

Institutional Equities  
 India Research

# Nestle India

**RESULT REVIEW**

 Bloomberg: NEST IN  
 Reuters: NEST.BO

**SELL**

## Unsustainable EBITDA Margin amid Slower Volume Growth

Nestlé India (Nestlé) once again reported weak performance in Q4CY12. Its net sales, EBITDA & Adjusted PAT grew by 10.1%, 19.5% & 16.6% YoY, respectively. Its domestic business – constituting 95% of sales – grew by 9.6% in Q4CY12 vs. average historical sales growth of >20%. The large part of domestic sales growth was due to net realization growth and favorable revenue mix. EBITDA margin has expanded by 179bps to 22.7% – the highest in past 16 quarters – in Q4CY12. Higher depreciation and interest cost has resulted in slower 16.6% growth in adjusted PAT to Rs. 2,789 bn compared with our estimate of Rs. 2,709mn.

**Expect Better Volume Growth:** Consistent price hike, focus on high-value segment, slower consumer spending on discretionary along with rising competition in most of the categories has been impacting Nestlé India's volume growth in last 5-6 quarters. We believe that the Company would focus more towards volume growth on the back of higher utilization of recently expanded capacities. However, there is a limited scope for sales growth through further price hike as the Company has already implemented significant price hike in the past few quarters.

**Unsustainable EBITDA Margin:** Nestlé has registered strong 22.7% EBITDA margin in Q4CY12, which we believe to be unsustainable, going forward. We expect ~100 bps YoY decline in EBITDA margin in CY13E.

**Decline in ROCE and ROE:** Ongoing capacity expansion and slower volume growth has impacted Nestlé's robust return ratio profile. Declining sharply in the past two years, its RoCE & RoE reached to 65% and 60%.

### Outlook & Valuation

Nestlé India has been the laggard in the FMCG space in last 15 months owing to slow volume growth and pressure on return ratios. We believe that the Company's increased focus on volume growth would slightly impact its EBITDA margin, going forward. We slightly reduce our EPS estimate by ~3% for CY13E & CY14E, as we cut our sales growth assumption marginally. We give 31x (PEG of 1.9x) P/E multiple on 24-month forward earnings. We reiterate our "SELL" recommendation on the stock with marginally downward revision in target price to Rs. 4,629 per share (earlier Rs. 4,692).

### Key Financials

Y/E Mar (Rs mn)	CY10	CY11	CY12P	CY13E	CY14E
Revenue	62,609	74,994	83,365	97,500	114,299
EBITDA	12,559	15,614	18,287	20,567	23,902
Net Profits (Adj)	8,188	9,616	10,668	11,769	14,042
EPS (Rs)	84.9	99.7	110.6	122.1	145.6
PER (x)	54.2	46.1	41.6	37.7	31.6
P/BV (x)	51.8	34.8	24.7	22.0	20.2
EV/EBITDA (x)	35.0	28.8	24.5	21.8	18.5

Source: Company, Karvy Institutional Research

### Recommendation

CMP:	Rs4,604
Target Price:	Rs4,629
Upside (%)	1%

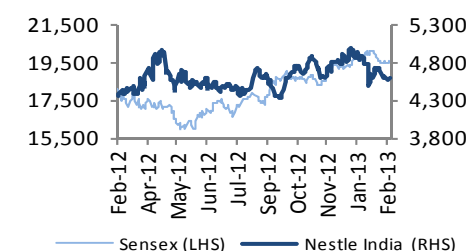
### Stock Information

Market Cap. (Rs bn / US\$ mn)	444/8,194
52-week High/Low (Rs)	5,544/4,300
3m ADV (Rs mn / US\$ mn)	121/2.2
Beta	0.4
Sensex/ Nifty	19,643/5,943
Share outstanding (mn)	96

### Stock Performance (%)

	1M	3M	12M	YTD
Absolute	(4)	(0.1)	5.7	(7.8)
Rel. to Sensex	(2.1)	(6.8)	(1.6)	(8.8)

### Performance



Source: Bloomberg

### Analysts Contact

**Naveen Trivedi**  
 022-6184 4316  
 naveen.trivedi@karvy.com

## Result Review

Domestic business (95% of sales) grew by slower 9.6% as compared to robust >20% average sales growth history. Consistent price hike, focus on high-value segment, slower consumer spending on discretionary along with the rising competition in most of the categories has been impacting Nestlé India's volume growth in the last 5-6 quarters. The large part of the sales growth during the quarter too has come through net realisation growth and favorable revenue mix. Besides, Exports has displayed strong 21% growth owing to strong 47% growth in third parties exports.

