

Nestlé

Performance Highlights

(₹ cr)	3QCY11	3QCY10	% yoy	Angel est.	% Diff
Revenue	1,963	1,637	19.9	1,928	1.8
EBITDA	410	323	27.2	395	3.8
OPM (%)	20.9	19.7	120bp	20.5	40bp
PAT	261	219	19.5	263	(0.7)

Source: Company, Angel Research

Nestlé reported a healthy performance for 3QCY2011, in-line with our expectations. The company's top line grew by 19.9% yoy and earnings grew by 19.5% yoy. Operating margin for the quarter contracted due to raw-material price inflation. **We maintain our Neutral view on the stock.**

Key highlights during the quarter: Top-line growth during the quarter was driven by value and volume growth. The company reported export sales growth of 4.6% yoy and domestic sales growth of 20.7% yoy. Export sales during the quarter were impacted because of ban on milk powder. Earnings for the quarter grew by healthy 19.5% yoy. Tax expense for the company increased as the Pantnagar plant tax holiday reduced to 30% from 100% earlier.

Outlook and valuation: At the CMP, Nestlé is trading at ~180% premium to the Sensex, significantly ahead of its five-year average historical premium of ~76%. We render caution on the company's high premium to the Sensex on account of 1) gross margin pressures due to rising input costs and 2) competition in the high-growth noodles category from HUL (Knorr soupy noodles), GSKCHL (Horlicks Foodles) and ITC (Sunfeast Yipee). Hence, we continue to maintain our Neutral view on the stock.

Key financials

Y/E March (₹ cr)	CY2009	CY2010	CY2011E	CY2012E
Net Sales	5,129	6,255	7,277	8,435
% chg	18.6	21.9	16.3	15.9
Net Profit (Adj.)	655	819	974	1,158
% chg	22.6	25.0	18.9	18.9
EBITDA (%)	20.2	20.0	20.1	20.7
EPS (₹)	67.9	84.9	101.0	120.1
P/E (x)	64.3	51.4	43.2	36.4
P/BV (x)	72.4	49.2	32.8	22.2
RoE (%)	124.2	114.0	91.1	72.9
RoCE (%)	164.3	149.4	120.4	97.6
EV/Sales (x)	8.2	6.7	5.7	5.0
EV/EBITDA (x)	40.5	33.5	28.2	23.4

Source: Company, Angel Research

NEUTRAL

CMP	₹4,349
Target Price	-
Investment Period	-
Stock Info	
Sector	FMCG
Market Cap (₹ cr)	42,500
Beta	0.3
52 Week High / Low	4,549/3,120
Avg. Daily Volume	7,620
Face Value (₹)	10
BSE Sensex	17,570
Nifty	5,289
Reuters Code	NEST.BO
Bloomberg Code	NEST@IN

Shareholding Pattern (%)

Promoters	62.8
MF / Banks / Indian Fls	8.0
FII / NRIs / OCBs	10.9
Indian Public / Others	18.4

