

**Nestle India – Healthy Food, but High Valuations**

- Date: 02<sup>nd</sup> Sept 2021
- Industry: Food & Beverages

- CMP: ₹19,950
- Large Cap: ₹1,88,000 cr. mkt cap
- P/E: 82.46 times and P/B: 88 times
- HOLD with a Jan'24 target of ₹26,400, a 33% gain in 2.5 years.



Nestlé Good food, Good life

- **About Nestle:** in India since 1912, Nestle has brands like Cerelac, Nescafe, Maggi, Milkybar, Kit Kat, Bar-One, Milkmaid and Nestea. With 8 mfg. locations, it primarily makes products in house. The premium products are widely distributed. Nestle revenue in CY20 was ₹13,290 cr. & profits ₹2,082 cr. Revenues, EBITDA and PAT have grown at 10%, 12.2% & 12.6% CAGR over 8 years. Nestle is investing in capex of ₹2600 cr. over the next 3-4 years, to augment capacities and locations. Innovation is impressive with several launches planned.
- **Risks:** 1) High valuations 2) intense competition 3) regulatory challenges 4) raw material price volatility 5) a new event like the 'Maggie crises'.
- **Opinion:** Given high valuations, we suggest **HOLD** with a target of ₹26,431, by Jan'24 a 33% gain.

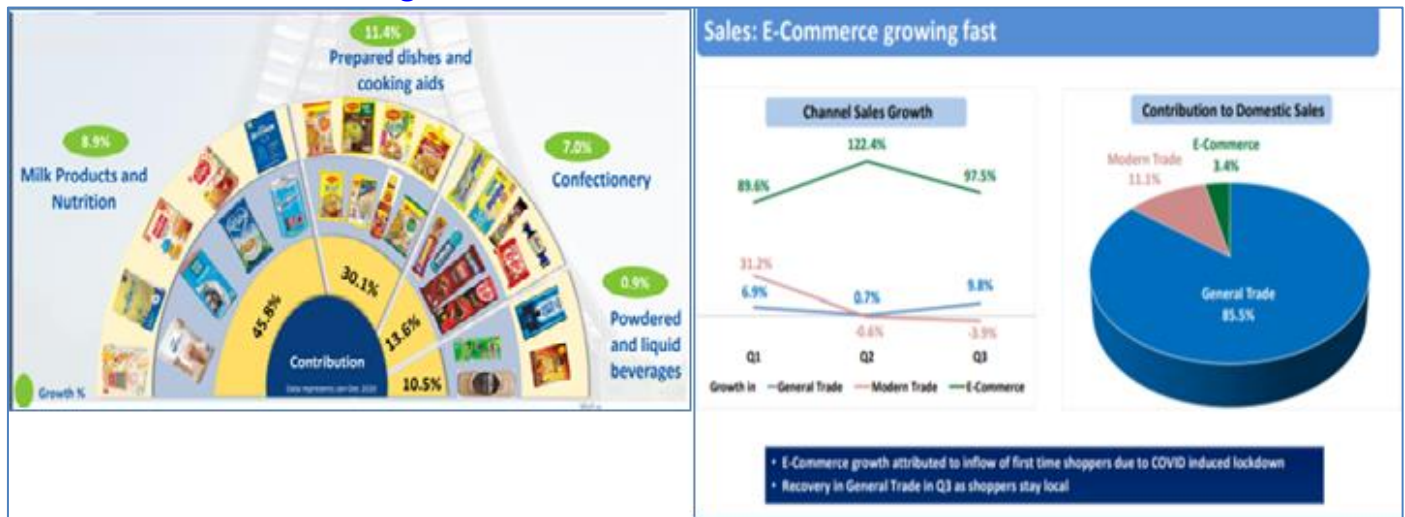
Here is our report on NESTLE INDIA (Nestle).

