



Nestlé India

Q1CY16 Result Update

"Improved Performance, Upgrade to BUY"

Sector: FMCG

CMP: ₹ 5,710

Recommendation: BUY

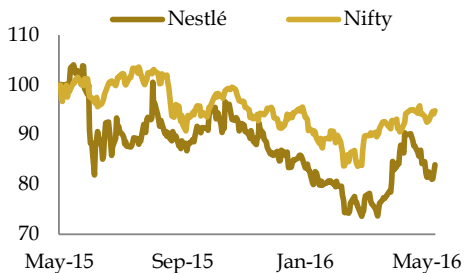
Market statistics

Current stock price (₹)	5,710
Shares O/S (cr.)	9.6
Mcap (₹ cr)	55,056
52W H/L (₹)	7,349/4,981
6m avg. volume	50,000
Bloomberg	NEST IN

Shareholding pattern (%)

Promoters	62.76
Domestic Institution	5.67
Foreign Institution	14.37
Non-institution	17.20
of which more than 1%	
Life Insurance Corporation of India	3.31
Arisaig Partners (Asia) PTE Ltd A/C	1.87
Arisaig India Fund Ltd	

Nestlé India vs. Nifty



Capital efficiency & valuations

Particulars	CY15	CY16E	CY17E
ROE (%)	32.3	38.5	42.8
ROCE (%)	58.3	62.8	67.3
P/B(x)	19.9	17.8	15.9
P/E (x)	61.7	46.2	37.2
P/CE (x)	44.7	35.4	29.7
EPS (₹)	94.4	123.5	153.3
CEPS (₹)	130.4	160.9	191.9
EV/OCF (x)	47.1	37.2	26.7

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Nestlé India (Nestlé) reported much better but anticipated performance during Q1CY16. Net Sales contracted by 8.4% YoY to ₹22.9bn (our expectation was 6.9% decline). Domestic business (92% of total sales) has declined by 8.7% while Exports down by 4.8%. Maggi Noodles regained market share to 50% within 5 months of re-launch. Nestle is in the rebuilding phase and we believe other products have also recovered to some extent during the quarter. Although, we couldn't see any unpredicted primary growth for Maggi Noodles in the last 2 quarters but Management's focus on gradual recovery can show better uptake in sales in the coming quarters.

Gross Margin contracted by 56bps YoY to 57.2% - lower than our expectation of 59.0%. Employee expenses grew by 12.9% (+205bps YoY) while other expenses was down by 12.6% (-111bps YoY). Therefore, EBITDA Margin contracted by 166bps YoY to 22.3% during the quarter - better than our expectation of 21.2%.

PBT before exceptional item was down by 13.6% to ₹4,202mn - in-line with our expectation of ₹4,279mn. Adjusted PAT (ex-exceptional items net of taxes) was down by 22.9% to ₹2,588mn (our expectation was ₹2,867mn).

Management focus on gradual recovery; Maggi Noodle gains 50% market share:

Nestlé's net sales were affected by slower pickup in Maggi Noodles and weakness in other product portfolio. Domestic business has continued to suffer and registered a decline of 9%. However, Maggi Noodles regained market share to 50% within 5 months of re-launch. Nestle is in the rebuilding phase and we expect its' other products have also recovered to some extent during the quarter. Management's focus on gradual recovery can show better uptake in overall sales in the coming quarters. We anticipate much better sales growth in the coming quarter owing to base benefits, re-launch of Maggi Noodles and new product launches.

Anticipate less challenging time going ahead: Gross margin has contracted by 56bps YoY due to high base of last year. Employee expenses continued to grow at healthy rate and reported 13% YoY growth that suggests Nestle has maintained the right atmosphere within the team and has not passed on sales contraction pressure to its employees. Other expenses were down by 13% as compared to our expectation of marginal growth as we were expecting higher marketing efforts during the quarter. EBITDA Margin declined by 166bps to 22.3%. We expect rise in marketing efforts to resolve Maggi brand issue and to accelerate volume growth for other brands. With favorable margin base and better expected sales growth, we expect EBITDA Margin can improve in the coming quarters.

