7	23.6	22.3	20.2	19.9	21.3	21.9	20.9
COGS	7,376	7,191	8,034	7,956	8,841	8,718	9,454	9,885	30,556	36,898
Gross Profit	7,422	7,476	8,339	8,754	9,259	8,912	10,177	10,392	31,992	38,740
Margin (%)	50.2	51.0	50.9	52.4	51.2	50.5	51.8	51.3	51.1	51.2
Operating Exp	4,382	4,537	5,113	5,457	5,406	5,467	6,074	6,313	19,495	23,261
EBITDA	3,040	2,940	3,226	3,298	3,853	3,445	4,103	4,079	12,497	15,479
Margins (%)	20.5	20.0	19.7	19.7	21.3	19.5	20.9	20.1	20.0	20.5
YoY Growth (%)	-1.8	12.3	22.1	66.4	26.7	17.2	27.2	23.7	20.8	23.9
Depreciation	310	304	306	358	327	367	394	381	1,278	1,468
Interest	6	4	1	1	1	6	12	21	11	39
Other income	91	101	95	139	128	80	121	144	427	472
PBT	2,816	2,733	3,015	3,078	3,653	3,152	3,819	3,821	11,635	14,444
Tax	845	718	840	861	1,027	956	1,134	1,159	3,265	4,276
Rate (%)	30.0	26.3	27.9	28.0	28.1	30.3	29.7	30.3	28.1	29.6
Adjusted PAT	1,971	2,015	2,175	2,217	2,626	2,196	2,685	2,661	8,370	10,169
YoY Change (%)	-5.2	13.1	21.9	66.3	33.3	9.0	23.5	20.1	19.9	21.5

E: MOSL Estimates

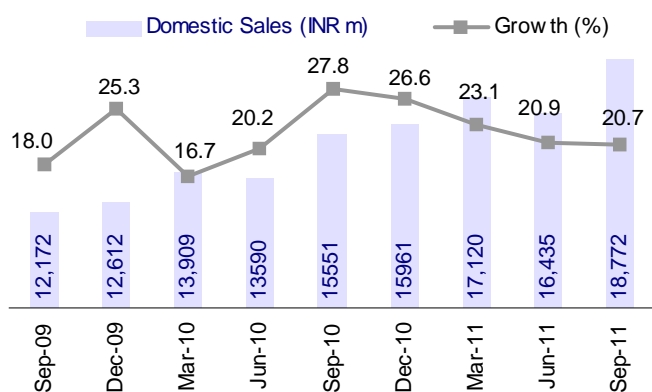
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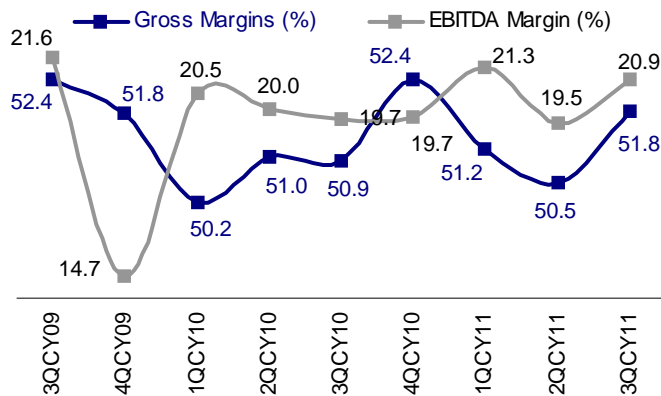
Domestic sales up 21%; Margins expand 120bp due to lower costs; gross margin expansion

- In 3QCY11 sales grew 19.9% to INR19.6b (against our estimate of INR20.1b), driven by domestic sales growth of 20.7% (against our estimate of volume growth in low teens). Exports grew 4.6%, and was impacted by a ban on milk powder exports (from February 2011).
- Gross margins expanded 90bp YoY to 51.8% (up 130bp QoQ), enabled by an improved channel mix and benefits of gradual price increases over the past two quarters. Overheads were lower by 120bp, which enabled a 120bp margin expansion despite a 90bp increase in staff costs.
- EBITDA increased 27% as lower other expenditure (120bp) more than neutralized the impact of higher staff costs (90bp). A 180bp increase in the tax rate (Pantnagar factory coming out of 100% tax exemption bracket) restricted PAT growth to 23%.

