

## NEUTRAL

CMP\* Rs4,499

Target Price -

## Stock Info

Sector FMCG

Market Cap (Rscr) 43,376

52 Week High/Low 4,520/3,162

Avg. Daily Volume (3m, '000) 19

Avg. Daily Value (3m, cr) 8.1

Dividend Yield (%) 1.1

Sensex 17,563

Nifty 5,284

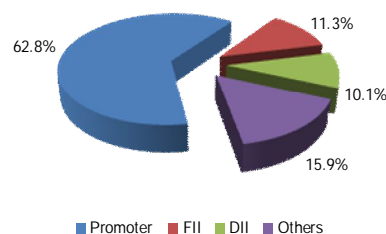
BSE Code 500790

NSE Code NESTLEIND

## Stock Performance

(%)	NESTLE	NIFTY
1-week	5.7	(1.4)
1-month	7.2	10.7
1-year	23.2	(15.9)

## Shareholding Pattern (%)



## Stock Price Chart



Note: \*CMP as on November 4, 2011

Analyst: ChitragdaKapur

chitragda.kapur@relianceada.com

## Result in-line with expectation, estimates unchanged

## Key highlights of the result

- **Top-line growth strong, aided by volume and value growth:** Nestle delivered top-line growth at 19.9% yoy aided by 20.7% yoy growth in the domestic sales (driven by volumes as the company continued to invest behind its brands) and muted 4.6% yoy growth in exports impacted by ban on the export of milk powder.
- **OPM expansion drives recurring earnings growth of 23.5% yoy:** Recurring earnings reported a growth of 23.5% yoy, aided by margin expansion and increase in other income (up 27% yoy to Rs12cr) despite increase in depreciation expense (up 29% yoy to Rs39cr) and increase in tax rate by 182bp yoy (as the Panthagar factory lost its 100% income tax holiday post its 5yr of operations). In terms of operating margins, the company registered margin expansion of 120bp yoy, aided by gross margin expansion of 91bp yoy (on account of improved product/channel mix) and decrease in other expenses (down 119bp yoy to Rs465cr).

## Outlook and Valuation

3QCY2011 results were in-line with our estimates. For CY2010-12E, we peg Nestle's revenue growth at 19% CAGR, with operating margins to hover in the range of 20-21% in CY2011-12E despite stiff commodity prices. While, we do not expect commodity prices to be as firm as CY2010 levels, increase in fuel prices and higher milk prices are likely to keep gross margins under check. The earnings are expected to grow at a CAGR of 22% over the same period.

We value the stock at 10% premium to its historic 5-yr average P/E of 29x on account of strong parentage, dominant brands, high ROEs and OPMs. However, the stock price captures full upside. **Hence, we recommend our Neutral view on the stock with a fair value of Rs4,068. Though we have a Neutral view on the stock at the current levels, primarily on account of stiff valuations, any respectable correction would warrant a re-look at this recommendation at a later date.**

## Risks to the view

- Continuous high inflation holds a downside risk to our estimates
- Increased competition in high growth noodles category from HUL (*Knorr soupy noodles*), GSKCHL (*Horlicks Foodles*) and ITC (*Sunfeast Yipee*) may impact our margin expectations

