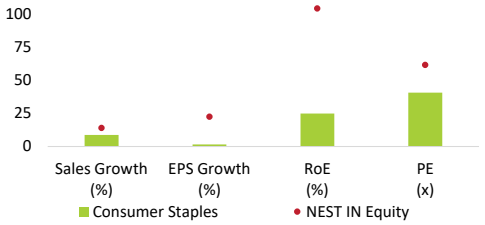
NESTLE INDIA

COMPANY UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	16,170
12 month price target (INR)	21,110
Market cap (INR bn/USD bn)	1,559/21.5
Free float/Foreign ownership (%)	37.2/11.5
What's Changed	
Target Price	—
Rating/Risk Rating	—

INVESTMENT METRICS

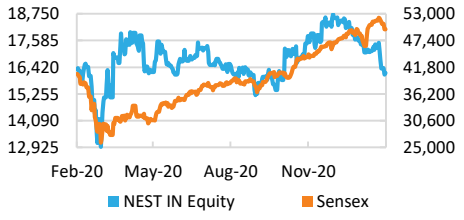


FINANCIALS

(INR mn)

Year to December	CY20A	CY21E	CY22E	CY23E
Revenue	1,33,500	1,51,923	1,67,970	1,85,222
EBITDA	31,037	36,765	42,091	47,791
Adjusted profit	20,824	25,456	29,073	33,310
Diluted EPS (INR)	216.0	264.0	301.5	345.5
EPS growth (%)	5.8	22.2	14.2	14.6
RoAE (%)	105.4	103.8	86.0	75.0
P/E (x)	74.9	61.2	53.6	46.8
EV/EBITDA (x)	49.7	41.9	36.4	31.9
Dividend yield (%)	1.2	1.1	1.2	1.4

PRICE PERFORMANCE



Explore:

Financial model

Podcast

Corporate access

Video

Robust plank to drive double-digit sales

Nestle India (Nestle) has been among the most consistent performers, clocking double-digit domestic sales growth in 12 of the past 13 quarters. In Q4CY20, its domestic sales (up 10.1% YoY) outgrew peer Britannia's 6.1% YoY. Even so, the stock has corrected 14% from peak due to: i) investors' perception that the latest union budget would hit rural FMCG growth; ii) a sequential dip in exports (~5% of revenue); iii) a 150bps YoY spike in staff cost; and iv) Marico's entry in noodles.

We do not view any of these as structural issues. On the contrary, we continue to expect Nestle's high innovation and 'premiumisation' agenda, and cluster-based distribution strategy to hold it in good stead. Maintain 'BUY' with a TP of INR21,110.

Double-digit domestic sales growth to sustain

With urban revenue contribution of 75%, Nestle is well placed to capture the likely urban recovery. Rural at ~25% of Nestle's sales is among the lowest. The company has doubled its reach from 45,000 villages to 90,000 over the past 18 months. We envisage Nestle to benefit from rising sampling of its new RTC/RTE products (*upma*, *poha*, breakfast cereals) as well as its new spice mixes. Milkmaid too is seeing an uptick due to higher baking and cooking at home. In the past two years, the company has launched 60 new products with a 70% success rate (innovating 3x its earlier rate). Nearly two-thirds of the company's key brands such as MAGGI Noodles, KITKAT and NESCAFÉ Classic posted YoY double-digit growth in CY20. E-commerce continues to grow (up 111% YoY); it now contributes 3.7% to domestic sales.

Multiple levers to address margin concerns; market share intact

We expect Nestle's EBITDA margins to bounce back on the back of the company's strong pricing power and operating leverage. Unlike many other consumer companies, Q4CY20 marked a second consecutive quarter of gross margin expansion (up 231bps YoY) for Nestle. Indeed, Marico entered the noodles segment recently. But, in our view, noodles is a tough category for new players considering Nestle Maggi commands a dominant 60% market share and ITC is a strong number two.