Outlook & Valuation

The stock has corrected 17% in the last 1 year on account of lackluster operational performance in the last 3-4 quarters owing to ban of Maggi Noodles. The re-launch of Maggi Noodles has happened during Q4CY15 and within 5 months it gained 50% market share. We expect less challenging time for Nestle in the coming quarters as compared to recent past which can improve operational performance significantly. Nestle has already invested huge money on capacity expansion over the last few years which is under-utilized hence, the company is ready for any uptake in demand. New management can also infuse the required energy in Nestle's business.

Nestlé is trading at low 33x 12-month forward Price to Cash EPS (P/CE) as compared to last 5 year average of over ~37x. Improving earnings along with re-rating potential can run up the stock in the coming quarters.

We upgrade the stock to BUY from HOLD rating and also suggest investors to see long term potential of the company.

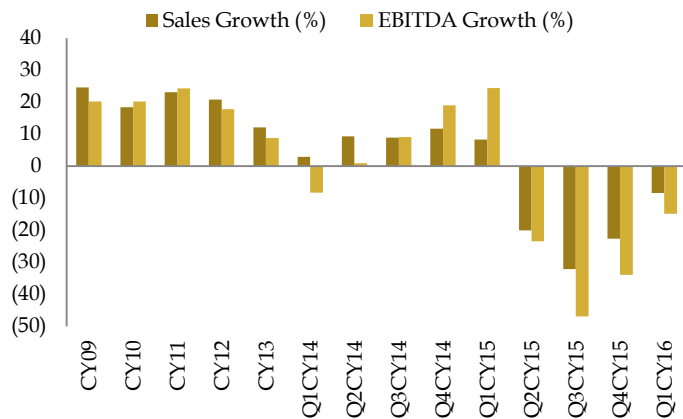


Exhibit 1: Quarterly Performance

Particulars (₹mn)	Q1CY14	Q2CY14	Q3CY14	Q4CY14	Q1CY15	Q2CY15	Q3CY15	Q4CY15	Q1CY16
Net Sales	23,135	24,189	25,578	25,161	25,068	19,338	17,362	19,464	22,957
YoY Gr%	2.9	9.3	8.9	11.7	8.4	(20.1)	(32.1)	(22.6)	(8.4)
EBITDA	4,847	4,909	5,383	5,595	6,031	3,756	2,859	3,694	5,135
YoY Growth	(8.3)	0.9	9.1	19.0	24.4	(23.5)	(46.9)	(34.0)	(14.9)
EBITDA Margin (%)	20.9	20.2	20.9	22.1	24.0	19.2	16.4	18.9	22.3
YoY expansion (bps)	-255bps	-171bps	3bps	134bps	308bps	-99bps	-453bps	-325bps	-166bps
PBT before exceptional	3,966	4,260	4,621	4,827	4,866	3,331	2,041	2,907	4,202
YoY Growth	(7.8)	5.2	8.3	15.9	22.7	(21.8)	(55.8)	(39.8)	(13.6)
PBT	3,966	4,260	4,621	4,897	4,866	(1,185)	1,795	2,661	4,204
Reported PAT	2,592	2,879	3,113	3,264	3,203	(644)	1,242	1,832	2,590
YoY Growth	(7.1)	6.0	9.2	15.9	23.6	(122.4)	(60.1)	(43.9)	(19.1)
Adjusted PAT	2,592	2,879	3,205	3,186	3,356	3,139	1,768	2,149	2,588
YoY Growth	(7.1)	6.0	14.4	13.2	29.5	9.0	(44.8)	(32.6)	(22.9)