**NESTLE - Description and Profile**

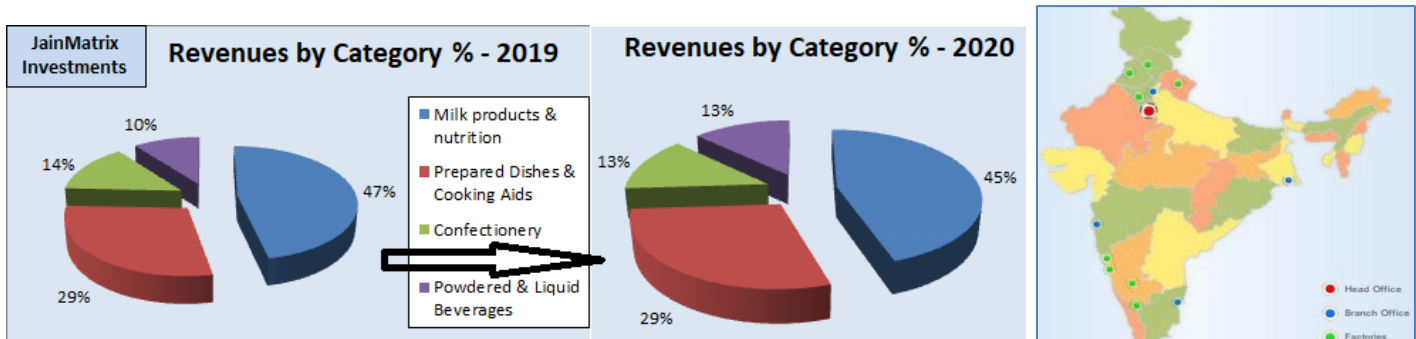
- Nestle is a Swiss Food & Beverage mfg. firm, in India since 1912. It is #6 in India by revenue in F&B.
- Nestle revenue in CY20 was ₹13,290 cr. & profits ₹2,082 cr. It follows the calendar year for accounts.
- “Good Food, Good Life” – is the slogan of Nestle; it is the largest food company in the world since 2014. Founded by “Henri Nestle” in 1867 with an Infant cereal for malnourished children. It launched Milo (1934) and Nescafe (1938). In 1988, Nestle acquired Rowntree (creator of kitkat).
- Nestle started in India in 1912, when it began trading as The Nestle Anglo-Swiss Condensed Milk Company (Export) Ltd. In 1961, they set up first factory at Moga, Punjab, to develop the milk economy. Currently, its HO is in Gurgaon, Delhi-NCR. Nestle is also one of the main shareholders of L'Oreal, the world's largest cosmetics company.
- Its products include baby food, medical food, bottled water, breakfast cereals, coffee and tea, confectionery, dairy products, ice cream, frozen food, pet foods, and snacks. It makes these under brands like Nescafe, Maggi, Milkybar, Kit Kat, Bar-One, Milkmaid and Nestea. In recent years it has introduced daily consumption products like Nestle Milk, Slim Milk, Nestle Dahi and Jeera Raita.
- Nestle e-commerce operations jumped 66%, sustaining the channel's strong contribution to revenue. This will be beneficial with ongoing covid-19 and will help it take advantage of the changing purchasing behavior of consumers triggered by the pandemic. See Fig 1b.
- Nestle has been awarded the highest rating “A1+ credit rating” for short term facilities by CRISIL.

- In 2020, Nestle Cerelac had 97% share of the instant cereal market in India. The instant pasta has 75% share. Most of its product categories having more than 50% market share in India.
- Nestle has 8 mfg. facilities and 4 branch offices in India. They set up the first mfg. facility at Moga (Punjab), then Choladi (TN), Nanjangud (Kar.), Samalkha (Har.), Ponda and Bicholim (Goa), Pantnagar (Uttarakhand), Tahliwal (HP) and the 9th factory is coming up in Sanad (Gujarat). See Fig 1d.
- Nestle has 7,700 employees in 2020, continuously increasing from 2010.
- BoD: Suresh Narayanan (CMD), Shobinder Duggal (CFO, ED), Martin Roemkens (ED- Technical).
- Shareholding % is: Promoters 62.8, NIIs 16.9, FIIs 12.4, MFs 3.7, Insurance cos 4.1 & 0.3 others.