Outlook and valuation: Best quality; maintain 'BUY'

We believe Nestle's focus on innovation, market share and premiumisation will boost its volume-led growth. The company is in a better position to fend off local competition as it has remapped India into 15 clusters, apart from decentralisation, which empowers factories and sales locations with lot of decision-making.

Besides, with normalcy fast returning to modern trade (MT) and out-of-home (OOH) consumption, and the company's widening rural reach, we believe Nestle is by far the best placed foods company to play domestic consumption. Retain **'BUY/SO'** with a TP of INR21,110. The stock is trading at ~53.6x CY22E EPS.

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Financial Statements

Income Statement (INR mn)

Year to December	CY20A	CY21E	CY22E	CY23E
Total operating income	1,33,500	1,51,923	1,67,970	1,85,222
Gross profit	76,761	87,610	97,257	1,07,664
Employee costs	16,591	17,402	18,723	20,265
Other expenses	22,754	24,969	27,249	29,660
EBITDA	31,037	36,765	42,091	47,791
Depreciation	3,704	4,056	4,553	5,183
Less: Interest expense	60	70	70	70
Add: Other income	1,459	2,393	2,400	2,994
Profit before tax	28,128	34,031	38,868	44,532
Prov for tax	7,304	8,576	9,795	11,222
Less: Other adj	0	0	0	0
Reported profit	20,824	25,456	29,073	33,310
Less: Excp.item (net)	0	0	0	0
Adjusted profit	20,824	25,456	29,073	33,310
Diluted shares o/s	96	96	96	96
Adjusted diluted EPS	216.0	264.0	301.5	345.5
DPS (INR)	200.0	174.2	199.0	228.0
Tax rate (%)	26.0	25.2	25.2	25.2

Balance Sheet (INR mn)

Year to December	CY20A	CY21E	CY22E	CY23E
Share capital	964	964	964	964
Reserves	19,229	27,884	37,769	49,094
Shareholders funds	20,193	28,848	38,733	50,059
Minority interest	0	0	0	0
Borrowings	348	348	348	348
Trade payables	15,166	13,215	14,530	15,937
Other liabs & prov	43,290	42,790	42,290	41,790
Total liabilities	78,997	85,201	95,901	1,08,133
Net block	21,794	25,507	27,954	29,770
Intangible assets	0	0	0	0
Capital WIP	6,386	6,386	6,386	6,386
Total fixed assets	28,180	31,893	34,339	36,156
Non current inv	7,408	7,408	7,408	7,408
Cash/cash equivalent	17,699	19,442	26,040	34,677
Sundry debtors	1,649	1,585	1,750	1,934
Loans & advances	1,187	1,187	1,187	1,187
Other assets	15,644	16,457	17,947	19,541
Total assets	78,997	85,201	95,901	1,08,133

Important Ratios (%)

Year to December	CY20A	CY21E	CY22E	CY23E
Other exp (% of rev)	17.0	16.4	16.2	16.0
Con A&P (% of rev)	4.8	5.6	5.5	5.4
Gross margin (%)	57.5	57.7	57.9	58.1
EBITDA margin (%)	23.2	24.2	25.1	25.8
Net profit margin (%)	15.6	16.8	17.3	18.0
Revenue growth (% YoY)	8.1	13.9	10.5	10.2
EBITDA growth (% YoY)	8.5	18.5	14.5	13.5
Adj. profit growth (%)	5.8	22.2	14.2	14.6

Free Cash Flow (INR mn)

Year to December	CY20A	CY21E	CY22E	CY23E
Reported profit	20,824	25,456	29,073	33,310
Add: Depreciation	3,704	4,056	4,553	5,183
Interest (net of tax)	60	70	70	70
Others	(48)	1,000	1,000	1,000
Less: Changes in WC	5	(1,906)	(1,840)	(1,871)
Operating cash flow	24,545	28,676	32,856	37,692
Less: Capex	(5,000)	(6,000)	(7,000)	(7,000)
Free cash flow	19,545	22,676	25,856	30,692

Assumptions (%)

