

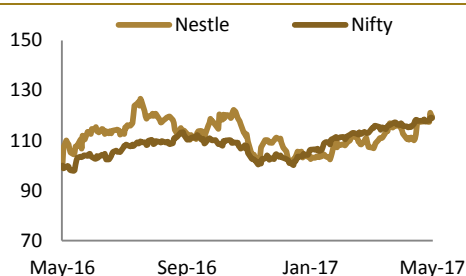
Market statistics

Current stock price (₹)	6,821
Shares O/S (cr.)	9.6
Mcap (₹cr)	67,769
52W H/L (₹)	7,390/5,656
6m avg. volume	44,391
Bloomberg	NEST IN

Shareholding pattern (%)

Promoters	62.8
Domestic Institution	7.15
Foreign Institution	12.52
Non-institution	17.57
of which more than 1%	
Life Insurance Corporation of India	3.62
Arisaig Partners (Asia) PTE Ltd A/C Arisaig India Fund Ltd	1.37

Nestlé India vs. Nifty



Capital efficiency & valuations

Particulars	CY16	CY17E	CY18E
ROE (%)	35.9	40.1	43.2
ROCE (%)	61.5	66.9	70.1
P/B(x)	19.7	20.1	18.2
P/E (x)	55.0	50.0	42.1
P/CE (x)	41.4	39.1	33.7
EPS (₹)	112.3	136.7	162.5
CEPS (₹)	148.9	174.8	202.7
EV/OCF (x)	38.8	41.2	30.4

Nestle has reported healthy 9.1% sales to ₹24,919mn growth during the quarter lower than our expectation of 13%. Domestic business grew healthy by 9.7% while Exports saw a lower growth of 0.6% YoY due to lower sales to Nepal & Bhutan. Gross Margin contracted by 67bps YoY to 56.1%. Employee and other expenses have increased by 12.7% & 17.7% while it expanded by 34bps & 180bps (% of sales). Therefore, EBITDA Margin contracted by 269bps YoY to 20.2%. However, EBITDA de-grew by 3.7%. YoY to ₹5,024mn

Other income and depreciation moved by 17.7% & -2.8%, respectively. Lower CSR expense & no provisions have supported the bottom-line. Hence, reported PAT grew by 6.8% to ₹3,068mn. Adjusted PAT increased by 5.2% to ₹3,121mn.

Q1CY17 sales moderates to 9.1%; CY16 year of recovery after Maggi fiasco:

Nestlé's displayed moderated sales growth of 9.1% in Q1CY17 largely led by volumes. Although sales growth is lower than our expectation, we believe volume pick up is better compared volume pressure faced by other FMCG companies. In CY16, overall volume growth was 26.2% led by 73% growth in prepared dishes segment (includes maggi) while excluding prepared dishes, volumes growth was flat YoY. Milk & Nutrition sales growth was muted at 0.9% while Beverages showed decline of 3.1%YoY in CY16. Company managed to comeback after Maggi crisis but other segments continue to post dismal performance. From last 5 years, Nestle was garnering high realization growth across categories while volume growth remained weak. However, CY16 witnessed 10.9% decline in realization growth of overall portfolio. We acknowledge the volume growth in the current quarter as positive but realization growth seems to be limited amid higher competitive environment.

EBITDA de-grew by 3.7%: Gross margin has contracted by 67bps YoY. Employee expenses & other expenses reported 12.7% & 17.7% YoY growth. Employee expenses were higher due to increase in compensation of factory workers, increase in volumes & one-off activities for the sales force. Increase in other expenses is mainly due to 1) high energy and distribution costs because of steep rise in fuel prices 2) stepped up brand building & demand generating activities. Employee and other expenses as % of sales expanded by 35bps & 180bps, hence EBITDA margin contracted by 269bps to 20.2%. We expect EBITDA Margin can improve in the coming quarters.

Outlook & Valuation: The re-launch of Maggi Noodles has happened during Q4CY15 and in 6-7 months it gained 57% market share. This performance was encouraging but growth in other segments remained weak. We expect less challenging time for Nestle in the coming quarters as compared to recent past which can improve operational performance significantly. We do expect Nestlé's focus on new launches would support volumes in coming qtrs but recent run up in the stock captures all the positives. We expect Sales, EBITDA and PAT to show CAGR from CY16-CY18 to 12%, 17% & 26% respectively.