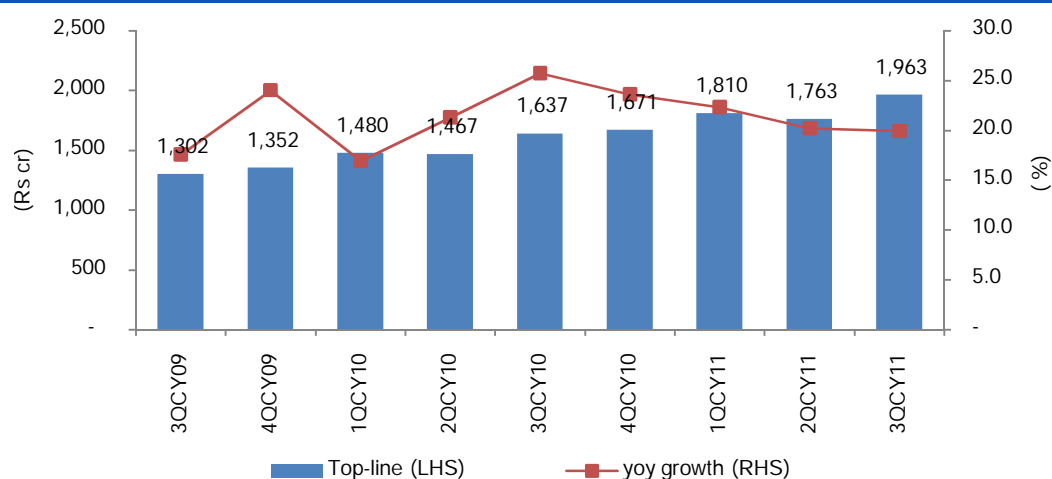
Year End	Net Revenues		EBITDA		Net income (reported)		RoaE	RoCE	EPS	Valuations (X)	
	(Rs cr)	% growth	(Rs cr)	% margin	(Rs cr)	% growth	%	%	(Rs)	P/E	EV/EBITDA
CY2009	5,129	18.6	1,034	20.2	655	22.6	124.2	164.3	67.9	66.2	41.8
CY2010	6,255	21.9	1,250	20.0	819	25.0	114.0	149.4	84.9	53.0	34.5
CY2011E	7,488	19.7	1,541	20.6	998	21.8	92.3	124.7	103.5	43.5	27.6
CY2012E	8,852	18.2	1,898	21.4	1,226	22.9	74.5	103.4	127.1	35.4	22.2

**Exhibit 1: Quarterly Performance**

Y/E Dec (Rs cr)	3QCY11	3QCY10	% yoy	2QCY11	% qoq	9MCY11	9MCY10	% chg
<b>Net Sales</b>	<b>1,963.1</b>	<b>1,637.3</b>	<b>19.9</b>	<b>1,107.6</b>	<b>77.2</b>	<b>5,536.1</b>	<b>4,583.8</b>	<b>20.8</b>
Consumption of RM	945.4	803.4	17.7	556.2	70.0	2,701.3	2,260.0	19.5
(% of Sales)	48.2	49.1		50.2		48.8	49.3	
Staff costs	142.4	104.1	36.8	75.6	88.3	400.4	315.5	26.9
(% of Sales)	7.3	6.4		6.8		7.2	6.9	
Other Expenses	465.0	407.3	14.2	268.6	73.1	1,294.3	1,087.7	19.0
(% of Sales)	23.7	24.9		24.3		23.4	23.7	
<b>Total Expenditure</b>	<b>1,552.8</b>	<b>1,314.7</b>	<b>18.1</b>	<b>900.4</b>	<b>72.5</b>	<b>4,396.1</b>	<b>3,663.2</b>	<b>20.0</b>
<b>Operating Profit</b>	<b>410.3</b>	<b>322.6</b>	<b>27.2</b>	<b>207.2</b>	<b>98.0</b>	<b>1,140.1</b>	<b>920.6</b>	<b>23.8</b>
OPM	20.9	19.7		18.7		20.6	20.1	
Depreciation	39.4	30.6	28.7	23.3	69.2	108.7	92.0	18.2
EBIT	370.9	292.0	27.0	184.0	101.6	1,031.4	828.6	24.5
Interest	1.2	0.1		0.0		1.8	1.0	85.6
Other Income	12.1	9.5	27.3	8.2	47.6	32.8	28.8	14.2
<b>PBT (incl. Extr Items)</b>	<b>381.9</b>	<b>301.5</b>	<b>26.7</b>	<b>192.2</b>	<b>98.7</b>	<b>1,062.4</b>	<b>856.4</b>	<b>24.1</b>
Provision for Taxation	113.4	84.0	35.0	59.6	90.3	311.6	240.4	29.6
(% of PBT)	29.7	27.9		31.0		29.3	28.1	
<b>Recurring PAT</b>	<b>268.5</b>	<b>217.5</b>	<b>23.5</b>	<b>132.6</b>	<b>102.5</b>	<b>750.8</b>	<b>616.0</b>	<b>21.9</b>
Extr Income/(Expense)	7.4	(1.1)	0.0	0.8		20.0	0.8	
<b>Reported PAT</b>	<b>261.2</b>	<b>218.6</b>	<b>19.5</b>	<b>131.8</b>	<b>98.2</b>	<b>730.7</b>	<b>615.3</b>	<b>18.8</b>
PATM	13.3	13.3		11.9		13.3	13.3	
<b>EPS (Rs)</b>	<b>27.1</b>	<b>22.7</b>	<b>19.5</b>	<b>13.7</b>	<b>98.2</b>	<b>75.8</b>	<b>63.8</b>	<b>18.8</b>