Year to December	CY20A	CY21E	CY22E	CY23E
GDP (YoY %)	4.8	(6.0)	7.0	6.0
Repo rate (%)	4.4	3.5	3.5	4.0
USD/INR (average)	70.7	75.0	73.0	72.0
Vol growth (Dom)	5.2	7.2	10.7	7.9
Pricing change (dom)	4.5	1.5	2.4	2.4
Milk Prods & Nutri vol	1.4	6.0	8.0	7.0
Beverages vol	(2.3)	3.0	10.0	7.5
Prepared dishes vol	9.6	11.0	13.0	8.5
Chocolate vol	16.2	6.0	15.0	9.5

Key Ratios

Year to December	CY20A	CY21E	CY22E	CY23E
RoE (%)	105.4	103.8	86.0	75.0
RoCE (%)	142.5	141.1	117.0	101.9
Inventory days	87	83	81	81
Receivable days	4	4	4	4
Payable days	97	81	72	72
Working cap (% sales)	(30.1)	(24.3)	(21.5)	(19.0)
Gross debt/equity (x)	0	0	0	0
Net debt/equity (x)	(0.9)	(0.7)	(0.7)	(0.7)
Interest coverage (x)	455.6	467.3	536.3	608.7

Valuation Metrics

Year to December	CY20A	CY21E	CY22E	CY23E
Diluted P/E (x)	74.9	61.2	53.6	46.8
Price/BV (x)	77.2	54.0	40.3	31.1
EV/EBITDA (x)	49.7	41.9	36.4	31.9
Dividend yield (%)	1.2	1.1	1.2	1.4

Valuation Drivers

Year to December	CY20A	CY21E	CY22E	CY23E
EPS growth (%)	5.8	22.2	14.2	14.6
RoE (%)	105.4	103.8	86.0	75.0
EBITDA growth (%)	8.5	18.5	14.5	13.5
Payout ratio (%)	92.6	66.0	66.0	66.0

Source: Company and Edelweiss estimates

Exhibit 1: Trends at a glance

	Q1CY18	Q2CY18	Q3CY18	Q4CY18	Q1CY19	Q2CY19	Q3CY19	Q4CY19	Q1CY20	Q2CY20	Q3CY20	Q4CY20
Net domestic sales growth (% YoY)	10.9	12.0	17.5	12.0	10.2	13.1	10.5	10.0	10.7	2.6	10.2	10.1
Exports growth(% YoY)	6.2	15.7	7.9	(0.0)	(8.9)	(13.9)	(7.1)	(9.7)	12.9	(9.3)	9.4	(7.7)
Net sales growth (% YoY)	10.5	12.2	16.8	11.2	8.9	11.2	9.5	8.7	10.8	2.0	10.2	9.2
Gross margin (%)	59.1	59.6	59.7	58.9	58.5	58.3	57.6	56.8	56.3	56.3	58.1	59.1
EBITDA margin(%)	26.1	25.0	25.4	21.4	25.3	23.9	23.8	21.8	24.1	24.9	25.4	22.1
Tax rate (%)	33.7	33.6	33.6	34.6	33.9	33.6	14.9	23.0	25.3	25.4	25.4	27.9
Other expenses (% of Sales)	23.4	24.3	24.6	28.1	23.2	24.1	23.9	24.9	21.6	19.4	22.4	25.4
COGS (% of Sales)	40.9	40.4	40.3	41.1	41.5	41.7	42.4	43.2	43.7	43.7	41.9	40.9

Source: Company

Market share in noodles to sustain

Nestle came back from a nought market share post-Maggi crisis in 2015 to 60% now. Even HUL couldn't step up to fill in the vacuum in noodles in spite of its superior distribution, which emphasizes Nestle's dominance and differentiation, as well as the difficulty in cracking the category.

Marico – Saffola noodles launch

Marico has entered the noodles category under the Oodles brand. The company has launched the product with a *No Maida* claim and has displayed it prominently on the packet. It is presently available only on e-commerce sites. Pricing of the large pack is three 184g packs at INR240. The product is advertised as ring noodles, yummy masala and no maida.