Nestlé's trading at 39x 12-month forward Price to Cash EPS (P/CE) as compared to last 5 year average of over ~38x. We downgrade to HOLD on account of expensive valuations.

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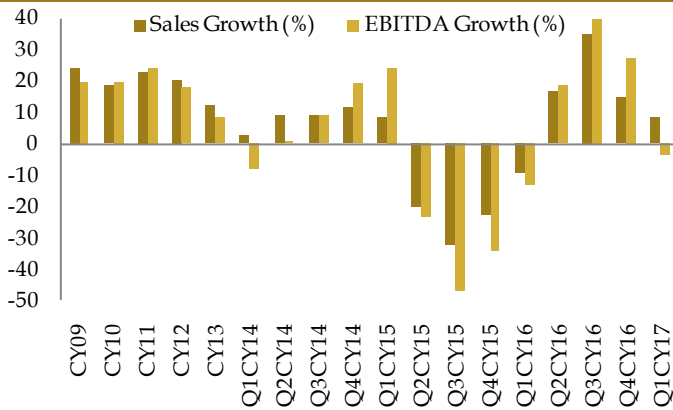


Exhibit 1: Quarterly Performance

Particulars (₹mn)	Q1CY15	Q2CY15	Q3CY15	Q4CY15	Q1CY16	Q2CY16	Q3CY16	Q4CY16	Q1CY17
Net Sales	25,165	19,570	17,424	19,595	22,837	22,717	23,635	22,664	24,919
YoY Gr%	8.4	(19.5)	(32.2)	(22.6)	(9.2)	16.1	35.6	15.7	9.1
EBITDA	6,031	3,756	2,859	3,694	5,219	4,466	4,621	4,702	5,024
YoY Growth	24.4	(23.5)	(46.9)	(34.0)	(13.5)	18.9	61.7	27.3	(3.7)
EBITDA Margin (%)	24.0	19.2	16.4	18.9	22.9	19.7	19.6	20.7	20.2
YoY expansion (bps)	308bps	-99bps	-453bps	-325bps	-111bps	47bps	315bps	189bps	-269bps
PBT before exceptional	4,866	3,331	2,041	2,907	4,329	3,765	3,967	3,219	4,496
YoY Growth	22.7	(21.8)	(55.8)	(39.8)	(11.0)	13.0	94.4	10.7	3.8
PBT	4,866	(1,185)	1,795	2,661	4,531	3,445	3,967	3,229	4,496
Reported PAT	3,203	(644)	1,242	1,832	2,873	2,309	2,694	1,954	3,068
YoY Growth	23.6	(122.4)	(60.1)	(43.9)	(10.3)	(458.7)	116.9	6.7	6.8
Adjusted PAT	3,490	4,613	1,555	2,126	2,966	2,656	2,793	2,566	3,121
YoY Growth	26.7	60.3	(50.8)	(35.2)	(15.0)	(42.4)	79.6	20.7	5.2

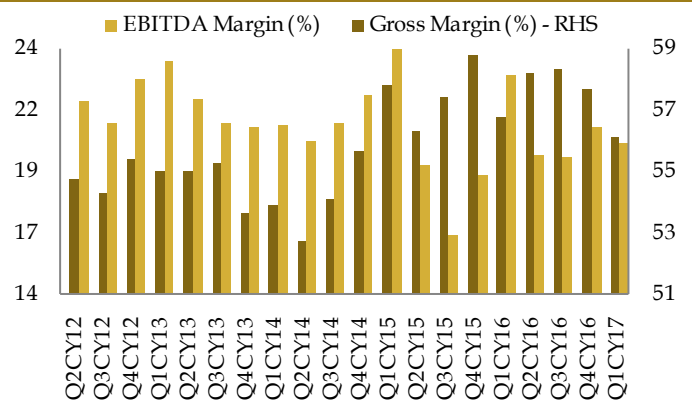
Source: Company, Trust

Exhibit 2: Sales and EBITDA Growth (%)