Abs. (%)	3m	1yr	3yr
Sensex	3.4	(15.7)	76.3
Nestle	6.1	17.9	215.8

Sreekanth P.V.S

022 - 3935 7800 Ext: 6841

sreekanth.s@angelbroking.com

Exhibit 1: Quarterly performance

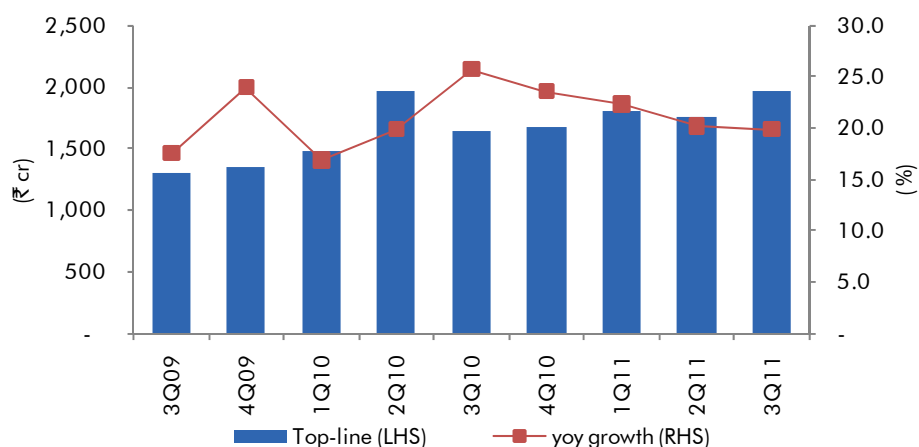
Y/E Dec. (₹ cr)	3QCY11	3QCY10	% chg	9MCY11	9M CY10	% chg
Net Sales	1,963	1,637	19.9	6,255	5,129	21.9
Consumption of RM	945	803	17.7	3,056	2,448	24.8
(% of Sales)	48.2	49.1		48.9	47.7	
Staff Costs	142	104	36.8	433	432	0.2
(% of Sales)	7.3	6.4		6.9	8.4	
Other Expenses	465	407	14.2	1,515	1,214	24.8
(% of Sales)	23.7	24.9		24.2	23.7	
Total Expenditure	1,553	1,315	18.1	5,004	4,095	22.2
Operating Profit	410	323	27.2	1,250	1,034	20.9
OPM	20.9	19.7		20.0	20.2	
Interest	1	0		1	1	(23.6)
Depreciation	39	31	28.7	128	111	14.8
Other Income	12	10	27.3	43	38	12.6
PBT (excl. Extr Items)	382	301	26.7	1,164	960	21.3
Extr Income/(Expense)	7	(1)	(768.2)	19	43	
PBT (incl. Extr Items)	375	303	23.8	1,145	917	24.9
(% of Sales)	19.1	18.5		18.3	17.9	
Provision for Taxation	113	84	35.0	326	262	24.6
(% of PBT)	29.7	27.9		28.0	27.3	
Reported PAT	261	219	19.5	819	655	25.0
PATM	13.3	13.3		13.1	12.8	
Recurring PAT	269	217	23.5	838	698	20.1
Equity shares (cr)	9.6	9.6		9.6	9.6	
EPS (₹)	27	23	19.5	85	68	

Source: Company, Angel Research

Steady double-digit top line growth aided by value and volume growth...

Nestlé registered robust top-line growth of 19.9% yoy to ₹1,963cr, driven by steady growth in its net domestic sales (up 20.7% yoy to ₹1,877cr, supported by volume growth and higher realization across categories). Exports also registered 4.6% yoy growth to ₹86cr during the quarter.

Exhibit 2: Double-digit top-line growth continues...

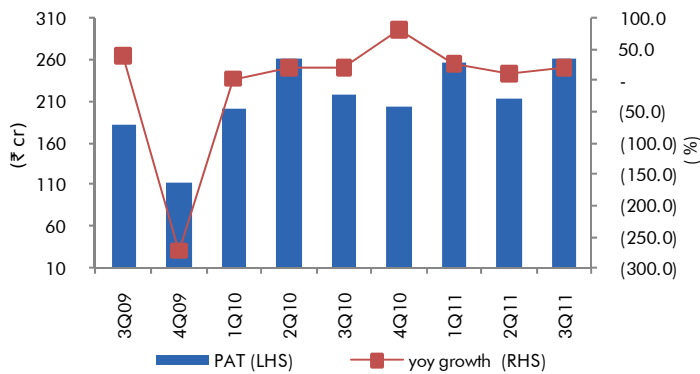


Source: Company, Angel Research

Input costs cool, margins rise, higher tax rate drags earnings

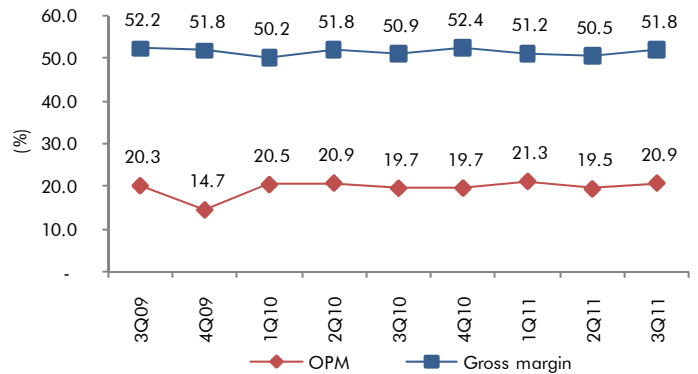
The company's earnings (on a reported basis) registered 19.5% yoy growth to ₹261cr, aided by margin expansion. Gross margin for the quarter expanded by 91bp yoy, as the company improved its product and channel mix. OPM for the quarter increased by 120bp yoy because of reduced other expenses (down by 11bp yoy) and higher gross margin. The company's earnings growth was impacted by its Pantnagar plant's 100% income tax holiday reducing to 30% as it completed five years of operation.