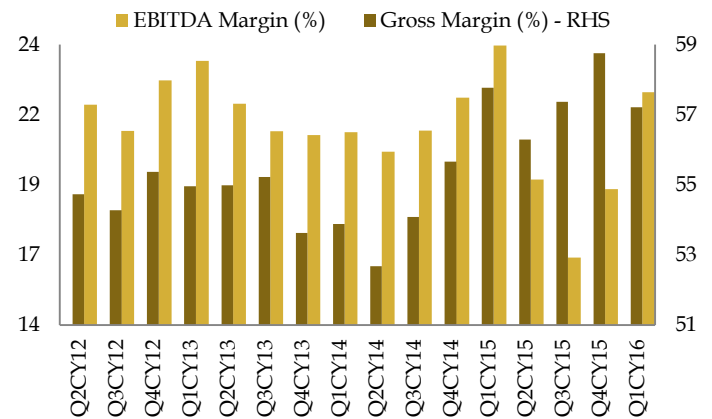
Source: Company, Trust

Exhibit 2: Sales and EBITDA Growth (%)



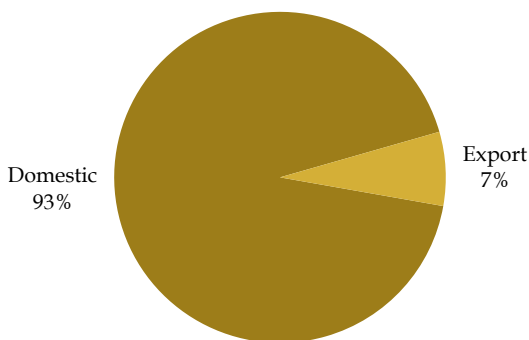
Source: Company, Trust

Exhibit 3: Gross Margin and EBITDA Margin Trend



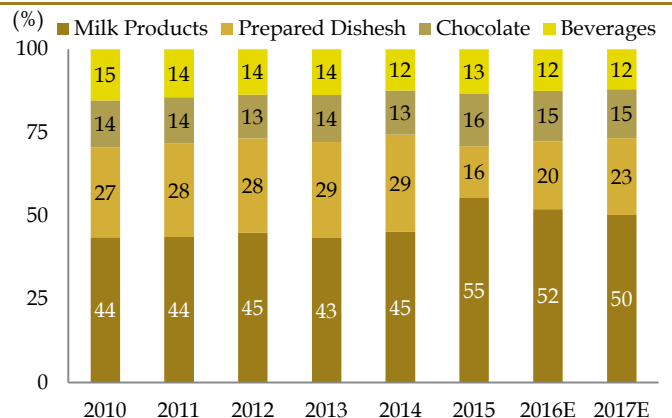
Source: Company, Trust

Exhibit 4: Domestic/Export Mix



Source: Company, Trust

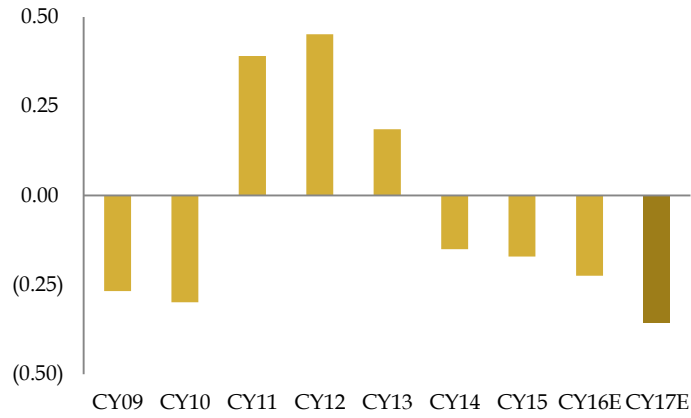
Exhibit 5: Category Revenue Mix



Source: Company, Trust

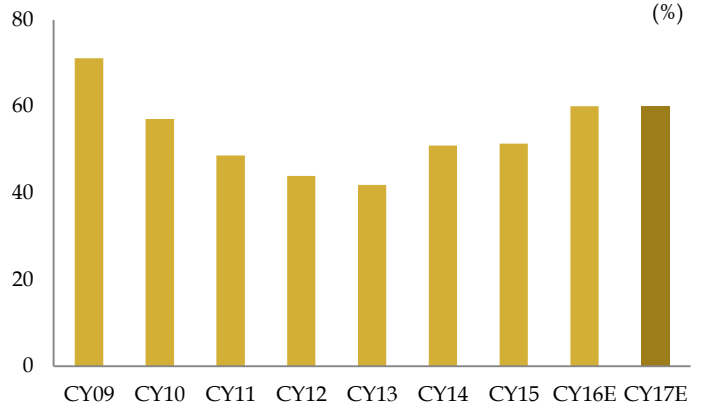


Exhibit 6: Net Debt/Equity (x)