**Business Notes, Strategies and Events**



**Fig 1a Product Segments / 1b E-com performance (Edelweiss) / 1c – Revenue by Category / 1d – Nestle Locations**



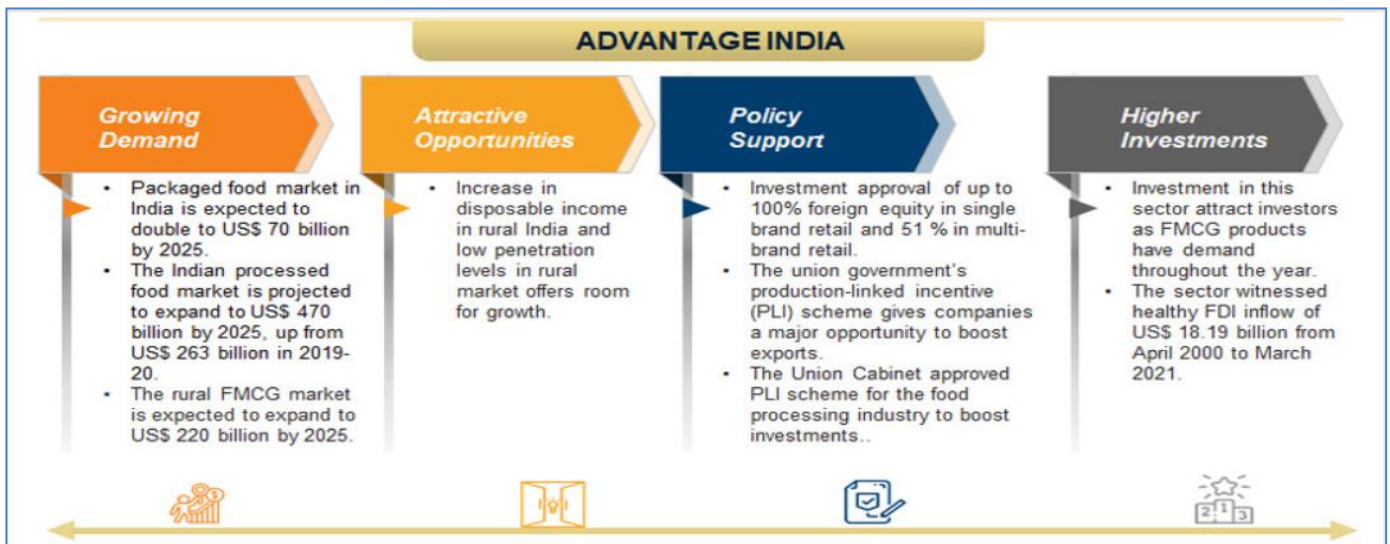
- Nestle ambition is to achieve 100% recyclable or reusable packaging by 2025.
- In Q2 CY21, domestic sales grew by 13.7% and exports by 17.7% YoY. (Source –Website). In Q2CY21, Nestle revenue grew 14% YoY to ₹3,477 cr. EBITDA rose 13.4% YoY to ₹848 cr. despite margin dropping YoY to 24.4% PAT improved 10.7% YoY, partly impacted by higher interest and taxes. Domestic sales improved due to better volume and improved mix. Key products posted double-digit growth on the back of improved in-house consumption.
- Nestle’s timely implementation of a ‘telecaller model’ to take orders across trade channels and ensure last mile access, was aided by e-commerce and in particular hyperlocal (quick commerce) channels which grew by 147% in the first half of this year.

- Nestle launched AskNestle Hindi portal, to help parents with children of 2-12 years, to make informed decisions about food choices and nutrition. The new range of Breakfast Cereals named Koko Krunch & NesPlus, have 'WholeGrains' with Fibre, Vitamin D, Calcium and Vitamin B.
- Nestle is in the process of setting up the oxygen plants in hospitals near its factories in Punjab, Himachal Pradesh, Uttarakhand, Karnataka and Goa. (Source – Indian Express).
- Launches 'MAGGI -Desh Ke Liye 2 Minute - Ek Chhoti Si Koshish'.
- In the last 5 years, Nestle expanded its rural distribution to 0.9 lakh villages and is looking to further expand it to 1.2 lakh villages by 2024 (villages with population of over 5,000).
- Cluster-Based Distribution - Nestle evolved their S&D structure to divide the country into 10-15 regional clusters and adopted a regional cluster-based approach to develop tailor-made brand, marketing and distribution to address the needs of consumers better.
- Evolving Business Strategies - Since the consumers are opting more for door-step delivery of food & grocery, Nestle strategized itself to B2B product range of food solutions for restaurants and cloud kitchens to enable them to sell their products through food delivery channels.
- Nestle will spend ₹2,600 cr. capex in 3-4 years. The new factory at Sanand would be ready by the end of CY21. The new capex would be for existing categories - noodles, coffee & confectionary.
- Covid Impact - On an average, the factories were operating at 75% of capacity during Q1FY21 and the firm has incurred ₹28.6 cr. of incremental costs related to COVID 19. Sales increased by only 2% in comparison to Q2FY20, and were impacted due to lockdown and production disruption in factories. Employee benefits expense is higher due to production related incentives offered to limited available manpower in COVID 19 impact.
- Nestle has launched a virtual internship programme 'Nesternship' for Graduates in the Final Year of any discipline. Post-Graduates will focus on upskilling and enabling the interns to thrive in workplaces, that they may join, at a later date.
- Nestle contributed ₹15 cr. towards CSR spends in the areas of nutrition awareness, COVID relief initiatives etc. in Q2CY'21. The focus on sustainability continues and they have invested ₹25 cr. in H1 CY21. They recycled 20,000 tons of plastic in 2020 and many key brands of Nestle are plastic neutral.
- GST: Nestle products like milk and curds have 0% GST, tea, coffee and skimmed milk powder are in the 5% slab. Butter, noodles, cheese, ketchups and sauces are in 12% while chocolate, chocolate-coated wafers, aerated water and drinks are under highest 28% slab.
- Maggi Crisis: In Apr'15, a govt. referral laboratory in Kolkata, following up on an initial report from Barabanki in UP, reported excess lead in samples of Maggi, Nestle's instant noodles brand. The product was banned by GoI in Jun'15. Nestle lost more than ₹500 cr. as the ban forced it to destroy 37,000 tons of product. Suresh Narayanan was brought in to manage the crisis, as the new MD & CEO. In Aug'15, the Bombay HC overturned the ban. In Nov'15, Maggi was relaunched after court-mandated tests. By Jun'16, Maggi noodles had a 57% market share, a remarkable comeback indeed.