Exhibit 3: Higher tax rate drags earnings growth



Source: Company, Angel research

Exhibit 4: Gross margin and OPM expand yoy



Source: Company, Angel research

Investment arguments

- **Best play on emerging growth opportunity in the foods and beverages space:** Nestlé enjoys a strong position across categories in the foods and beverage space through its diversified portfolio of established brands such as *Maggi*, *Nescafe*, *Everyday*, *Kit Kat* and *Milkmaid*. We are particularly bullish on underpenetrated categories such as instant noodles, value-added dairy products, chocolates and confectionery, which are witnessing an uptrend in consumer demand.
- **However, valuations at 180% premium to the Sensex capture full potential:** At the CMP, Nestlé is trading at ~180% premium to the Sensex, significantly ahead of its five-year average historical premium of ~76%. While Nestlé has been able to maintain these premium valuations because of its strong parentage, dominant brands, high RoE and OPM, we believe current valuations capture the full potential of near-term growth. We remain cautious in terms of Nestlé being able to maintain this triple-digit premium to the Sensex on account of gross margin pressures due to rising input costs and competition in the high-growth noodles category from HUL, GSKCHL and ITC.

Outlook and valuation

Post 3QCY2011 results, we continue to maintain our revenue and earnings estimates. **At the CMP, Nestlé is trading at ~180% premium to the Sensex, significantly ahead of its five-year average historical premium of ~76%.** We render caution on Nestlé's high premium to the Sensex on account of 1) gross margin pressures due to rising input costs and 2) competition in the high-growth noodles category from HUL, GSKCHL and ITC. **Hence, we continue to maintain our Neutral view on the stock.**

Exhibit 5: Key assumptions

Sales (₹ cr)	CY08	CY09	CY10	CY11E	CY12E	CY09-12E
Total Milk Products	1,939	2,311	2,776	3,095	3,448	14.3
Beverages	801	804	899	1,022	1,157	12.9
Prepared Dishes & Cooking Aids	1,052	1,335	1,725	2,132	2,613	25.1
Chocolates & Confectionaries	680	772	976	1,176	1,389	21.6
Total Gross Revenue	4,471	5,222	6,377	7,426	8,607	18.1
YoY % Growth						
Total Milk Products	23.1	19.2	20.1	11.5	11.4	
Beverages	10.9	0.4	11.8	13.7	13.2	
Prepared Dishes & Cooking Aids	34.7	26.9	29.2	23.6	22.6	
Chocolates & Confectionaries	19.5	13.6	26.4	20.5	18.1	
Total Revenue	22.6	16.8	22.1	16.5	15.9	
Volume Growth %						
Total Milk Products	10.1	13.1	7.6	7.2	7.1	
Beverages	0.0	(3.1)	13.2	12.0	11.5	
Prepared Dishes & Cooking Aids	30.1	21.7	24.4	20.0	19.0	
Chocolates & Confectionaries	12.4	9.7	21.2	17.0	14.6	
Total Gross Revenue	16.9	14.9	17.0	14.7	17.0	
Realisation Growth %						
Total Milk Products	11.7	5.4	11.6	4.0	11.6	
Beverages	10.9	3.6	(1.2)	1.5	(1.2)	
Prepared Dishes & Cooking Aids	3.5	4.3	3.9	3.0	3.9	
Chocolates & Confectionaries	6.3	3.5	4.3	3.0	4.3	