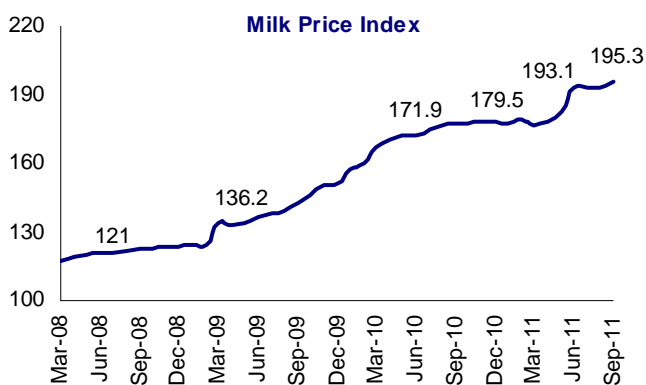
Domestic sales growth sustained at 20%+



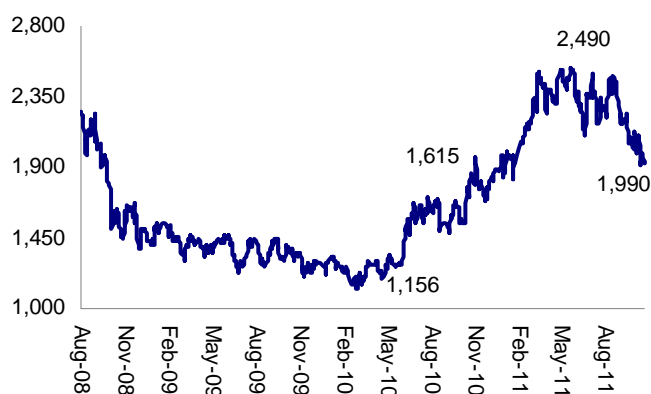
Higher realizations, lower overheads enable margin expansion



Milk prices are moving up in the flush season



Coffee prices down 20% from their peak



Source: Company/MOSL

MTM loss of INR575m on forex loans; Volume growth slowing, input costs a challenge

- NEST availed debt of USD25m from its parent company (average rate 4.9%) for its ongoing expansion plans, taking the total loans availed to USD85m. NEST suffered an MTM loss of INR421.5m on USD85m drawn so far. In addition it has another loss of INR153.3m with respect of impending draw downs of USD46m. It charged these (excluding income of INR8.8m) to reserves.

- The input-cost scenario remains challenging as milk prices continue to harden. Industry players expect a 20% increase in prices in the current year. Coffee prices, although down 20% from their peak, are still up YoY, Palm oil prices are also up YoY though down 20% from their peak. In addition, the depreciation of the rupee will increase costs during the coming quarters.
- We note that domestic sales growth has been steady while the element of pricing has been increasing, indicating that volume growth has slowed, which might be due to a lack of capacity in few segments. We expect volume growth to rebound as new capacities come on stream.

High input cost inflation a concern though long-term growth outlook bright; Rich valuations limit upside; Maintain Neutral

- NEST has maintained domestic sales growth trajectory at over 20%, though volume growth is slowing. We expect volume growth to rebound as new capacities come on stream in the coming quarters. However, we don't rule out a decline in volume growth in select categories due to high food inflation.
- Input cost scenario remains a challenge. Milk prices are moving up even in the flush season despite a good monsoon, which does not augur well for costs in the medium term. NEST has some respite as other costs like palm oil and coffee have come off their peaks. Any slowdown in volume growth remains a key risk to our estimates as interest, depreciation and overhead costs will increase in CY12 due to new units going on stream.
- We revise upwards our estimates by 1-2%, which factor in gains from an improved channel mix and lower overheads. We are positive on the long-term growth opportunity for NEST in the Indian consumer space.
- The stock trades at 42.7x CY11E EPS of INR105.5 and 36x CY12E EPS of INR124.8. Maintain **Neutral**.