### Industry Outlook

- FMCG sector is India's #4 sector with household and personal care accounting for 50% of FMCG sales in India. The urban segment accounts for 55%, and is the largest contributor to the overall revenue generated by the FMCG sector in India. See Fig 2.

- GST is beneficial for the industry as many FMCG products such as soap, toothpaste and hair oil now come in 18% tax bracket against previous 23-24%. GST on food and hygiene products has been reduced to 0-5% & 12-18% resp.
- The average per capita consumption of baby food is approx 5.1 kg in 2020 in India. Growth drivers of Infant nutrition market are population, household income, CPI, spending PC, price level, etc.
- The GoI has approved 100% FDI in the cash and carry segment and in single-brand retail along with 51% FDI in multi-brand retail.
- According to Nielsen, the Indian FMCG industry grew 9.4% in Q1CY21, supported by consumption-led growth and value expansion from higher product prices, particularly for staples. The rural market had an increase of 14.6% and metro markets recorded positive growth after two quarters.



**Fig 2 - FMCG Industry (Source: IBEF)**

- With over 2.5 cr. children born each year, India is the fastest-growing infant nutrition market in the world. The Baby Food segment comprises 3% of the global Food market. On the basis of product type, cereals based baby food segment dominate the market with a share of 35.1% and it is closely followed by the milk formula segment market that will grow at 6.9% CAGR over the next few years.
- India is the world's #1 producer of dairy products by volume with 13% of total milk production and it also has the world's largest dairy herd. However, India has only 1% of global dairy trade.

### Stock Evaluation, Performance and Returns

- The share has risen from a low of ₹5,609 in Dec'16, to a high of ₹20,021 in July'21, a good sign. The share price of Nestle has grown at 30% CAGR over 5 years. See Fig 3.
- Revenues, EBITDA and PAT have grown at 10%, 12.2% & 12.6% CAGR over 8 years. See Fig 4a. EBITDA and PAT margins have continued to improve. EPS TTM is at a high.
- The company declared an interim dividend of ₹25/share in CY20.
- Cash flow from operations rose over 3 years, but declined in FY21, perhaps due to covid. Dividend growth has been excellent, with the high given in CY'19, see Fig 4b. Nestle has also generated positive FCF throughout the last 10 years. See Fig 4b.