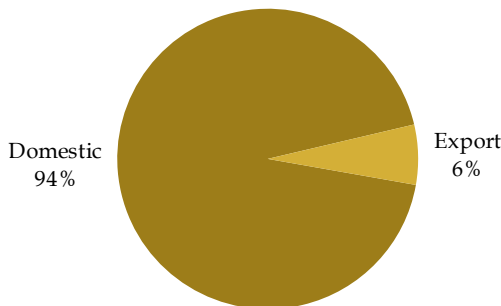
Source: Company, Trust

Exhibit 3: Gross Margin and EBITDA Margin Trend



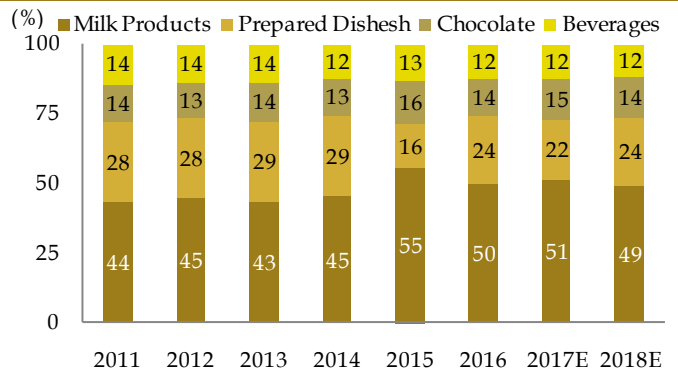
Source: Company, Trust

Exhibit 4: Domestic/Export Mix(Q1CY17)



Source: Company, Trust

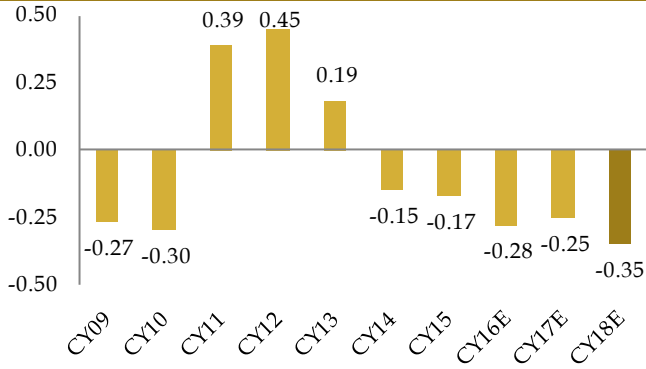
Exhibit 5: Category Revenue Mix



Source: Company, Trust

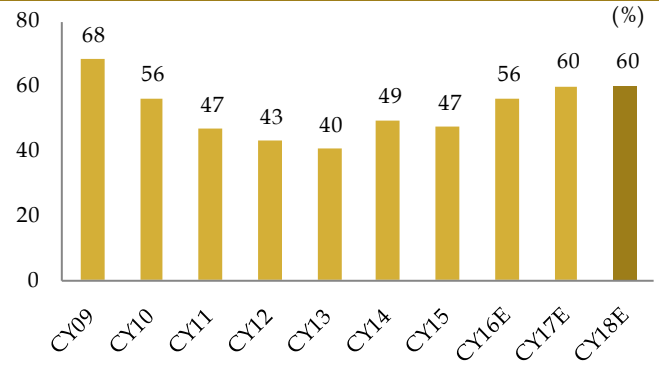


Exhibit 6: Net Debt/Equity (x)



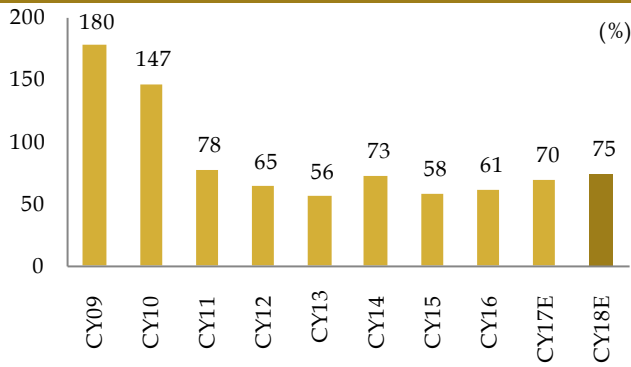
Source: Company, Trust

Exhibit 7: Dividend Payout Ratio (%)



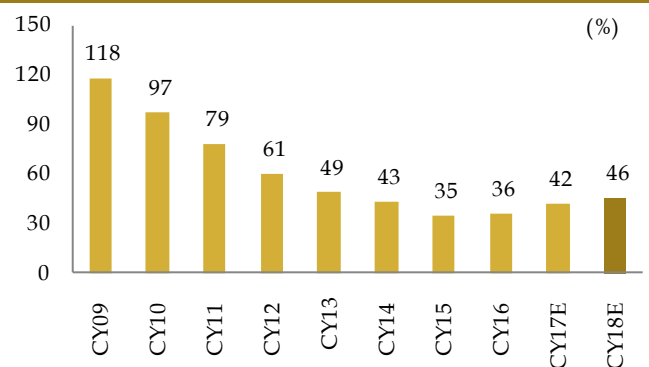
Source: Company, Trust

Exhibit 8: Stable RoCE (%)