Source: Company, RSec Research

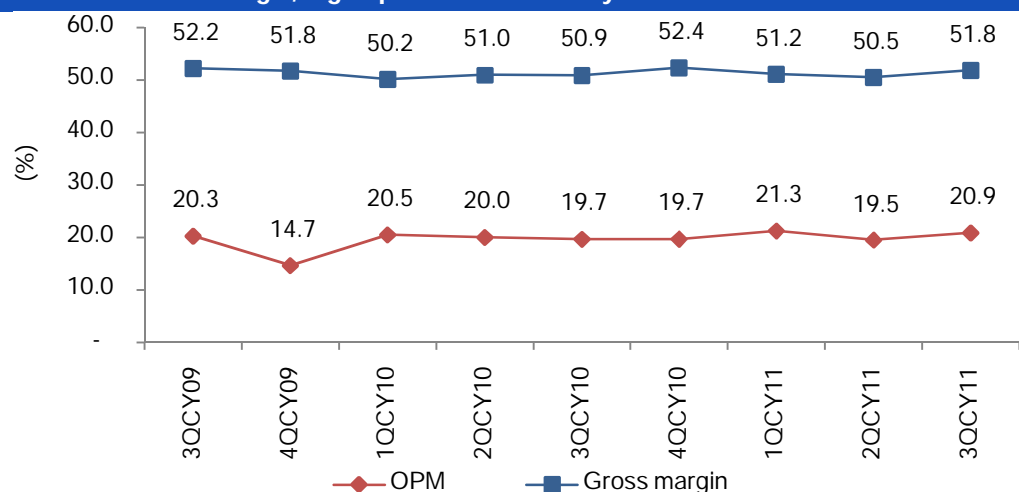
Net top-line growth as per expectation, however, lower than estimated exports revenue on account of ban in milk powder export has been factored in our numbers

**Exhibit 2: Higher price realization and volumes aid top-line growth**

Source: Company, RSec Research

Improved product/channel mix has aided Nestle on the gross margin front despite firm milk prices