Fig 3 – Nestle Price History

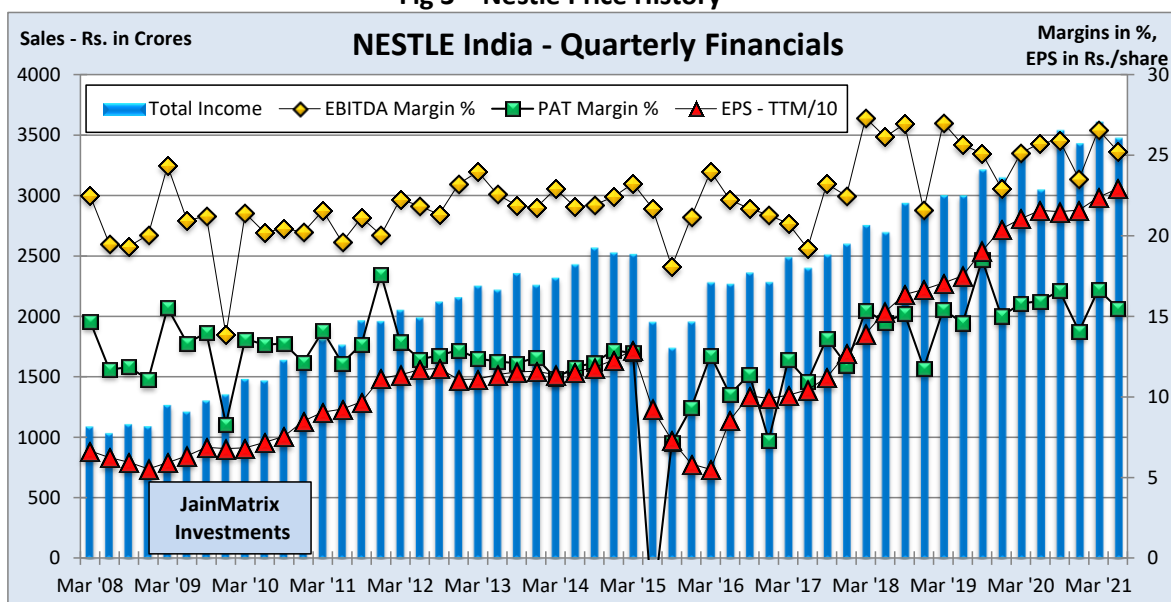
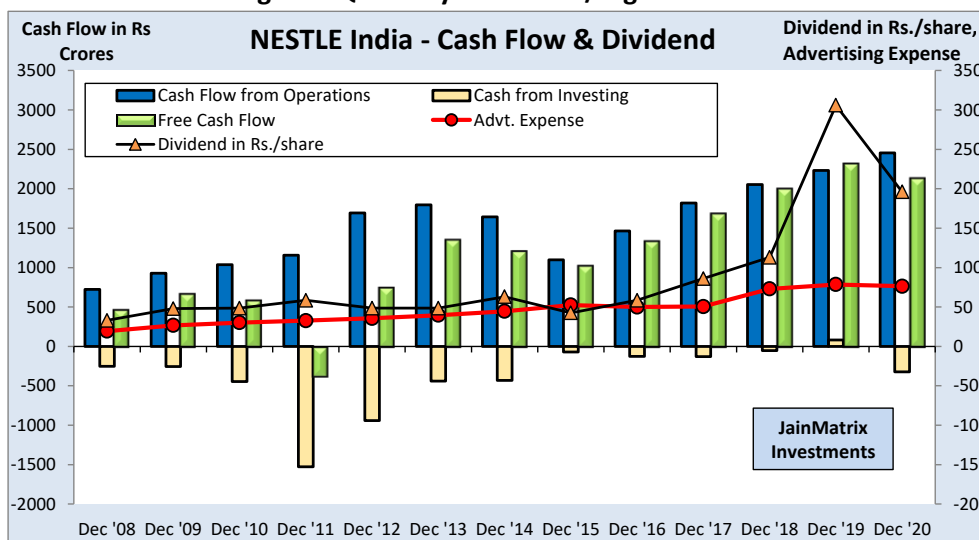


Fig 4a – Quarterly Financials / Fig 4b – Cash Flow





- The historical PE average is 65 times and the range we see is between 40-90 times. See Fig 5a Price and PE Chart. Currently Nestle PE is 86 times and is in top quadrant. So it appears overvalued.
- In Fig 5b, we can see the steady rise in EPS TTM was only interrupted shortly by a fall over CY15-17. In CY15, Nestle reported a steep fall of profits from ₹1,184 Cr in CY14 to ₹563 Cr in CY15, see Fig 5b. The reason was the Maggi Crisis, but earnings recovered & are growing well since.
- ROCE and ROE for CY21 are 55% and 103% resp. in CY20 which is robust.
- The D/E of the firm has fallen from over 0.58 in CY12 to 0.02 in CY20. This is a good sign for the company. This is because the volumes and margins are up.
- Employee costs rose gradually in last 10 years affecting the EPS growth.