Source: Company, Trust

Exhibit 10: Stable RoE (%)



Source: Company, Trust

**Exhibit 9: Volume grew by 26.4% led prepared dishes seg**

Revenue Break up (Rs mn)	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16
Milk and Nutrition	23,113	27,763	33,510	38,594	40,712	45,752	46,694	47,137
Prepared dishes & Cooking Aids	13,350	17,250	21,544	24,302	26,982	29,613	13,141	22,989
Beverages	8,042	8,994	10,684	11,227	13,241	13,398	13,360	12,949
Chocolates	7,719	9,759	10,997	11,691	12,864	12,532	11,109	11,843
Total	52,224	63,766	76,735	85,814	93,799	1,01,295	84,304	94,917

Revenue mix (%)								
Milk and Nutrition	44	44	44	45	43	45	55	50
Prepared dishes & Cooking Aids	26	27	28	28	29	29	16	24
Beverages	15	14	14	13	14	13	16	14
Chocolates	15	15	14	14	14	12	13	12
Total	100	100	100	100	100	100	100	100

Revenue Growth (%)								
Milk and Nutrition	19.2%	20.1%	20.7%	15.2%	5.5%	12.4%	2.1%	0.9%
Prepared dishes & Cooking Aids	26.9%	29.2%	24.9%	12.8%	11.0%	9.7%	-55.6%	74.9%
Beverages	0.4%	11.8%	18.8%	5.1%	17.9%	1.2%	-0.3%	-3.1%
Chocolates	13.6%	26.4%	12.7%	6.3%	10.0%	-2.6%	-11.4%	6.6%
Total	16.8%	22.1%	20.3%	11.8%	9.3%	8.0%	-16.8%	12.6%

Volume Growth (%)								
Milk and Nutrition	13.1%	7.6%	2.5%	-5.1%	-1.1%	-2.3%	-3.0%	-1.2%
Prepared dishes & Cooking Aids	21.7%	24.4%	13.2%	8.0%	3.8%	3.7%	-59.5%	73.0%
Beverages	-3.1%	13.2%	0.9%	-5.0%	9.3%	-11.0%	-10.3%	1.3%
Chocolates	9.7%	21.2%	-1.5%	-9.4%	-2.2%	-12.1%	-19.5%	7.7%
Total Volume	14.9%	17.0%	6.8%	0.8%	1.9%	-0.6%	-36.4%	26.4%

Price Growth (%)								
Milk and Nutrition	5.4%	11.6%	17.8%	21.4%	6.7%	15.0%	5.2%	2.2%
Prepared dishes & Cooking Aids	4.3%	3.9%	10.3%	4.4%	7.0%	5.8%	9.5%	1.1%
Beverages	3.6%	-1.2%	17.8%	10.6%	7.9%	13.7%	11.2%	-4.3%
Chocolates	3.5%	4.3%	14.4%	17.3%	12.4%	10.8%	10.1%	-1.0%
Total Price	1.6%	4.4%	12.6%	10.9%	7.3%	8.6%	30.9%	-10.9%



Financials

P&L Statement

Y/E Dec (₹mn)	CY14	CY15	CY16	CY17E	CY18E
Net Revenues	CY14	CY15	CY16	CY17E	CY18E
% Growth	98,329	81,609	92,058	1,02,965	1,16,309
Raw Material	8.3	(17.0)	12.8	11.8	13.0
Staff	45,239	34,689	38,798	43,247	48,227
Other Expenses	8,371	9,128	10,734	11,003	12,377
Total Expenditures	23,840	21,264	23,790	26,471	29,992
EBITDA	77,450	65,081	73,322	80,722	90,596
% Growth	20,879	16,528	18,736	22,243	25,713
EBITDA Margins (%)	4.4	(20.8)	13.4	18.7	15.6
Other Income	21.2	20.3	20.4	21.6	22.1
Interest	1,093	1,245	1,674	1,911	2,444
Depreciation	142	33	35	49	56
Profit Before Tax	3,375	3,473	3,536	3,680	3,873
Provision for tax	17,745	8,136	14,415	18,659	22,446
Effective tax rate (%)	5,897	2,504	5,150	6,437	7,744
Reported PAT	33.2	30.8	35.7	34.5	34.5
% Growth	11,848	5,633	9,265	12,222	14,702
Adjusted Net Profit	6.1	(52.5)	64.5	31.9	20.3
% Growth	12,322	9,877	10,823	13,177	15,668