***Our take*: Marico has done really well in Masala Oats. Noodles is a much larger category, but has well-entrenched players such as Nestle (60% market share) and ITC, apart from many other players. Ultimately, the battle will boil down to taste, advertising spends, differentiation and distribution reach.**

As the work-from-home norm continues in some form, we expect Nestle's portfolio's demand to sustain, unlike demand for biscuits which has cooled.

Exhibit 2: Strong customer proposition enabled rapid growth for Maggi brand

Source: Company, Edelweiss Research

E-commerce, modern trade recovery: Positives

With 75% of its portfolio being urban, Nestle is well placed to capture the likely urban recovery, e-commerce boom and resumption in modern trade and out-of-home consumption.

The company has the opportunity to close the gap with a few other FMCG players for whom e-commerce makes up 5–6% of sales, through introduction of digital-only products, focus on digital marketing and meeting new consumption needs.

Exhibit 3: Nestle lagging peers; right levers in place to bridge the gap

Company	Approx. e-commerce channel contribution to sales (%)
Marico	8
Amul	7-8
Dabur	6
HUL	6
GCPL	4.5
Nestle	4

Source: Edelweiss Research, Company

We believe the company's portfolio is among the most suited to e-commerce, not to mention its strong presence as an anchor tenant among key e-commerce channels. In fact, in India, Nestle's e-commerce business as a proportion of its sales is similar to that in a few advanced markets. In our view, the current work-from-home culture will boost consumption of Nestle's offerings, especially cooking aids, noodles, pasta, coffee, sauces and milk products.

It has reached out to consumers via digital platforms Maggi.in and AskNestle.com, wherein it put out interesting recipes and health-related information. According to CEO Mr. Narayanan, AskNestle, which recorded 300,000 visitors in April 2019, clocked 7.6mn visitors by October 2020. The company has also launched a Hindi version of the platform, which, according to Mr. Narayanan, logged 300,000 visitors in the first one week of launch itself.

"People's thirst for genuine knowledge, growth, nutrition and health has gone up. I feel heartened that the new digital age for the country has arrived... in some of my

brands where digital media expenses used to be 10–15% two years ago, they now spend half of their money on digital," he says. The company is planning to launch an app soon to enable *kirana* store owners order digitally.

Exhibit 4: Nestle expects e-commerce channel to continue to grow faster

Source: Edelweiss Research

Modern trade: Recovery bodes well

Most of the company's categories have a strong presence in MT. With worst behind for the channel and most players likely to return to growth track from Q1CY21, we envisage Nestle's discretionary portfolio would benefit. MT is a vital tool for the company as it enables activations of different brands and sampling of new products.

Exhibit 5: Boosting e-commerce engagement through marketing

Source: Company, Edelweiss Research

Exhibit 6: *Ask Nestle* platform gaining traction

Source: Company, Edelweiss Research

Exhibit 7: Focus on e-commerce channel has sharpened

Source: Company, Edelweiss Research

Exhibit 8: Charting out key future trends

Source: Company, Edelweiss Research

Exhibit 9: Unlocking the Maggi brand through different channels

Source: Company, Edelweiss Research

Out-of-home consumption: Worst behind

We expect normalcy in this part of Nestle's business to return soon. The company has also innovated to respond in response to new opportunities thrown up by the pandemic.

Exhibit 10: Ready to tap into growth in OOH consumption

Source: Company, Edelweiss Research

Exhibit 11: Using supplementary marketing to increase awareness and boost sales

Source: Company, Edelweiss Research

Exhibit 12: Building products to fill new/emerging white spaces

Source: Company, Edelweiss Research

Innovation to remain strong

Out of Nestle Global's 35 'billionaire brands', only nine are present in India. Over the past two years, the company has launched 60 new products with a 70% success rate. Nestle has now been innovating at 3x its earlier pace. New launches contribute about 3% to the company's revenue. Innovation and renovation remain a key strategy for the company.