Source: Company, Angel research

Exhibit 6: Peer valuation

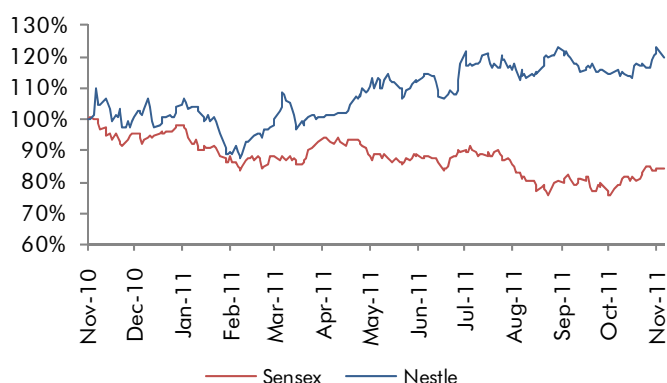
Company	Reco.	Mcap (₹ cr)	CMP (₹)	TP (₹)	Upside (%)	P/E (x)		EV/Sales (x)		RoE (%)		CAGR	
						FY12E	FY13E	FY12E	FY13E	FY12E	FY13E	Sales	PAT
Asian Paints	Neutral	30,412	3,171	-	-	30.9	25.1	3.3	2.7	39.6	38.3	17.3	19.8
Britannia	Neutral	5,638	472	-	-	30.6	21.0	1.1	0.9	37.8	46.0	17.3	36.0
Colgate	Neutral	14,532	1,069	-	-	33.1	28.3	5.5	4.7	111.7	108.0	14.9	12.9
Dabur	Buy	17,320	100	115	16	24.7	21.6	3.4	3.0	44.9	41.6	20.5	18.8
GSKCHL [^]	Neutral	10,781	2,563	-	-	31.0	26.1	3.6	3.0	32.6	31.8	20.1	23.9
GCPL	Accumulate	13,421	415	457	10	25.1	19.3	3.3	2.7	36.6	29.4	22.9	20.2
HUL	Neutral	83,003	380	-	-	32.6	28.6	3.6	3.2	87.5	85.3	12.7	17.1
ITC	Neutral	162,539	210	-	-	28.2	23.7	6.3	5.2	32.7	31.5	17.6	17.4
Marico	Neutral	9,127	149	-	-	29.4	23.6	2.7	2.3	30.4	28.6	15.7	27.6
Nestlé[^]	Neutral	42,500	4,366	-	-	43.2	36.4	5.7	5.0	91.1	72.9	16.1	18.9

 Source: Company, Angel Research; Note: [^] December year end

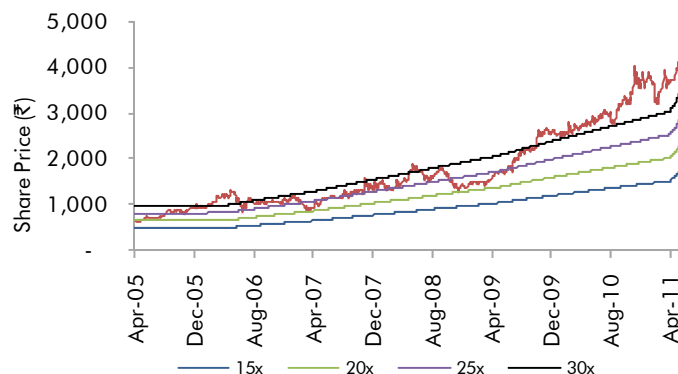
Exhibit 7: Angel vs. Consensus estimates

Top-line (₹ cr)	CY2011E	CY2012E	EPS (₹)	CY2011E	CY2012E
Angel estimates	7,277	8,435	Angel estimates	101.0	120.1
Consensus	7,579	9,049	Consensus	103.5	124.0
Diff (%)	(4.0)	(6.8)	Diff (%)	(2.4)	(3.2)