Nestle India: an investment profile

Company description

Nestle India (NEST) is the largest packaged food company in India. A 63% subsidiary of Nestle SA, the company has a diversified portfolio with strong brands like Nescafe, Everyday and Maggi. NEST will invest INR25b-30b on capacity expansion over the next 2-3 years to support its strong growth trajectory.

Key investments arguments

- NEST is in a dominant position and best placed to capture the huge opportunity in processed foods.
- The company's strong pricing power and healthy innovation pipeline enables profitable volume growth.

Investment risks

- Continued input cost pressure could impact margins in the near term.
- Steep valuations leave little room for disappointment.

Recent developments

- The company has taken staggered price increases in dairy, infant nutrition, coffee and chocolates to pass on a portion of its cost pressure.
- The company raised USD85m debt from its parent to fund acquisitions.

Valuation and view

- Our estimates are marginally revised by 1-2% to INR105.5 for CY11E and INR124.8 for CY12E
- The stock trades at 42.7x CY11E EPS of INR105.5 and 36x CY12E EPS of INR124.8. Maintain **Neutral**.

Sector view

- We have a cautious view on the sector due to the inflationary tendency in the economy, which could impact volumes and profit margins of companies.
- Companies with low competitive pressures and broad product portfolios will be able to better withstand a slowdown in a segment.
- Long-term prospects are bright, given rising incomes and low penetration.

Comparative valuations

		Nestle#	HLL*	ITC*
P/E (x)	CY11E	42.7	32.2	27.1
	CY12E	36.0	27.9	22.9
EV/EBITDA (x)	CY11E	28.0	24.0	17.2
	CY12E	23.0	20.5	14.4
EV/Sales (x)	CY11E	5.7	3.5	6.2
	CY12E	4.7	3.0	5.3
P/BV (x)	CY11E	34.4	24.7	8.6
	CY12E	25.3	19.9	7.3

December Y/E; * March Y/E

Shareholding Pattern (%)

	Sep-11	Jun-11	Sep-10
Promoter	62.8	62.8	62.8
Domestic Inst	8.0	8.2	8.4
Foreign	11.3	11.1	11.0
Others	18.0	18.0	17.8

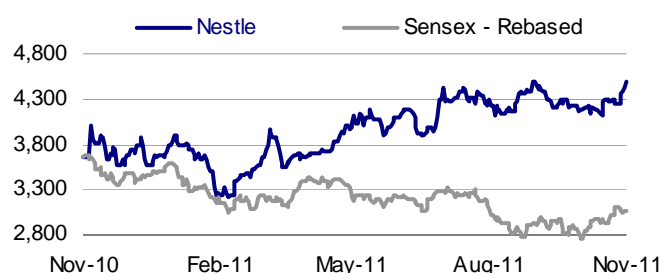
EPS: MOSL forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
CY11	105.5	102.1	3.4
CY12	124.8	122.6	1.8

Target Price and Recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
4,499	3,994	-11.2	Neutral

Stock performance (1 year)



Financials and Valuation

Income Statement		(INR Million)			
Y/E December	2009	2010	2011E	2012E	
Domestic Sales	48,938	60,262	73,872	90,482	
Export Sales	3,286	3,503	3,643	4,363	
Excise	930	1,218	1,878	2,296	
Net Sales	51,294	62,547	75,638	92,549	
Change (%)	18.6	21.9	20.9	22.4	
Total Expenditure	40,949	50,051	60,158	73,647	
EBITDA	10,345	12,497	15,479	18,902	
Change (%)	19.8	20.8	23.9	22.1	
Margin (%)	20.2	20.0	20.5	20.4	
Depreciation	1,113	1,278	1,468	2,006	
Int. and Fin. Ch.	14	11	39	176	
Other Inc. - Rec.	378	427	472	469	
PBT	9,596	11,635	14,444	17,189	
Change (%)	19.4	21.2	24.1	19.0	
Margin (%)	18.7	18.6	19.1	18.6	
Tax	2,669	3,252	4,190	5,002	
Deferred Tax	-49	13	86	155	
Tax Rate (%)	27.3	28.1	29.6	30.0	
Adjusted PAT	6,976	8,370	10,169	12,033	
Change (%)	23.5	20.0	21.5	18.3	
Margin (%)	13.6	13.4	13.4	13.0	
Non-rec. (Exp)/Inc.	426	184	202	222	
Reported PAT	6,550	8,187	9,967	11,810	