Nestle has specialised products in its health science portfolio under its resource and other brands. Similar products will be introduced and infant milk will drive growth in the milk and nutrition segment. The company will continue to sell value-added products, according to management.

Ready-to-cook (RTC) is a big opportunity for the company. Nestle looks at convenience, taste and variety as well as the everyday eating or one-off consumption opportunity. It looks at how to use Nestle's global expertise to scale up its presence the RTC category in India.

The covid-19-induced lockdown gave customers the opportunity to sample the company's new products. Nestle's new offerings such as Maggi Upma, Maggi Poha and NesPlus breakfast cereals were well sampled. We expect some of these to gain significant heft over the long term.

Late entry in breakfast cereals and Milo; differentiation will be key

Management believes Nestle is a late entrant in breakfast cereals and Milo segments, but reiterates it commitment to grow thereof. In malted food drinks, Milo is the No. 1 brand globally, so there is brand equity and the company has plans to grow the brand sizeably over coming years. Given that nutrition products is the company's domain, we expect Nestle to deliver strong results in this portfolio.

RTC *poha* and *upma* are evolving categories, and consumer habits too are evolving. Variety, nutrition, snack occasions, seeking convenience and using spices are part of the consumer journey; hence the company is extending the Maggi brand to related categories. Nestle's seasoning and condiment products aim to address gaps in what the homemaker needs. Though the company draws upon it global expertise in making these products, the food is local so it is made in India.

Milkmaid is seeing an uptick due to higher baking and cooking at home. World-class exotic coffee recipes made with Nescafé Gold, *upma* and *poha* have gotten off to a great start.

Exhibit 13: Nestle is building a holistic breakfast portfolio

Source: Edelweiss Research, Company

Exhibit 14: Strong attention on RTC category: Accelerated ramp-up of Maggi Poha and Maggi Upma

Source: Company, Edelweiss Research

Exhibit 15: Maggi Masala e Magic a versatile product

Source: Company, Edelweiss Research

Exhibit 16: Equally focused on competing in the RTC category

Source: Company, Edelweiss Research

Exhibit 17: Nestle entered fried rice spice mix segment under Maggi (Chilli Garlic Fried Rice and Classic Veg Fried Rice)