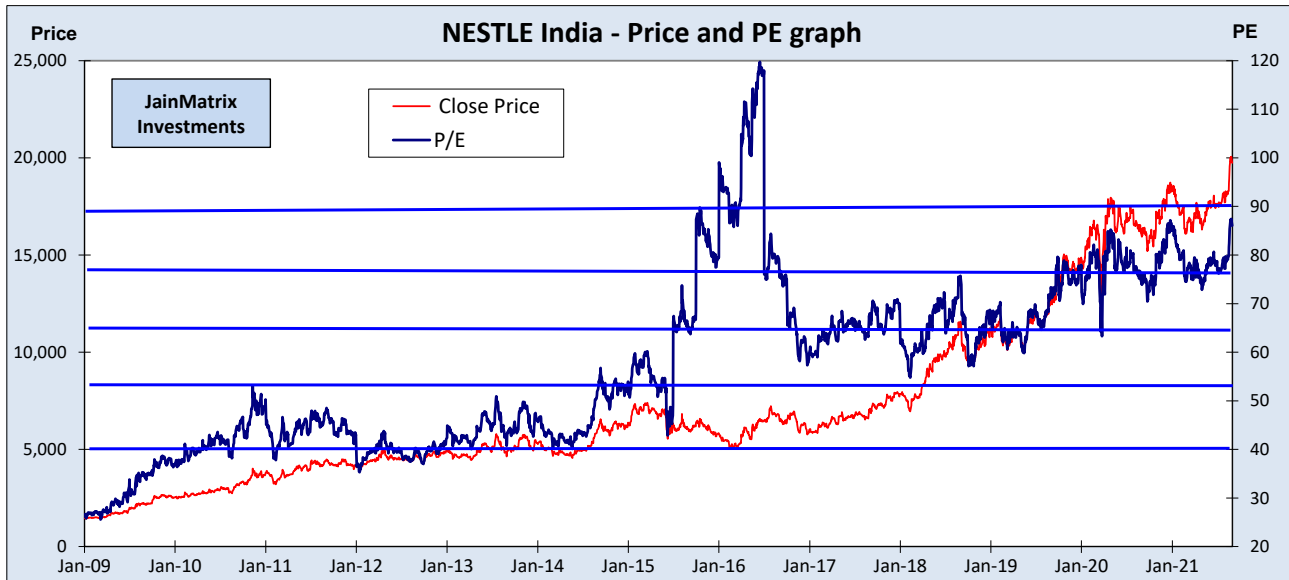
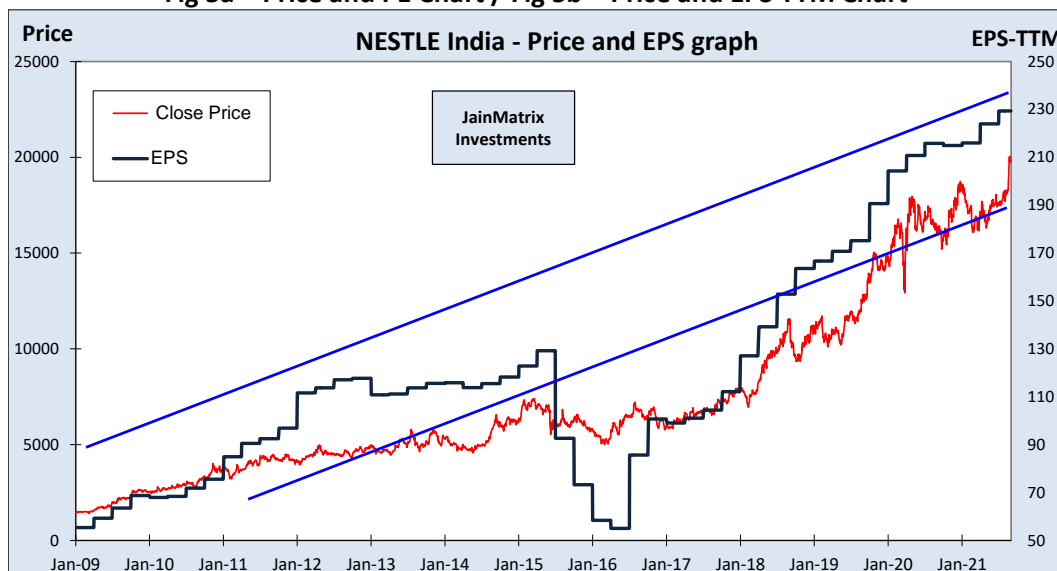


Fig 5a – Price and PE Chart / Fig 5b – Price and EPS TTM Chart



- See Fig. 6 for Financial Metrics. Profit margins have reduced from CY19 due to Covid impact.
- Inventory Turnover ratio have declined throughout last 2 years due to Covid-19 pandemic.
- Interest cover ratio has declined 18.13% due to covid-19 pandemic.
- RoA rose to 26.63% as the demand grew and company expands operations and utilization.

We can see that on most parameters Nestle is showing YoY improvements.