Balance Sheet		(INR Million)			
Y/E December	2009	2010	2011E	2012E	
Share Capital	964	964	964	964	
Reserves	4,848	7,590	11,660	16,169	
Net Worth	5,813	8,554	12,624	17,133	
Loans	6	87	3,800	5,000	
Capital Employed	5,819	8,641	16,424	22,133	
Gross Block	16,408	18,547	26,622	35,104	
Less: Accum. Depn.	7,446	8,420	9,888	11,894	
Net Fixed Assets	8,962	10,127	16,735	23,210	
Capital WIP	796	3,489	3,664	3,847	
Investments	2,033	1,507	1,350	1,592	
Curr. Assets, L&A	8,566	10,460	13,881	16,191	
Inventory	4,987	5,760	7,584	9,394	
Account Receivables	642	633	1,211	1,559	
Cash and Bank Balance	1,556	2,553	2,548	2,324	
Others	1,380	1,514	2,539	2,913	
Curr. Liab. and Prov.	14,218	16,609	18,787	22,134	
Account Payables	5,817	7,454	8,795	10,851	
Other Liabilities	53	75	93	114	
Provisions	8,348	9,079	9,899	11,169	
Net Curr. Assets	-5,652	-6,149	-4,906	-5,943	
Def. Tax Liability	-320	-333	-418	-573	
Appl. of Funds	5,819	8,641	16,424	22,133	

E: MOSL Estimates

Ratios		(INR Million)			
Y/E December	2009	2010	2011E	2012E	
Basic (INR)					
EPS	72.4	86.8	105.5	124.8	
Cash EPS	83.9	100.1	120.7	145.6	
BV/Share	60.3	88.7	130.9	177.7	
DPS	48.5	48.5	52.5	65.0	
Payout %	78.4	65.1	58.0	60.7	
Valuation (x)					
P/E		51.8	42.7	36.0	
Cash P/E		45.0	37.3	30.9	
EV/Sales		6.9	5.7	4.7	
EV/EBITDA		34.4	28.0	23.0	
P/BV		50.7	34.4	25.3	
Dividend Yield (%)		1.1	1.2	1.4	
Return Ratios (%)					
RoE	132.3	116.5	96.0	80.9	
RoCE	167.8	151.0	110.0	86.5	
Working Capital Ratios					
Debtor (Days)	4.5	3.6	5.7	6.0	
Asset Turnover (x)	8.4	7.0	4.5	4.1	
Leverage Ratio					
Debt/Equity (x)	0.0	0.0	0.3	0.3	

Cash Flow Statement		(INR Million)			
Y/E December	2009	2010	2011E	2012E	
OP/(loss) before Tax	9,232	11,219	14,011	16,896	
Int./Div. Received	378	427	472	469	
Depn. and Amort.	927	974	1,468	2,006	
Interest Paid	14	11	39	176	
Direct Taxes Paid	2,669	3,252	4,190	5,002	
Incr in W/C	-1,088	-1,310	1,450	-591	
CF from Operations	8,943	10,667	10,272	14,785	
Extraordinary Items	0	0	0	0	
Incr in FA	2,064	4,832	8,250	8,665	
Pur of Investments	1,684	-526	-157	242	
CF from Invest.	-3,748	-4,306	-8,093	-8,907	
Issue of Shares	0	0	0	0	
Incr in Debt	-2	81	3,713	1,200	
Dividend Paid	5,471	5,448	5,897	7,301	
Others	-103	3	0	0	
CF from Fin. Activity	-5,576	-5,364	-2,184	-6,101	
Incr/Decr of Cash	-381	997	-5	-223	
Add: Opening Balance	1,937	1,556	2,553	2,548	
Closing Balance	1,556	2,553	2,548	2,324	

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Nestle

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