Source: Company, Edelweiss Research

Exhibit 18: Products catering to travel/on-the-go consumption

Source: Company, Edelweiss Research

Exhibit 19: Targeting in-house/restaurant consumption with cooking aids

Source: Company, Edelweiss Research

Deepening rural reach and new distribution clusters

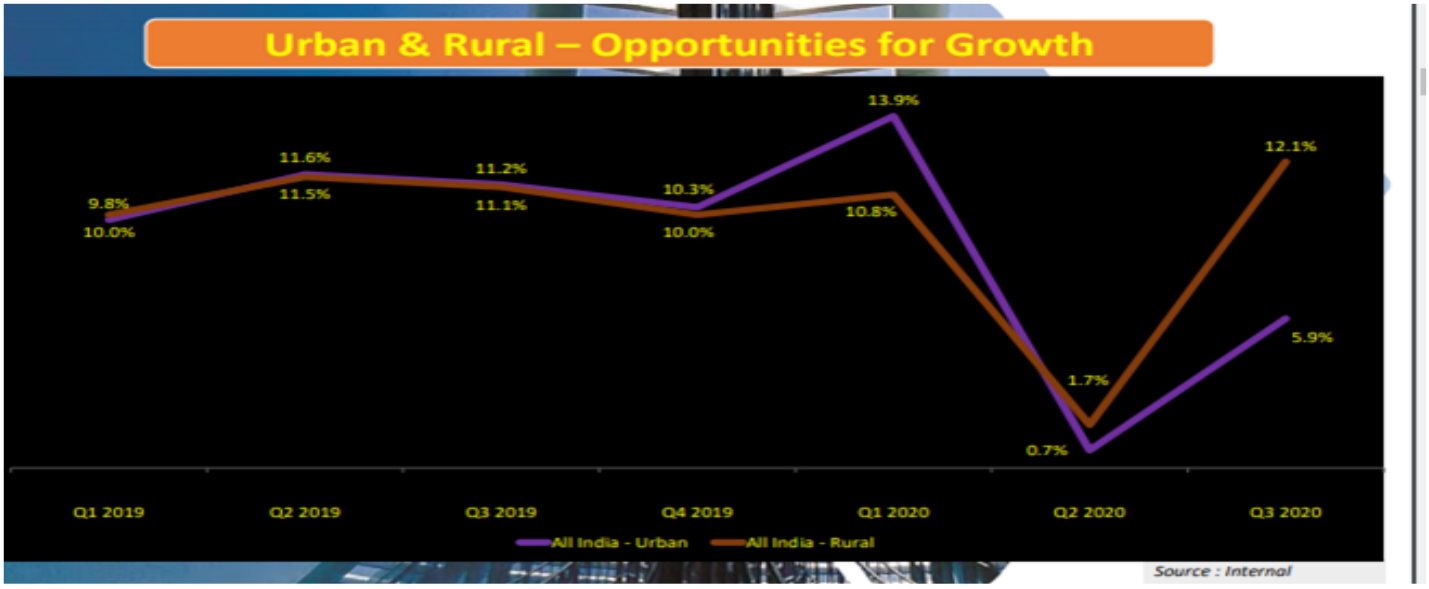
Last year, Nestle had announced remapping India into 15 clusters (similar to WIMI strategy of HUL) on the basis of geography, psychographics and other purchasing habits. Cluster-based model is central to the company, and it is recalibrating the same for the post-pandemic world. Nestle has also added more decentralisation to it, by moving a lot of decision-making to factories and sales locations. The company has invested a lot in analytics and calls it MIDAS (multi-disciplinary analytic system). This is helping in terms of granular data and sharpening plans. The company's automation is high and data are now available real time.

Rural distribution spreading significantly

Nestle has strengthened its rural distribution and now covers 90,000 villages. Distribution hubs have increased from 4,000 to 15,000. In 2017, Nestle had 9,000 distribution points, which now count 12,000-plus. A year ago, Nestle covered 30,000–40,000 villages, but it now covers 90,000-plus, and the vision is to take it up to 1,20,000.

The company has also tweaked its portfolio to stay relevant to those markets. Nestle has a total reach of ~5mn in terms of distribution. Moreover, it wants to sustainably increase its distribution footprint. Nestle communicates and markets Maggi relevantly in rural areas to drive penetration. In terms of distribution, the company is increasing the number of access points using data and analytics.

Exhibit 20: Rural picking up faster than urban



Source: Company

Exhibit 21: Segmental performance trend

	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	CY18	CY19
Milk Products & Nutrition											
Volume growth (% YoY)	13.1	7.6	2.5	(5.1)	(1.1)	(2.3)	(2.7)	(2.4)	1.6	4.8	1.4
Value growth (% YoY)	5.4	11.6	17.8	21.4	6.7	15.0	4.9	(0.7)	4.0	7.6	8.9
Beverages											
Volume growth (% YoY)	(3.1)	13.2	0.9	(5.0)	9.3	(11.0)	(10.3)	(0.2)	10.6	10.6	(2.3)
Value growth (% YoY)	3.6	(1.2)	17.8	10.6	7.9	13.7	11.2	(3.7)	7.8	9.8	(1.4)
RTE & cooking aids											
Volume growth (% YoY)	21.7	24.4	13.2	8.0	3.8	3.7	(59.5)	71.5	19.0	14.5	9.6
Value growth (% YoY)	4.3	3.9	10.3	4.4	7.0	5.8	9.5	76.4	16.8	14.7	12.7
Confectionary											
Volume growth (% YoY)	9.7	21.2	(1.5)	(9.4)	(2.2)	(12.1)	(19.5)	6.7	4.3	14.7	16.2
Value growth (% YoY)	3.5	4.3	14.4	17.3	12.4	10.8	10.1	5.4	4.3	14.7	17.3