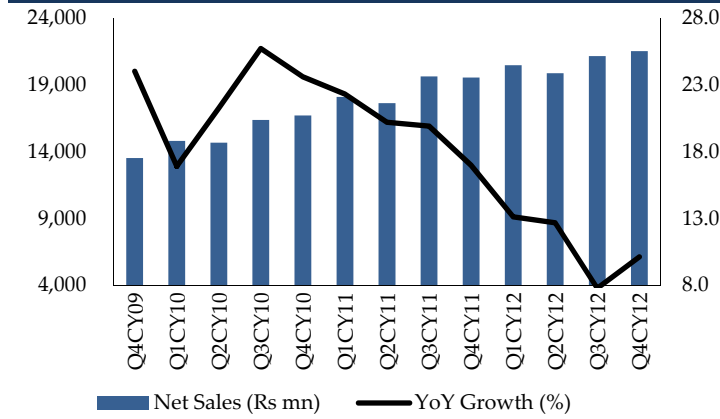
EBITDA margin during the quarter was at 22.7% which we believe is not sustainable owing to the expectation of higher marketing efforts and limited scope of further price hike. We believe, to achieve better volume growth Nestle would have to sacrifice profitability.

### Exhibit 1: Quarterly Performance

Particulars (Rs mn)	Q4CY11	Q4CY12	YoY Change	Q3CY12	QoQ Change	CY11	CY12	YoY Change
<b>Net Sales</b>	<b>19,547</b>	<b>21,526</b>	<b>10.1</b>	<b>21,156</b>	<b>1.7</b>	<b>74,908</b>	<b>83,022</b>	<b>10.8</b>
Other Operating Income	80	85	5.7	86	(0.8)	236	323	
<b>Total Income</b>	<b>19,627</b>	<b>21,611</b>	<b>10.1</b>	<b>21,241</b>	<b>1.7</b>	<b>75,144</b>	<b>83,345</b>	<b>10.9</b>
Raw Material Consumed	9,370	9,723		9,010		35,229	37,569	
Stock Adjustment	(820)	(346)		404		(483)	(920)	
Purchase of Finished Goods	331	268		298		1,148	1,115	
<b>Total RM cost</b>	<b>8,880</b>	<b>9,644</b>	<b>8.6</b>	<b>9,712</b>	<b>(0.7)</b>	<b>35,893</b>	<b>37,764</b>	<b>5.2</b>
<b>Gross Profit</b>	<b>10,747</b>	<b>11,966</b>	<b>11.3</b>	<b>11,530</b>	<b>3.8</b>	<b>39,251</b>	<b>45,581</b>	<b>16.1</b>
<i>Gross Margin</i>	<i>54.8%</i>	<i>55.4%</i>	<i>62bps</i>	<i>54.3%</i>	<i>109bps</i>	<i>52.2%</i>	<i>54.7%</i>	<i>246bps</i>
Employee Expenses	1,461	1,750	19.8	1,671	4.7	5,465	6,634	21.4
Other Expenses	5,079	5,175	1.9	5,339	(3.1)	18,022	20,367	13.0
<b>Total Expenditures</b>	<b>15,519</b>	<b>16,700</b>	<b>7.6</b>	<b>16,796</b>	<b>(0.6)</b>	<b>59,668</b>	<b>65,104</b>	<b>9.1</b>
<b>EBITDA</b>	<b>4,108</b>	<b>4,911</b>	<b>19.5</b>	<b>4,446</b>	<b>10.5</b>	<b>15,477</b>	<b>18,241</b>	<b>17.9</b>
<i>EBITDA Margin (%)</i>	<i>20.9%</i>	<i>22.7%</i>	<i>179bps</i>	<i>20.9%</i>	<i>179bps</i>	<i>20.6%</i>	<i>21.9%</i>	<i>129bps</i>
Other Income	101	126	25.8	88	44.5	272	310	14.0
Interest	33	99	199.4	(76)	(230.1)	50	266	427.8
Depreciation	550	835	51.9	735	13.6	1,629	2,771	70.2
<b>PBT</b>	<b>3,456</b>	<b>4,083</b>	<b>18.1</b>	<b>3,870</b>	<b>5.5</b>	<b>13,888</b>	<b>15,527</b>	<b>11.8</b>
Total Tax	1,148	1,293	12.7	1,197	8.0	4,264	4,847	13.7
<i>Effective Tax Rate</i>	<i>33%</i>	<i>32%</i>	<i>-153bps</i>	<i>31%</i>	<i>75bps</i>	<i>31%</i>	<i>31%</i>	<i>52bps</i>
<b>Reported PAT</b>	<b>2,308</b>	<b>2,789</b>	<b>20.8</b>	<b>2,673</b>	<b>4.3</b>	<b>9,624</b>	<b>10,680</b>	<b>11.0</b>
Net Extra-ordinary income/ (expense)	(83)	-		121		(83)	27	
<b>Adjusted PAT</b>	<b>2,391</b>	<b>2,789</b>	<b>16.6</b>	<b>2,553</b>	<b>9.3</b>	<b>9,707</b>	<b>10,653</b>	<b>9.7</b>
<b>EPS (Adjusted)</b>	<b>24.8</b>	<b>28.9</b>	<b>16.6</b>	<b>26.5</b>	<b>9.3</b>	<b>100.7</b>	<b>110.5</b>	<b>9.7</b>