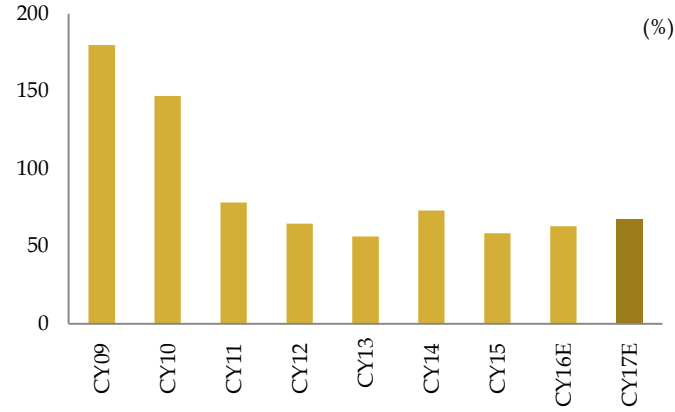
Source: Company, Trust

Exhibit 7: Dividend Payout Ratio (%)



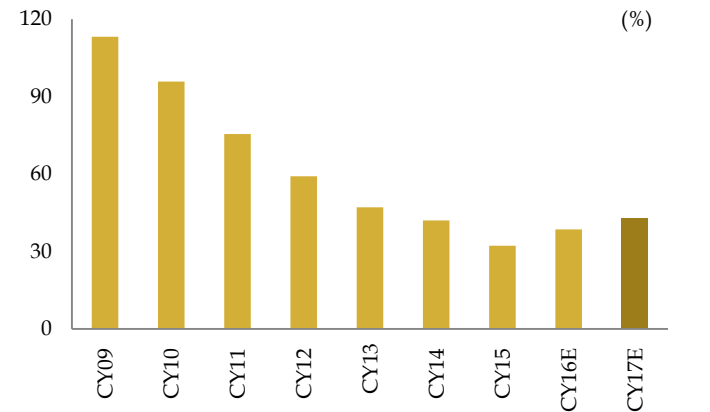
Source: Company, Trust

Exhibit 8: Stable RoCE (%)



Source: Company, Trust

Exhibit 9: Stable RoE (%)



Source: Company, Trust



Financials

P&L Statement

Y/E Dec (₹ mn)	CY13	CY14	CY15	CY16E	CY17E
Net Revenues	90,814	98,329	81,609	95,039	108,780
% Growth	9.2	8.3	(17.0)	16.5	14.5
Raw Material	41,224	45,239	34,689	41,590	47,047
Staff	7,415	8,371	9,128	10,197	11,421
Other Expenses	22,176	23,840	21,264	23,733	26,976
Total Expenditures	70,815	77,450	65,081	75,521	85,443
EBITDA	19,999	20,879	16,528	19,518	23,336
% Growth	8.8	4.4	(20.8)	18.1	19.6
EBITDA Margins (%)	22.0	21.2	20.3	20.5	21.5
Other Income	1,028	1,093	1,245	1,502	1,993
Interest	365	142	33	30	27
Depreciation	3,300	3,375	3,473	3,609	3,730
Profit Before Tax	16,642	17,745	8,136	16,247	20,429
Provision for tax	5,609	5,897	2,504	5,118	6,435
Effective tax rate (%)	33.7	33.2	30.8	31.5	31.5
Reported PAT	11,033	11,848	5,633	11,129	13,994
% Growth	3.7	7.4	(52.5)	97.6	25.7
Adjusted Net Profit	11,171	11,918	9,100	11,906	14,778
% Growth	5.0	6.7	(23.6)	30.8	24.1