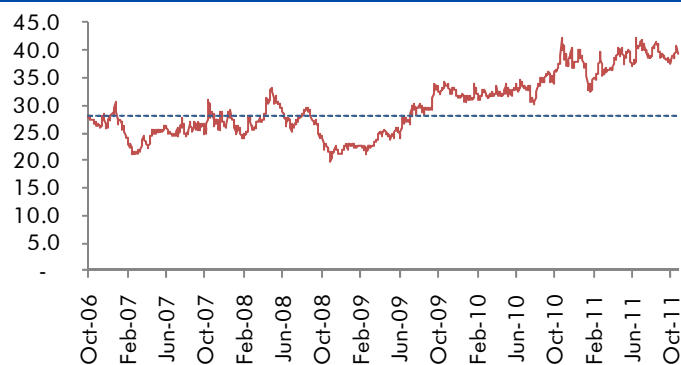
Source: Company, Angel Research

Exhibit 8: Absolute returns of Nestlé vs. Sensex


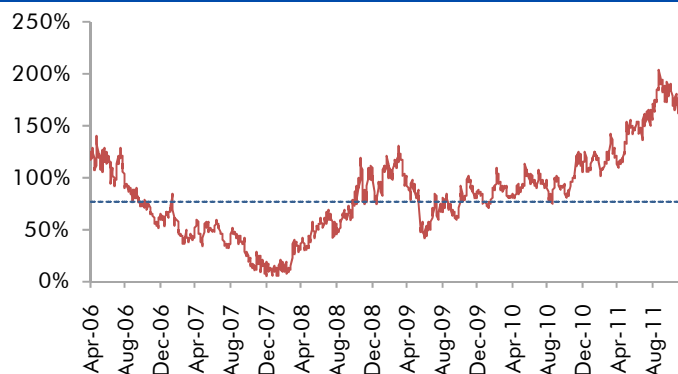
Source: Company, Angel Research

Exhibit 9: One-year forward P/E band


Source: Company, Angel Research

Exhibit 10: One-yr forward P/E chart


Source: Company, Angel Research

Exhibit 11: One-yr forward Premium v/s Sensex chart


Source: Company, Angel Research

Profit & Loss Statement

Y/E Dec (₹ cr)	CY07	CY08	CY09	CY10	CY11E	CY12E
Gross sales	3,647	4,471	5,222	6,377	7,426	8,607
Less: Excise duty	143	147	93	122	149	172
Net Sales	3,504	4,324	5,129	6,255	7,277	8,435
Total operating income	3,504	4,324	5,129	6,255	7,277	8,435
% chg	24.4	23.4	18.6	21.9	16.3	15.9
Total Expenditure	2,808	3,461	4,095	5,005	5,811	6,691
Cost of Materials	1,685	2,104	2,448	3,056	3,563	4,077
Advertising Exp	172	194	268	303	364	422
Personnel	263	307	432	433	509	590
Others	688	855	947	1,213	1,375	1,603
EBITDA	696	864	1,034	1,250	1,466	1,743
% chg	28.6	24.1	19.8	20.8	17.3	18.9
(% of Net Sales)	19.9	20.0	20.2	20.0	20.1	20.7
Dep. & Amortisation	75	92	111	128	139	161
EBIT	622	771	923	1,122	1,327	1,582
% chg	30.8	24.1	19.7	21.5	18.3	19.2
(% of Net Sales)	17.7	17.8	18.0	17.9	18.2	18.8
Interest & other Charges	1	2	1	1	1	1
Other Income	25	34	38	43	47	55
(% of PBT)	3.9	4.2	3.9	3.7	3.4	3.4
Share in profit of Asso.	-	-	-	-	-	-
Recurring PBT	646	804	960	1,163	1,373	1,636
% chg	30.4	24.4	19.4	21.2	18.0	19.1
Extraordinary Expense/(Inc.)	18	31	43	18	15	20
PBT (reported)	629	773	917	1,145	1,358	1,616
Tax	215	239	262	326	384	458
(% of PBT)	33.2	29.7	27.3	28.1	28.0	28.0
PAT (reported)	414	534	655	819	974	1,158
Add: Share of earn of asso	-	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-	-
PAT after MI (reported)	414	534	655	819	974	1,158
ADJ. PAT	431	565	698	837	989	1,178
% chg	30.7	31.0	23.5	20.0	18.1	19.1
(% of Net Sales)	12.3	13.1	13.6	13.4	13.6	14.0
Basic EPS (₹)	42.9	55.4	67.9	84.9	101.0	120.1
FDEPS (₹)	42.9	55.4	67.9	84.9	101.0	120.1
% chg	31.3	29.1	22.6	25.0	18.9	18.9