Source: Company, Edelweiss Research

Exhibit 22: Leadership in seven out of eight categories

Category	Brands	Nestle India position
Instant Noodles	Maggi	First
Infant Formula	Lactogen Nan	Second
Infant Cereals	Cereclac	First
Tea creamer	EveryDay	First
Instant coffee	Nescafe	First
Wafers and whites	KitKat, Munch and Milkybar	First
Ketchup & sauces	Maggi	First
Instant Pasta	Maggi	First

Source: Company, Edelweiss Research

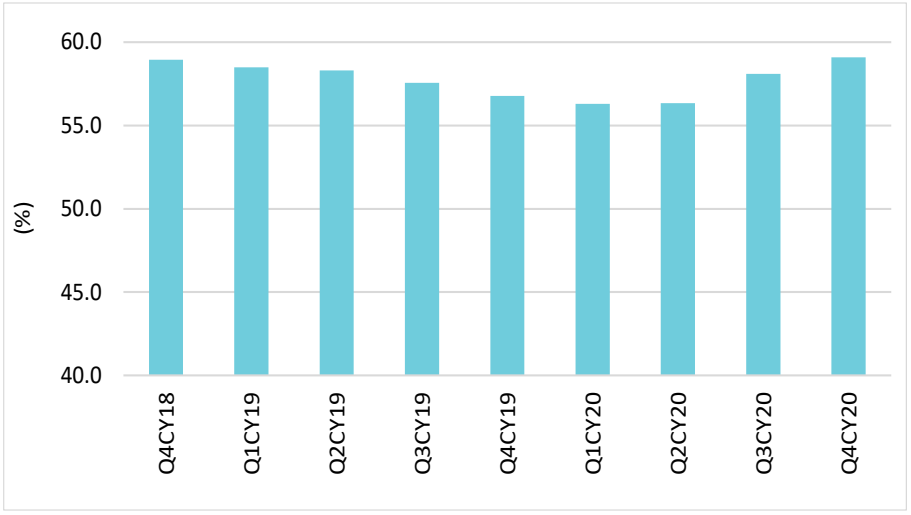
Exhibit 23: Leadership in 85% of portfolio

Source: Company, Edelweiss Research

Exhibit 24: Decent growth seen across product portfolio

Source: Company, Edelweiss Research

Exhibit 25: Gross margin likely to improve with higher discretionary consumption



Source: Company, Edelweiss Research

Company Description

Nestle, a subsidiary of its parent Nestlé S.A. of Switzerland, is India's third largest FMCG company after HUL and ITC. The company set up its first factory at Moga, Punjab, to develop milk production. Over the years, Nestle has set up seven factories across the country and is now involved in manufacturing and marketing of a range of quality products. It has well-established brands, including Maggi, Nescafe, Lactogen, KitKat and Milkmaid. Nestle enjoys leadership in its core categories like baby foods, instant noodles and instant coffee. It enjoys a distinct advantage over competitors in the F&B space on account of its strong focus on developing products around the nutrition, health, and wellness platform, and a culture of renovation and innovation in its offerings, backed by strong parent support.

Investment Theme

Nestle is one of the best plays on the Indian processed food industry, which has multiple growth drivers in place, including low penetration levels, rising income levels, urbanisation and changing lifestyle. Nestle, with established brands across food categories, is expected to be a major beneficiary of this growth. The new MD has embarked on a journey of regaining growth and has already taken significant corrective measures. Post regaining majority of the market share in Maggi, the company is also focusing on new launches in other than noodles categories like dairy, chocolates and beverages. This will help revive growth in other segments and will also reduce reliance on the noodles category. The likely introduction of new brands from the global portfolio and entry in new categories will be positive

Key Risks

- **Sharp increase in input costs**

  Sharp rise in prices of key inputs such as milk, wheat flour, edible oils and sugar could adversely impact margin.

- **Higher Competition**

  ITC and Patanjali are key aggressive players in the noodles category. Marico also has made a foray in this category.