Balance Sheet

Y/E Dec	CY13	CY14	CY15	CY16E	CY17E
Equity Share Capital	964	964	964	964	964
Reserves & surplus	22,723	27,408	27,214	29,959	33,545
Shareholders' funds	23,688	28,372	28,178	30,923	34,509
Total Debt	11,894	196	177	158	148
Capital Employed	35,582	28,568	28,356	31,081	34,657
Net fixed assets	36,640	34,214	31,286	28,277	25,147
Cash & Cash Eq.	7,494	4,458	4,996	7,094	12,487
Net Other current assets	(14,950)	(16,148)	(19,446)	(18,810)	(20,496)
Investments	8,554	8,270	13,248	16,248	19,248
Misc Exp not written off	-	-	-	-	-
Net Deferred tax Assets	(2,155)	(2,227)	(1,729)	(1,729)	(1,729)
Total Assets	35,582	28,568	28,356	31,081	34,657



Cash Flow

Cash Flow Statement	CY13	CY14	CY15	CY16E	CY17E
Pre-tax profit	16,780	17,744	8,136	16,247	20,429
Depreciation	3,300	3,375	3,473	3,609	3,730
Total Tax Paid	(4,857)	(5,891)	(2,899)	(5,118)	(6,435)
Chg in working capital	3,553	1,818	2,800	(636)	1,686
Other operating activities	(523)	(606)	33	30	27
Cash flow from oper (a)	18,253	16,440	11,543	14,133	19,437
Capital Expenditure	(3,282)	(4,044)	(944)	(600)	(600)
Chg in investments	(2,241)	(1,091)	(4,978)	(3,000)	(3,000)
Other investing activities	825	818	-	-	-
Cash flow from inv.(b)	(4,698)	(4,317)	(5,922)	(3,600)	(3,600)
Free cash flow (a+b)	13,555	12,123	5,621	10,533	15,837
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	(2)	41	(18)	(19)	(10)
Interest paid	(364)	(1,055)	(33)	(30)	(27)
Dividend (incl. Tax)	(4,676)	(6,074)	(4,676)	(7,143)	(8,867)
Other financing activities	(759)	(9,264)	(813)	(1,242)	(1,541)
Cash flow from fin. (c)	(5,801)	(16,353)	(5,540)	(8,434)	(10,444)
Net chg in cash (a+b+c)	7,753	(4,229)	81	2,099	5,392

Key Ratios

Y/E Mar	CY13	CY14	CY15	CY16E	CY17E
Raw Material Cost/Sales (%)	45.4	46.0	42.5	43.8	43.2
Manpower Cost/Sales (%)	8.2	8.5	11.2	10.7	10.5
Operating & Other Cost/Sales (%)	24.4	24.2	26.1	25.0	24.8
Revenue Growth (%)	9.2	8.3	(17.0)	16.5	14.5
EBITDA Margins (%)	22.0	21.2	20.3	20.5	21.5
Net Income Margins (%)	12.3	12.1	11.2	12.5	13.6
ROCE (%)	56.2	73.1	58.3	62.8	67.3
ROE (%)	47.2	42.0	32.3	38.5	42.8

Valuation Parameters

Y/E Mar	CY13	CY14	CY15	CY16E	CY17E
EPS (₹.)	115.9	123.6	94.4	123.5	153.3
P/E (x)	43.4	49.4	61.7	46.2	37.2
BV (₹)	245.7	294.3	292.2	320.7	357.9
P/BV (x)	20.5	20.7	19.9	17.8	15.9
EV/EBITDA (x)	24.0	27.6	32.9	27.0	22.2
Fixed assets turnover ratio (x)	2.5	2.9	2.6	3.4	4.3
Net Debt/Equity (x)	0.2	(0.2)	(0.2)	(0.2)	(0.4)
EV/Sales (x)	5.3	5.9	6.7	5.5	4.8



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