Balance Sheet

Y/E Dec	CY14	CY15	CY16	CY17E	CY18E
Equity Share Capital	964	964	964	964	964
Reserves & surplus	27,408	27,214	29,173	31,879	35,266
Shareholders' funds	28,372	28,178	30,137	32,843	36,231
Total Debt	196	177	332	382	432
Capital Employed	28,568	28,356	30,469	33,225	36,662
Net fixed assets	34,214	31,286	29,176	28,278	27,287
Cash & Cash Eq.	4,458	4,996	8,800	9,791	14,091
Net Other current assets	(16,148)	(19,447)	(23,460)	(22,796)	(24,668)
Investments	8,270	13,248	17,494	19,494	21,494
MiscExp not written off	-	-	-	-	-
Net Deferred tax Assets	(2,227)	(1,729)	(1,542)	(1,542)	(1,542)
Total Assets	28,568	28,356	30,469	33,225	36,662

**Cash Flow**

Cash Flow Statement	CY14	CY15	CY16	CY17E	CY18E
Pre-tax profit	17,744	8,136	14,415	18,659	22,446
Depreciation	3,375	3,673	3,536	3,680	3,873
Total Tax Paid	(5,891)	(3,422)	(5,029)	(6,437)	(7,744)
Chg in working capital	1,818	3,316	2,853	(663)	1,872
Other operating activities	(606)	(723)	(1,117)	49	56
Cash flow from oper (a)	16,440	10,981	14,658	15,287	20,503
Capital Expenditure	(4,044)	(1,493)	(1,133)	(2,782)	(2,882)
Chg in investments	(1,091)	(373)	(1,528)	(2,000)	(2,000)
Other investing activities	818	1,162	1,387	-	-
Cash flow from inv.(b)	(4,317)	(705)	(1,274)	(4,782)	(4,882)
Free cash flow (a+b)	12,123	10,276	13,384	10,506	15,621
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	41	(32)	(9)	50	50
Interest paid	(1,055)	(33)	(35)	(49)	(56)
Dividend (incl. Tax)	(6,074)	(4,932)	(6,789)	(7,906)	(9,401)
Other financing activities	(9,264)	13	168	(1,610)	(1,914)
Cash flow from fin. (c)	(16,353)	(4,983)	(6,666)	(9,515)	(11,321)
Net chg in cash (a+b+c)	(4,229)	5,293	6,719	991	4,300

Key Ratios

Y/E Mar	CY14	CY15	CY16	CY17E	CY18E
Raw Material Cost/Sales (%)	46.0	42.5	42.1	42.0	41.5
Manpower Cost/Sales (%)	8.5	11.2	11.7	10.7	10.6
Operating & Other Cost/Sales (%)	24.2	26.1	25.8	25.7	25.8
Revenue Growth (%)	8.3	(17.0)	12.8	11.8	13.0
EBITDA Margins (%)	21.2	20.3	20.4	21.6	22.1
Net Income Margins (%)	12.5	12.1	11.8	12.8	13.5
ROCE (%)	73.1	58.3	61.5	66.9	70.1
ROE (%)	43.4	35.1	35.9	40.1	43.2

Valuation Parameters

Y/E Mar	CY14	CY15	CY16	CY17E	CY18E
EPS (₹.)	127.8	102.4	112.3	136.7	162.5
P/E (x)	47.7	56.9	55.0	50.0	42.1
BV (₹)	294.3	292.2	312.6	340.6	375.8
P/BV (x)	20.7	19.9	19.7	20.1	18.2
EV/EBITDA (x)	27.6	32.9	30.4	28.3	24.3
Fixed assets turnover ratio (x)	2.9	2.6	3.2	3.6	4.3
Net Debt/Equity (x)	(0.2)	(0.2)	(0.3)	(0.3)	(0.4)
EV/Sales (x)	5.9	6.7	6.2	6.1	5.4



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Recommendation **Expected absolute returns (%) over 12 months**

Buy More than 15%

Hold 15% to -15%

Sell Less than -15%

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