- **Failure of new products**

  Nestle has launched premium variants in various categories such as chocolates, noodles, ketchup and dairy products, which could hit margin, in case they do not click in the market.

Additional Data

Management

MD and Chairman	Mr. Suresh Narayanan
CFO	Mr. Shobinder Duggal
Director	Mr. Matthias C. Lohner
Non-Executive Director	Mr. R. V. Kanoria
Auditor	BSR & Co. LLP

Holdings – Top 10*

	% Holding		% Holding
LIC	3.04	Vanguard	0.65
SBI funds	1.51	Uti AMC	0.48
Axis AMC	1.23	Standard Life A	0.34
Arisaig	1.03	Mitsubishi	0.26
Blackrock	0.82	Norges Bank	0.23

**Latest public data*

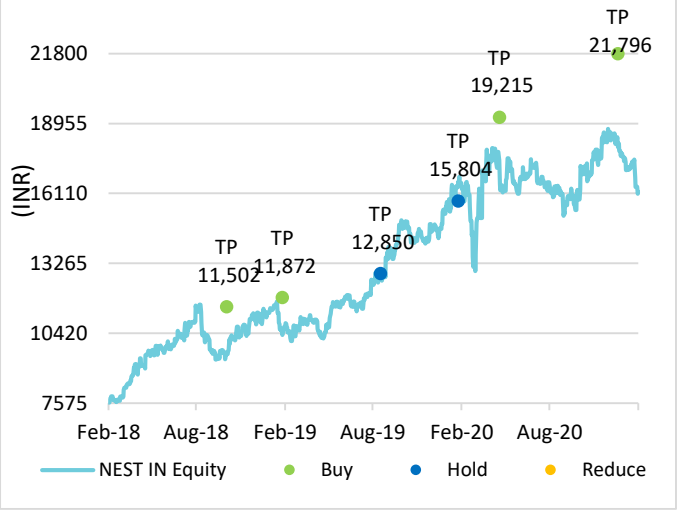
Recent Company Research

Date	Title	Price	Reco
16-Feb-21	Revenue in line; staff cost nibbles marg; *Result Update*	17217.25	Buy
12-Jan-21	Evolving with the trends; *Company Update*	18306.25	Buy
23-Oct-20	Mr. Consistent back with a bang; *Result Update*	15865.45	Buy

Recent Sector Research

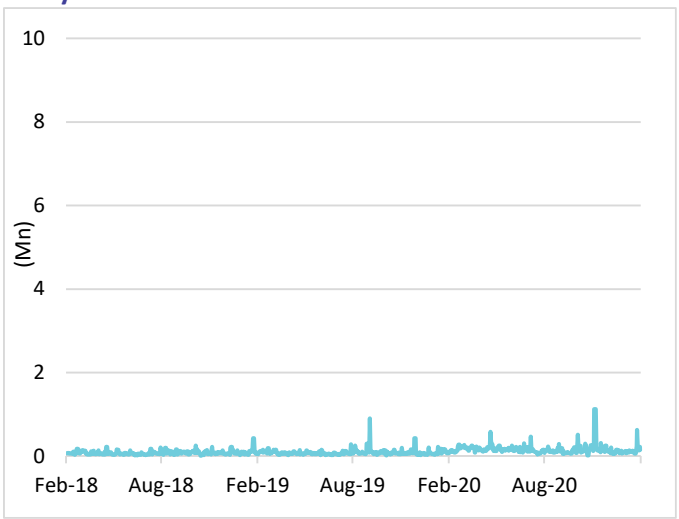
Date	Name of Co./Sector	Title
19-Feb-21	Bajaj Consumer Care	Well-oiled for growth; *Company Update*
17-Feb-21	Emami	Health and rural focus drive growth; *Company Update*
12-Feb-21	Dabur India	Multiple positives at play; *Company Update*

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	165	59	17	241
	>50bn	**>10bn and <50bn**	**<10bn**	**Total**
Market Cap (INR)	194	53	4	251

** stocks under review*

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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