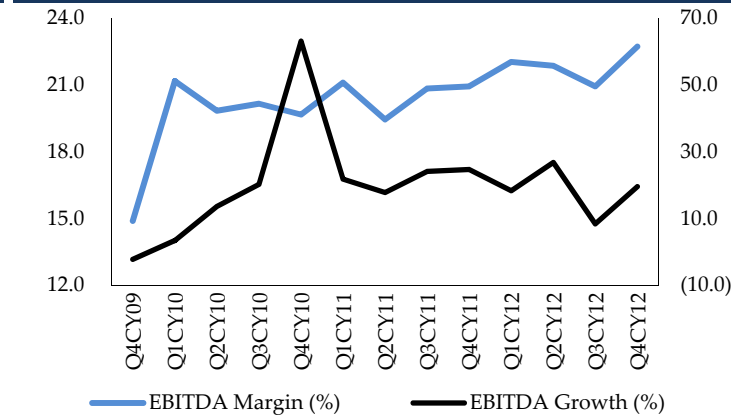
Source: Company, Karvy Institutional Research

**Exhibit 2: Quarterly Sales Growth Performance**



Source: Company, Karvy Institutional Research

**Exhibit 3: Quarterly EBITDA Performance**



Source: Company, Karvy Institutional Research

## Financials

### Exhibit 4: Profit & Loss Statement

Rs mn	CY10	CY11	CY12P	CY13E	CY14E
<b>Net sales</b>	62,609	74,994	83,365	97,500	114,299
<b>EBIDTA</b>	12,559	15,614	18,287	20,567	23,902
Depreciation	1,278	1,533	2,756	3,501	3,830
Interest Expense	11	51	259	543	510
PBT	11,452	13,879	15,460	16,813	20,059
Tax	3,264	4,264	4,793	5,044	6,018
<b>Adj. PAT</b>	8,188	9,616	10,668	11,769	14,042
EPS (Rs)	84.9	99.7	110.6	122.1	145.6
DPS (Rs)	48.5	48.5	48.5	58.2	72.8
<b>Profit and Loss Ratios</b>					
EBIDTA Margin %	20.1	20.8	21.9	21.1	20.9
Adj Net Margin %	13.1	12.8	12.8	12.1	12.3
<b>Valuation Multiples</b>					
P/E (X)	54.2	46.1	41.6	37.7	31.6
EV/EBIDTA (X)	35.0	28.8	24.5	21.8	18.5
EV/Sales (X)	7.0	6.0	5.4	4.6	3.9

Source: Company, Karvy Institutional Research

### Exhibit 5: Balance Sheet

Y/E Dec	CY10	CY11	CY12P	CY13E	CY14E
Equity Share Capital	964	964	964	964	964
Reserves & surplus	7,590	11,775	17,013	19,215	21,028
<b>Shareholders' funds</b>	<b>8,554</b>	<b>12,740</b>	<b>17,977</b>	<b>20,179</b>	<b>21,992</b>
Total Debt	-	9,708	10,508	11,208	9,208
<b>Capital Employed</b>	<b>8,554</b>	<b>22,448</b>	<b>28,485</b>	<b>31,388</b>	<b>31,200</b>
Net fixed assets	13,616	29,943	35,187	38,687	34,857
Cash & Cash Eq.	2,553	2,271	2,586	2,365	5,048
Net Other current assets	(8,789)	(10,676)	(11,316)	(11,893)	(11,933)
Investments	1,505	1,344	3,649	3,849	4,849
Net Deferred tax Assets	(333)	(435)	(1,621)	(1,621)	(1,621)
<b>Total Assets</b>	<b>8,554</b>	<b>22,448</b>	<b>28,485</b>	<b>31,388</b>	<b>31,200</b>