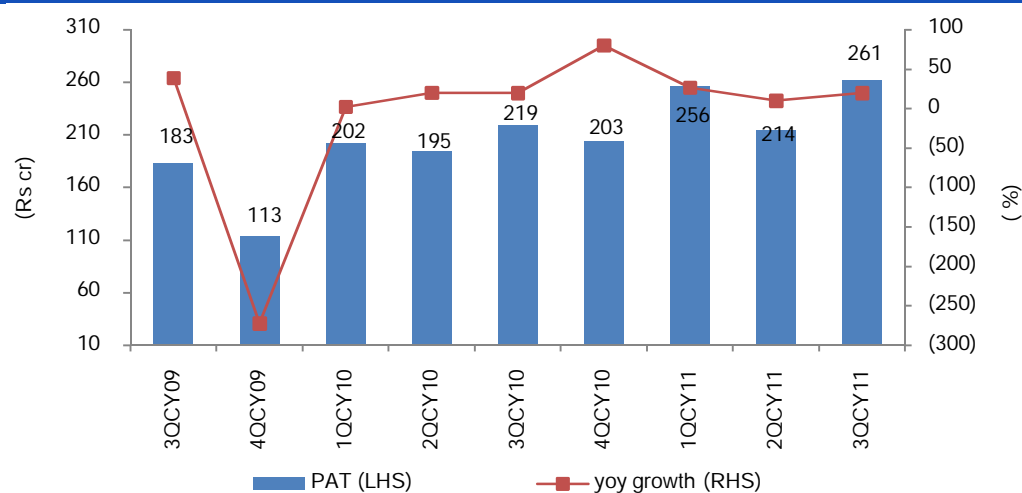
**Exhibit 3: Gross margin, high operational efficiency aid OPM**



Source: Company, RSec Research

Despite higher depreciation expense and yoy increase in tax rate, Nestle has registered consistent Net Profit margin aided by margin expansion and higher other income (benefit accruing from increase in interest rates)

**Exhibit 4: Recurring earnings growth strong despite higher tax rate**



Source: Company, RSec Research

**Profit & Loss Statement**

Y/E Dec (Rs cr)	CY2009	CY2010	CY2011E	CY2012E
<b>Gross sales</b>	<b>5,222</b>	<b>6,377</b>	<b>7,641</b>	<b>9,033</b>
Less: Excise duty	93	122	153	181
Net Sales	5,129	6,255	7,488	8,852
<b>Total operating income</b>	<b>5,129</b>	<b>6,255</b>	<b>7,488</b>	<b>8,852</b>
% chg	18.6	21.9	19.7	18.2
<b>Total Expenditure</b>	<b>4,095</b>	<b>5,005</b>	<b>5,947</b>	<b>6,954</b>
<b>EBITDA</b>	<b>1,034</b>	<b>1,250</b>	<b>1,541</b>	<b>1,898</b>
% chg	19.8	20.8	23.3	23.1
(% of Net Sales)	20.2	20.0	20.6	21.4
Depre. & Amortization	111	128	152	161
<b>EBIT</b>	<b>923</b>	<b>1,122</b>	<b>1,389</b>	<b>1,736</b>
(% of Net Sales)	18.0	17.9	18.6	19.6
Interest	1	1	3	2
Other Income	38	43	60	71
Share in profit of Asso.	-	-	-	-
<b>PBT (reported)</b>	<b>960</b>	<b>1,163</b>	<b>1,446</b>	<b>1,806</b>
Tax	262	326	434	560
Tax rate (%)	27.3	28.1	30.0	31.0
<b>PAT (recurring)</b>	<b>698</b>	<b>837</b>	<b>1,013</b>	<b>1,246</b>
Ext. Exp./ (Income)	43	18	15	20
Minority interest (MI)	-	-	-	-
<b>PAT (reported)</b>	<b>655</b>	<b>819</b>	<b>998</b>	<b>1,226</b>
% chg	22.6	25.0	21.8	22.9
(% of Net Sales)	12.8	13.1	13.3	13.8
<b>Basic EPS (Rs)</b>	<b>67.9</b>	<b>84.9</b>	<b>103.5</b>	<b>127.1</b>
<b>Fully Diluted EPS (Rs)</b>	<b>67.9</b>	<b>84.9</b>	<b>103.5</b>	<b>127.1</b>
% chg	22.6	25.0	21.8	22.9