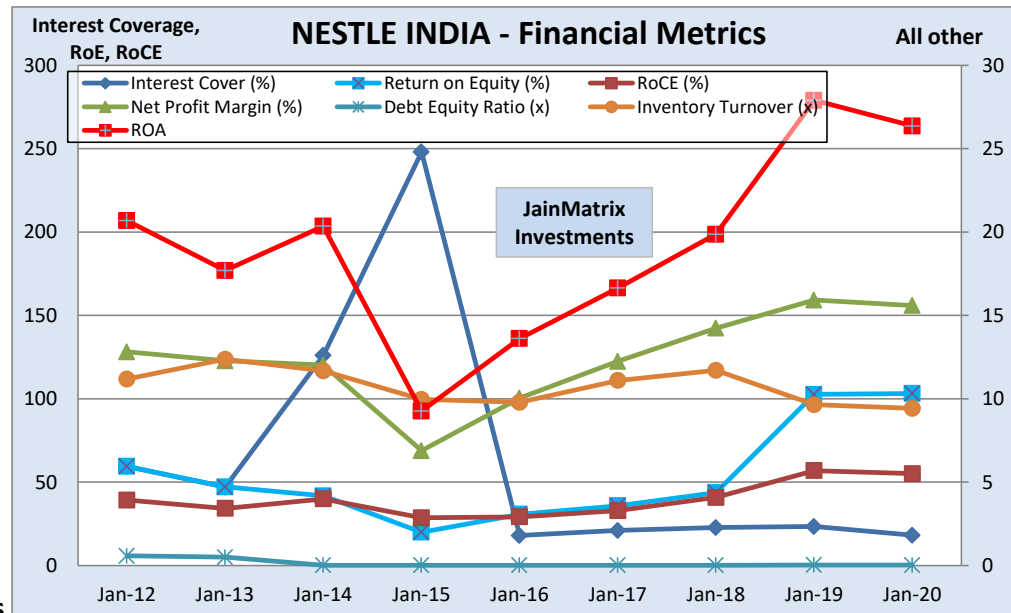


Fig 6 – Financial Metrics

**Benchmarking and Financial Estimates**

We present a benchmarking exercise with listed peers in similar product categories as well as the parent company Nestle SA. See Exhibit 7.

- Revenues & profits of Nestle is <2% of its parent i.e. Nestle Global. While revenue is close to its domestic competitor Britannia but profits of Nestle are higher, indicating a better margin. Nestle 3 yr CAGR of sales & profits is quite strong compared to Nestle SA which is lower.
- Nestle is a debt-free company but we can also see that the parent Nestle Global has a high D/E.
- Peer comparison: Nestle PE & P/B Ratio is the highest indicating it appears overvalued.
- Nestle profits and sales growth are close to the highest levels of Britannia and Tata Con.
- Nestle debt-to-equity ratio is the lowest compared to the peers, a good sign.
- Nestle Margins are close to the highest margins of HUL.
- The return ratios are quite impressive with the RoE and RoCE among the leaders.

Particulars	Nestle India	Brittania Ind.	TATA Con. Products	Asian Paints	HUL	DABUR	MARICO	Hatsun Agro	GSK Consumer	Nestle Global
Revenues in Rs. cr's	13,350	13,136	11,602	21,712	47,028	9,546	8,048	5,569	4,782	687,525
EBITDA in Rs. cr's	3,111	2,644	1,052	4,860	11,837	1,836	1,500	784	1,574	149,146
Profits in Rs. cr's	2,082	1,849	993	3,178	8,000	1,695	1,201	246	982	99,295
Market Cap - Rs. Crores	181,618	89,675	77,503	288,229	584,108	105,682	67,663	20,155	45,225	2,596,643
PE (x) TTM	86.09	46.82	68.7	77.53	71.45	56.42	45.3	63.42	31.01	26.62
Price to Book Value (x)	87.82	24.64	4.05	19	11.98	12.47	16.38	15.29	7.41	7.16
3 Yr CAGR Sales (%)	15.49	15.11	30.47	13.6	15.02	11.19	12.83	13.98	5.35	-2.05
3 Yr CAGR Profit (%)	30.37	35.73	32.36	0	23.74	11.77	20.47	64.68	19.61	19.41
Debt to equity ratio (x)	0.02	0.59	0.05	0.03	0	0.06	0.11	1.08	0	31.72
EBITDA Margin (%)	22.29	19.97	12.15	20.11	23.3	21.86	19.2	8.52	31.64	16.78
Net Profit Margin (%)	15.59	14.08	8.56	14.63	17	17.76	14.92	4.42	20.55	14.44
Return on Equity (%)	103.12	52.53	5.9	24.51	16.77	22.09	36.17	24.11	24	
RoCE (%)	55.05	59.71	8.21	30.23	19.01	26.38	44.2	26.66	35.56	
Dividend Yield (%)	1.06	4.23	0.48	0.59	1.25	0.79	1.43	0.86	0.98	2.37

Exhibit 7 – Benchmarking

Nestle already appears to be doing well among peers on financial metrics, coming out of the covid situation. In future, it should be able to maintain or improve these due to their pricing power of strong well-known brands, premiumization, procurement efficiencies & cost reduction initiatives.