Balance Sheet

Y/E Dec (₹ cr)	CY07	CY08	CY09	CY10	CY11E	CY12E
SOURCES OF FUNDS						
Equity Share Capital	96	96	96	96	96	96
Preference Capital	-	-	-	-	-	-
Reserves & Surplus	322	377	485	759	1,185	1,796
Shareholders' Funds	418	473	581	855	1,282	1,893
Minority Interest	-	-	-	-	-	-
Total Loans	3	-	-	-	-	-
Deferred Tax Liability	29	37	32	33	33	33
Total Liabilities	450	510	613	889	1,315	1,926
APPLICATION OF FUNDS						
Gross Block	1,180	1,405	1,641	1,855	2,140	2,481
Less: Acc. Depreciation	578	652	745	842	981	1,142
Net Block	602	753	896	1,013	1,159	1,338
Capital Work-in-Progress	74	109	80	349	107	124
Goodwill	-	-	-	-	-	-
Investments	94	35	203	151	151	151
Current Assets	638	798	857	1,046	1,747	2,385
Cash	38	194	156	255	815	1,301
Loans & Advances	145	124	138	151	167	194
Other	455	481	563	639	765	890
Current liabilities	958	1,185	1,422	1,670	1,849	2,072
Net Current Assets	(320)	(387)	(566)	(624)	(102)	313
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	450	510	613	889	1,315	1,926

Cash Flow Statement

Y/E Dec ₹ cr)	CY07	CY08	CY09	CY10	CY11E	CY12E
Profit before tax	629	773	917	1,145	1,358	1,616
Depreciation	75	92	111	128	139	161
Change in Working Capital	8	84	131	140	31	71
Interest / Dividend (Net)	(4)	(13)	(13)	(18)	(17)	(18)
Direct taxes paid	215	239	262	326	384	458
Others	22	21	(14)	(11)	7	1
Cash Flow from Operations	514	719	871	1,057	1,134	1,372
(Inc.)/ Dec. in Fixed Assets	(157)	(261)	(206)	(483)	(44)	(357)
(Inc.)/ Dec. in Investments	(17)	60	(168)	53	-	-
Cash Flow from Investing	(174)	(201)	(375)	(431)	(44)	(357)
Issue of Equity	-	-	-	-	-	-
Inc./(Dec.) in loans	(13)	(3)	-	-	-	-
Dividend Paid (Incl. Tax)	370	372	547	545	547	547
Interest / Dividend (Net)	(4)	(13)	(13)	(18)	(17)	(18)
Cash Flow from Financing	(379)	(362)	(534)	(527)	(530)	(529)
Inc./(Dec.) in Cash	(39)	156	(38)	100	560	486
Opening Cash balances	76	38	194	156	255	815
Closing Cash balances	38	194	156	255	815	1,301

Key Ratios

Y/E Dec (₹ cr)	CY07	CY08	CY09	CY10	CY11E	CY12E
Valuation Ratio (x)						
P/E (on FDEPS)	101.7	78.8	64.3	51.4	43.2	36.4
P/CEPS	86.2	67.2	54.9	44.5	37.8	31.9
P/BV	100.6	88.9	72.4	49.2	32.8	22.2
Dividend yield (%)	0.8	1.0	1.1	1.1	1.1	1.1
EV/Sales	11.9	9.7	8.2	6.7	5.7	5.0
EV/EBITDA	60.4	48.5	40.5	33.5	28.2	23.4
EV / Total Assets	93.5	82.1	68.4	47.1	31.4	21.2
Per Share Data (₹)						
EPS (Basic)	42.9	55.4	67.9	84.9	101.0	120.1
EPS (fully diluted)	42.9	55.4	67.9	84.9	101.0	120.1
Cash EPS	50.7	65.0	79.5	98.2	115.4	136.8
DPS	33.0	42.5	48.5	48.5	48.5	48.5
Book Value	43.4	49.1	60.3	88.7	132.9	196.3
Returns (%)						
ROCE (Pre-tax)	142.2	160.7	164.3	149.4	120.4	97.6
Angel ROIC (Pre-tax)	141.1	180.9	250.4	219.0	229.6	276.5
ROE	102.5	119.8	124.2	114.0	91.1	72.9
Turnover ratios (x)						
Asset Turnover (GB)	3	3	3	3	3	3
Inventory / Sales (days)	42	37	35	34	34	34
Receivables (days)	6	4	5	4	5	5
Payables (days)	48	43	42	44	43	42
WC cycle (ex-cash) (days)	(10)	(7)	(7)	(7)	(8)	(9)

Research Team Tel: 022 - 39357800

 E-mail: research@angelbroking.com

 Website: www.angelbroking.com

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1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	Buy (> 15%) Reduce (-5% to 15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)
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