**Cash Flow Statement**

Y/E Dec (Rs cr)	CY2009	CY2010	CY2011E	CY2012E
Profit before tax	917	1,145	1,431	1,786
Depreciation	111	128	152	161
Change in Working Capital	131	140	23	63
Interest / Dividend (Net)	(13)	(18)	(16)	(18)
Direct taxes paid	262	326	434	560
Others	(14)	(11)	7	1
<b>Cash Flow from Operations</b>	<b>871</b>	<b>1,057</b>	<b>1,165</b>	<b>1,433</b>
(Inc.)/ Dec. in Fixed Assets	(206)	(483)	(109)	(421)
(Inc.)/ Dec. in Investments	(168)	53	-	-
<b>Cash Flow from Investing</b>	<b>(375)</b>	<b>(431)</b>	<b>(109)</b>	<b>(421)</b>
Issue of Equity	-	-	-	-
Inc./(Dec.) in loans	-	-	-	-
Dividend Paid (Incl. Tax)	547	545	547	547
Interest / Dividend (Net)	(13)	(18)	(16)	(18)
<b>Cash Flow from Financing</b>	<b>(534)</b>	<b>(527)</b>	<b>(532)</b>	<b>(530)</b>
Inc./(Dec.) in Cash	(38)	100	524	482
<b>Opening Cash balances</b>	<b>194</b>	<b>156</b>	<b>255</b>	<b>779</b>
<b>Closing Cash balances</b>	<b>156</b>	<b>255</b>	<b>779</b>	<b>1,261</b>

**Balance Sheet**

Y/E Dec (Rs cr)	CY2009	CY2010	CY2011E	CY2012E
<b>SOURCES OF FUNDS</b>				
Equity Share Capital	96	96	96	96
Preference Capital	-	-	-	-
Reserves & Surplus	485	759	1,209	1,888
<b>Shareholders Funds</b>	<b>581</b>	<b>855</b>	<b>1,306</b>	<b>1,985</b>
Minority Interest	-	-	-	-
Total Loans	-	-	-	-
Deferred Tax Liability	32	33	33	33
<b>Total Liabilities</b>	<b>613</b>	<b>889</b>	<b>1,339</b>	<b>2,018</b>
<b>APPLICATION OF FUNDS</b>				
Gross Block	1,641	1,855	2,202	2,603
Less: Acc. Depreciation	745	842	994	1,155
<b>Net Block</b>	<b>896</b>	<b>1,013</b>	<b>1,208</b>	<b>1,448</b>
Capital Work-in-Progress	80	349	110	130
Goodwill	-	-	-	-
<b>Investments</b>	<b>203</b>	<b>151</b>	<b>151</b>	<b>151</b>
Current Assets	857	1,046	1,739	2,399
Cash	156	255	779	1,261
Loans & Advances	138	151	172	204
Other	563	639	787	934
Current liabilities	1,422	1,670	1,869	2,110
<b>Net Current Assets</b>	<b>(566)</b>	<b>(624)</b>	<b>(130)</b>	<b>289</b>
<b>Total Assets</b>	<b>613</b>	<b>889</b>	<b>1,339</b>	<b>2,018</b>

**Key Ratios**

Y/E Dec	CY2009	CY2010	CY2011E	CY2012E
<b>Valuation Ratio (x)</b>				
P/E (on FDEPS)	66.2	53.0	43.5	35.4
P/CEPS	56.6	45.8	37.7	31.3
P/BV	74.6	50.7	33.2	21.9
Dividend yield (%)	1.1	1.1	1.1	1.1
EV/Sales	8.4	6.9	5.8	4.9
EV/EBITDA	41.8	34.5	27.6	22.2
EV / Total Assets	70.5	48.5	31.8	20.9
<b>Per Share Data (Rs)</b>				
EPS (Basic)	67.9	84.9	103.5	127.1
EPS (fully diluted)	67.9	84.9	103.5	127.1
Cash EPS	79.5	98.2	119.2	143.9
DPS	48.5	48.5	48.5	48.5
Book Value	60.3	88.7	135.4	205.8
<b>Returns (%)</b>				
RoCE	164.3	149.4	124.7	103.4
RoE	124.2	114.0	92.3	74.5
<b>Turnover ratios (x)</b>				
Asset Turnover	3.1	3.4	3.4	3.4
Inventory / Sales (days)	35	34	34	34
Receivables (days)	5	4	5	5
Payables (days)	42	44	42	42
WCC (days)	(7)	(7)	(8)	(9)