Source: Company, Karvy Institutional Research

**Nestle India**
**Exhibit 6: Cash Flow Statement**

Rs mn	CY10	CY11	CY12P	CY13E	CY14E
PBT	11,451	13,879	15,460	16,813	20,059
Depreciation	1,278	1,533	2,756	3,501	3,830
Tax	(3,207)	(3,640)	(4,793)	(5,044)	(6,018)
Change in Wkg Cap	756	(164)	1,826	577	40
<b>CF from Operations</b>	<b>10,368</b>	<b>11,876</b>	<b>15,508</b>	<b>16,389</b>	<b>18,422</b>
Capex	(4,459)	(15,552)	(8,000)	(7,000)	-
Investments	526	-	(2,305)	(200)	(1,000)
<b>CF from Investing</b>	<b>(3,933)</b>	<b>(15,552)</b>	<b>(10,305)</b>	<b>(7,200)</b>	<b>(1,000)</b>
Change in Equity	-	-	-	-	-
Change in Debt	-	8,652	800	700	(2,000)
Dividends & others	(4,654)	(4,649)	(4,676)	(8,239)	(10,531)
<b>CF from Financing</b>	<b>(5,438)</b>	<b>3,232</b>	<b>(4,889)</b>	<b>(9,410)</b>	<b>(14,740)</b>
Change in Cash	<b>997</b>	<b>(444)</b>	<b>314</b>	<b>(220)</b>	<b>2,682</b>

Source: Company, Karvy Institutional Research

**Exhibit 7: Key Ratios**

Y/E Dec	CY10	CY11	CY12P	CY13E	CY14E
Raw Material Cost/Sales (%)	48.8	47.9	45.3	45.9	46.0
Manpower Cost/Sales (%)	6.9	7.3	7.9	7.9	8.0
Operating & Other Cost/Sales (%)	24.2	24.0	24.9	25.1	25.1
Revenue Growth (%)	21.8	19.8	11.2	17.0	17.2
EBITDA Margins (%)	20.1	20.8	21.9	21.1	20.9
Net Income Margins (%)	13.1	12.8	12.8	12.1	12.3
ROCE (%)	146.8	69.6	64.2	65.5	76.6
ROE (%)	95.7	75.5	59.3	58.3	63.8

Source: Company, Karvy Institutional Research

**Exhibit 8: Valuation Parameters**

Y/E Dec	CY10	CY11	CY12P	CY13E	CY14E
EPS (Rs.)	84.9	99.7	110.6	122.1	145.6
P/E (x)	54.2	46.1	41.6	37.7	31.6
BV (Rs)	88.7	132.1	186.4	209.3	228.1
P/BV (x)	51.8	34.8	24.7	22.0	20.2
EV/EBITDA (x)	35.0	28.8	24.5	21.8	18.5
Fixed assets turnover ratio (x)	4.6	2.5	2.4	2.5	3.3
Net Debt/Equity (x)	(0.3)	0.6	0.4	0.4	0.2
EV/Sales	7.0	6.0	5.4	4.6	3.9