### Financial Projections

We present financial projections for Nestle, see Exhibit 8.

	Dec '18	Dec '19	Dec '20	Dec '21	Dec '22	Dec '23
Sales Turnover - crores	11,216	12,295	13,290	15,284	17,271	19,343
EBITDA - crores	2,877	3,111	3,347	3,668	4,318	5,029
Net Profit - crores	1,607	1,970	2,082	2,293	2,763	3,288
Earnings Per Share - Rs	166.7	204.3	216.0	237.8	286.6	341.0
PE (at current Price)			92.4	83.9	69.6	58.5

**Fig 8 – Projections**

The basis for the projections are: 1) A recovery post covid 2) Nestle's capacity expansion plans – a ₹1000 cr. capex done, of a budget of ₹2,600 over 3 years 3) Past profitability trends continue.

### Strengths

- During covid, consumers became conservative and turned to the known brands rather than experiment with new ones. Nestle will gain from this.
- Nestle is a monopoly in Infant cereals category with 96.5% domestic market share. It is also a market leader in categories of instant noodles, infant formula, pasta, chocolates, etc. Nestle has strong brands in the domestic market like Cerelac, Maggi, Kitkat, etc.
- Nestle has a strong distribution network and is gradually increasing presence in rural market with activities like "Village Haat" - a local market in which Nestle brings their products to to the villages & connect with the villagers to generate awareness, and Cluster-Based Distribution.
- Rural growth as consumers are mirroring urban. Positivity as 1,000 employees hired in H1CY22.
- Strong global presence & well established parentage of world's best food company. Nestle Global has 447 factories, operates in 189 countries, and employs 339,000 people.
- Nestle has a good product launch/ improvement pipeline, as in the last 5 years they have come up with 80 new products, and have 40 new innovation projects in pipeline. (Source Investor PPT).
- Exports of Nestle are just 5% of revenues. Good capacity adds and global integration can boost India as a mfg. base for Nestle Global.
- Nestle faced the Maggi crisis in 2015 and was able to handle the PR challenge. Also Mr. Suresh Narayanan (MD-CEO) established his position by diffusing the crisis and once again Maggi has taken the leadership position in the noodles market.
- All this has resulted in good FCF for Nestle, high margins, and good return ratios of ROCE and ROE. Thus the balance sheet is strong. It is able to reinvest capital sufficiently in the business, and also distribute much of the rest of the cash back to shareholders as dividend.

### Risks and Challenges

- A rise in prices of key inputs like milk, wheat flour, edible oils & sugar could impact margins.
- Nestle has launched new and premium product variants, these must click in the market.
- Competition: External threat from continuously growing competitors in key segments of instant noodles like Top ramen, Sunfeast yippee, etc & of Nescafe. Recently Tata Tea have also introduced Tata coffee. ITC and Patanjali are key aggressive players in the noodles category.



- Modern retail (with private labeling) and eCommerce are disrupting traditional distribution chains and can affect Nestle.
- High valuations – at a PE of 86 times, a lot of growth and profitability expectations are baked into the price. Any non-delivery of such performance will result in a large price correction.
- Macro-economic factors like current COVID situation, downturn in the economy, unforeseen political and social upheavals, natural calamities and below normal monsoon can affect Nestle.
- In FMCG industry, there is a constant risk of ever changing consumers tastes & preferences, which impose challenges to the business.
- Any change in Govt. policies, exchange rates and GST tinkering can affect Nestle.
- In India, food products are under the scrutiny of FSSAI & individuals in authority could be corrupt, and try to exploit the brand image of MNCs like Nestle.

### Opinion, Outlook and Recommendation

- As India's GDP grows, we expect consumption to increase sharply. Particularly premium FMCG products may do well. This reflects well on Nestle India.
- Nestle's brand presence, expanding distribution network and distinctive packaged food portfolio with Innovation, new products and good R&D should continue to drive growth momentum.
- As in-home consumption increases, we expect Nestle is well-placed to capture the opportunity and could do well over medium-to-long term.
- The company has been led by sturdy leadership since the Maggi Crisis, and with a basket of awards like Best CEO, the future prospects are good.
- Nestle is a strong company with robust financials compared to peers and Nestle Global.
- The key risks are: 1) High valuations 2) intense competition 3) regulatory challenges 4) raw material price volatility 5) a new event like the 'Maggie crises'.
- Given high valuations, we opine a **HOLD** with a Jan'24 target of ₹26,400, a 33% gain in 2.5 years.

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The basis for Target Price is a target P/E of 77.5 times, management commentary and analyst judgement.

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