**General Disclaimers:** This Research Report (hereinafter called 'Report') is prepared and distributed by Reliance Securities Limited (RSL) for information purposes only. The views herein constitute only the opinions and do not constitute any guidelines or recommendation and should not be deemed or construed to be neither advice for the purposes of purchase or sale of any security, derivatives or any other security through RSL nor any solicitation or offering of any investment /trading opportunity on behalf of the issuer(s) of the respective security(ies) referred to herein. These information / opinions / views are not meant to serve as a professional investment guide for the readers. No action is solicited based upon the information provided herein. Recipients of this Report should rely on information/data arising out of their own investigations. Readers are advised to seek independent professional advice and arrive at an informed trading/investment decision before executing any trades or making any investments. This Report has been prepared on the basis of publicly available information, internally developed data and other sources believed by RSL to be reliable. RSL or its directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information / opinions / views. While due care has been taken to ensure that the disclosures and opinions given are fair and reasonable, none of the directors, employees, affiliates or representatives of RSL shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way whatsoever from the information / opinions / views contained in this Report.

**Risks:** Trading and investment in securities are subject market risks. There are no assurances or guarantees that the objectives of any of trading / investment in securities will be achieved. The trades/ investments referred to herein may not be suitable to all categories of traders/investors. The names of securities mentioned herein do not in any manner indicate their prospects or returns. The value securities referred to herein may be adversely affected by the performance or otherwise of the respective issuer companies, changes in the market conditions, micro and macro factors and forces affecting capital markets like interest rate risk, credit risk, liquidity risk and reinvestment risk. Derivative products may also be affected by various risks including but not limited to counter party risk, market risk, valuation risk, liquidity risk and other risks. Besides the price of the underlying asset, volatility, tenor and interest rates may affect the pricing of derivatives.

**Disclaimers in respect of jurisdiction:** The possession, circulation and/or distribution of this Report may be restricted or regulated in certain jurisdictions by appropriate laws. No action has been or will be taken by RSL in any jurisdiction (other than India), where any action for such purpose(s) is required. Accordingly, this Report shall not be possessed, circulated and/or distributed in any such country or jurisdiction unless such action is in compliance with all applicable laws and regulations of such country or jurisdiction. RSL requires such recipient to inform himself about and to observe any restrictions at his own expense, without any liability to RSL. Any dispute arising out of this Report shall be subject to the exclusive jurisdiction of the Courts in India.

**Disclosure of Interest:** The research analysts who have prepared this Report hereby certify that the views /opinions expressed in this Report are their personal independent views/opinions in respect of the securities and their respective issuers. Neither RSL nor the research analysts did have any known direct /indirect conflict of interest including any long/short position(s) in any specific security on which views/opinions have been made, during the preparation of this Report.

**Copyright:** The copyright in this Report belongs exclusively to RSL. This Report shall only be read by those persons to whom it has been delivered. No reprinting, reproduction, copying, distribution of this Report in any manner whatsoever, in whole or in part, is permitted without the prior express written consent of RSL.

**Important** These disclaimers, risks and other disclosures must be read in conjunction with the information / opinions / views of which they form part of.

**Reliance Securities Limited is a Stock Broker with Bombay Stock Exchange Limited (SEBI Registration Nos. INB011234839, INF011234839 and INE011234839); with National Stock Exchange of India Limited (SEBI Registration Nos. INB231234833, INF231234833, and INF231234833); and with MCX Stock Exchange Limited (SEBI Registration No. INE261234833)**