Source: Company, Karvy Institutional Research

## Institutional Equities Team

Rangachari Muralikrishnan	Head – Institutional Equities / Research / Strategy	+91-22 61844301	muralikrishnan@karvy.com
K. Anant Rao	Head - Sales-Trading & Derivatives	+91-22 61844303	k.anantrao@karvy.com
Uday Raval	Karvy Inc. USA	+1 212 2674334	udayr@karvy.com
<b>INSTITUTIONAL RESEARCH</b>			
Analysts	Industry / Sector	Desk Phone	Email ID
Amey Chalke	Research Associate - Pharmaceuticals	+91 -22 61844325	amey.chalke@karvy.com
Dwaipayan Poddar	Chief Technical Strategist	+91-22 61844372	dwaipayan.poddar@karvy.com
Hatim Broachwala, CFA	Banking	+91-22 61844329	hatim.broachwala@karvy.com
Kruti Shah	Economist	+91-22 61844320	kruti.shah@karvy.com
Manoj Kumar Manish	Derivatives and Quant Analyst	+91-22 61844327	manojkumar.m@karvy.com
Maruti Kadam	Research Associate	+91-22 61844326	maruti.kadam@karvy.com
Mitul Shah	Automobiles	+91-22 61844312	mitul.shah@karvy.com
Naveen Trivedi	FMCG	+91-22-61844316	naveen.trivedi@karvy.com
Paresh Jain	BFSI	+91-22 61844324	paresh.jain@karvy.com
Parikshit Kandpal	Infra / Real Estate / Strategy	+91-22 61844311	parikshit.kandpal@karvy.com
Rahul Sharma	Pharmaceuticals	+91-22 61844310	rahul.sharma@karvy.com
Rahul Singh	MidCap	+91-40-44857911	rahulsingh@karvy.com
Rajesh Kumar Ravi	Cement & Logistics	+91-22 61844313	rajesh.ravi@karvy.com
Rupesh Sankhe	Power/Capital Goods	+91-22 61844315	rupesh.sankhe@karvy.com
Varun Chakri	Research Associate	+91 22 61844326	varun.chakri@karvy.com
Vinay Nair	Oil & Gas	+91-22 61844319	vinaynair@karvy.com
<b>INSTITUTIONAL SALES</b>			
Dinesh Bajaj	Sales	+91-22 61844341	dinesh.bajaj@karvy.com
R. Sriram	Sales	+91-22 61844340	sriram.rangarajan@karvy.com
Shabbir Dahodwala	Sales (USA)	+1-212-2674334	shabbir@karvy.com
Tejash Gandhi	Sales	+91-22 61844345	tejash.gandhi@karvy.com
<b>INSTITUTIONAL SALES TRADING &amp; DEALING</b>			
Bhavesht Gandhi	Institutional Dealer	+91-22 61844368 /69	bhavesht.gandhi@karvy.com
Prashant Oza	Institutional Dealer	+91-22 61844370 /71	prashant.oza@karvy.com
Parag Shah	Sales Trader	+91-22 61844364 /65	parag.shah@karvy.com
Sriram Jagdish	Sales Trader	+91-22 61844366 /67	sriram.jagdish@karvy.com
Gurdarshan Singh Kharbanda	Sales Trader	+91-22-61844368 / 69	gurdarshansingh.k@karvy.com
<b>PRODUCTION</b>			
Asim Kumar Mohapatra	Editor	+91-22 61844318	asim.mohapatra@karvy.com
Vijayalaxmi L. Moolya	Production	+91-22 61844328	vijayalaxmi.m@karvy.com

Stock Ratings		Absolute Returns
Buy	:	> 15%
Hold	:	5-15%
Sell	:	< 5%

---

For further enquiries please contact:

---

**research@karvy.com**

**Tel: +91-22-6184 4300**

## Disclosures Appendix

### Analyst certification

The following analyst(s), who is (are) primarily responsible for this report, certify (ies) that the views expressed herein accurately reflect his (their) personal view(s) about the subject security (ies) and issuer(s) and that no part of his (their) compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report.

### Disclaimer

The information and views presented in this report are prepared by Karvy Stock Broking Limited. The information contained herein is based on our analysis and upon sources that we consider reliable. We, however, do not vouch for the accuracy or the completeness thereof. This material is for personal information and we are not responsible for any loss incurred based upon it. The investments discussed or recommended in this report may not be suitable for all investors. Investors must make their own investment decisions based on their specific investment objectives and financial position and using such independent advice, as they believe necessary. While acting upon any information or analysis mentioned in this report, investors may please note that neither Karvy nor Karvy Stock Broking nor any person connected with any associate companies of Karvy accepts any liability arising from the use of this information and views mentioned in this document.

The author, directors and other employees of Karvy and its affiliates may hold long or short positions in the above mentioned companies from time to time. Every employee of Karvy and its associate companies are required to disclose their individual stock holdings and details of trades, if any, that they undertake. The team rendering corporate analysis and investment recommendations are restricted in purchasing/selling of shares or other securities till such a time this recommendation has either been displayed or has been forwarded to clients of Karvy. All employees are further restricted to place orders only through Karvy Stock Broking Ltd. This report is intended for a restricted audience and we are not soliciting any action based on it. Neither the information nor any opinion expressed herein constitutes an offer or an invitation to make an offer, to buy or sell any securities, or any options, futures nor other derivatives related to such securities.

## Karvy Stock Broking Limited

### Institutional Equities

Office No. 702, 7<sup>th</sup> Floor, Hallmark Business Plaza, Opp.-Gurunanak Hospital, Mumbai 400 051

Regd Off : 46, Road No 4, Street No 1, Banjara Hills, Hyderabad – 500 034.

Karvy Stock Broking Research is also available on: Bloomberg - KRVY <GO>, Thomson Publisher & Reuters.