

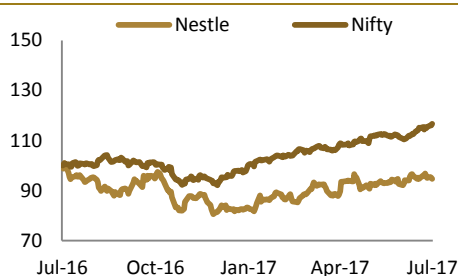
Market statistics

Current stock price (₹)	6,786
Shares O/S (cr.)	9.6
Mcap (₹cr)	65,424
52W H/L (₹)	7,390/5,656
6m avg. volume	43,265
Bloomberg	NEST IN

Shareholding pattern (%)

Promoters	62.8
Domestic Institution	5.34
Foreign Institution	12.59
Non-institution	19.31
of which more than 1%	
Life Insurance Corporation of India	4.07
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	18.1
P/E (x)	55.0	50.0	41.8
P/CE (x)	41.4	39.1	33.5
EPS (₹)	112.3	136.7	162.5
CEPS (₹)	148.9	174.8	202.7
EV/OCF (x)	38.8	41.2	30.2

Associate

Ritu Chaudhary

+91-22 4224 5183

ritu.chaudhary@trustgroup.in

Nestlé has reported moderate 6.9% sales to ₹23,865mn growth during the quarter lower than our expectation of 9.0%. Domestic business grew healthy by 8.5% while Exports declined by 12% YoY due to lower sales of Milk & Nutrition products to Bangladesh & Middle East. Gross Margin contracted by 269bps YoY to 55.1% due to higher cost of milk & its derivatives. Employee and other expenses have increased by 11.1% & 4.8% while it moved by 43bps & -49bps (% of sales). Therefore, EBITDA Margin contracted by 202bps YoY to 18.5%. However, EBITDA de-grew by 3.7%. YoY to ₹4,437mn

Other income and depreciation moved by 12.2% & -3.9%, respectively. Lower CSR expense & no provisions have supported the bottom-line. Hence, reported PAT grew by 9.7% to ₹2,634mn. Adjusted PAT (adjusting other comprehensive income and exceptional items) declined by 2.4% to ₹2,590mn YoY.

Weak exports & trade disruption impacts overall Sales; domestic is healthy:

Nestlé's displayed sales growth of 6.9% in Q2CY17 largely led by volumes. Domestic business performed better and showed 8.5% led by new product launches, better sales in Maggi noodles and better realizations. This performance is healthy in our opinion against the backdrop of GST rollout leading to de-stocking in trade channel. 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, Nestlé witnessed sharp decline in realizations hence, improvement in realizations in the current quarter is quite encouraging. Despite better realizations, gross margins reduced sharply by 269bps which suggest Nestlé has to take further price revision to maintain margins. From last 5 years, Nestlé was garnering high realization growth across categories while volume growth remained weak. Volume pickup from last 2 qtrs is positive and we expect it to maintain in coming qtrs.

EBITDA de-grew by 3.7%: Gross margin has contracted by 269bps YoY due to sharp rise in milk and milk derivatives. Employee expenses & other expenses reported 11.1% & 4.8% YoY growth. Employee expenses were higher due to increase in compensation of factory workers. Employee and other expenses as % of sales moved by 44bps & -49bps, hence EBITDA margin contracted by 202bps to 18.5%. We expect EBITDA Margin can improve in the coming quarters.

Higher Tax rate 33.2% vs 30.4%: Tax rate was higher at 33.2% vs 30.4% last year due to the end of 5 years of Income Tax holiday @100 profits of Samalkha Factory. For the next 5 years, tax rate for this factory would be @30%.

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 Nestlé 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 current price of stock captures all the positives. We expect Sales, EBITDA and PAT to show CAGR from CY16-CY18 to 12%, 17% & 26% respectively.

Nestlé is trading at 39x 12-month forward Price to Cash EPS (P/CE) as compared to last 5 year average of over ~38x. We maintain HOLD rating.

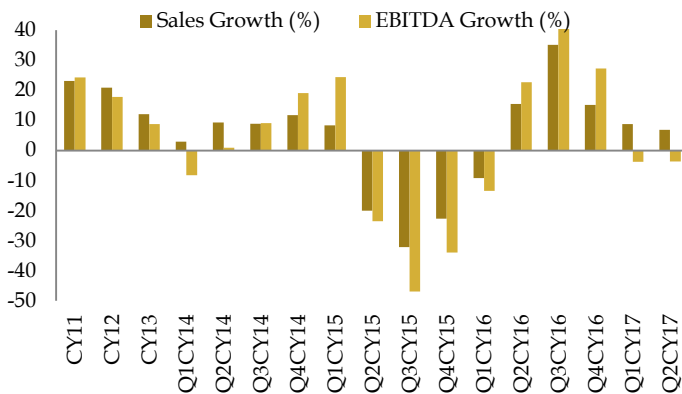


Exhibit 1: Quarterly Performance

Particulars (₹mn)	Q2CY15	Q3CY15	Q4CY15	Q1CY16	Q2CY16	Q3CY16	Q4CY16	Q1CY17	Q2CY17
Net Sales	19,570	17,424	19,595	22,837	22,489	23,635	22,664	24,919	24,022
YoY Gr%	(19.5)	(32.2)	(22.6)	(9.2)	14.9	35.6	15.7	9.1	6.8
EBITDA	3,756	2,859	3,694	5,219	4,607	4,621	4,702	5,024	4,437
YoY Growth	(23.5)	(46.9)	(34.0)	(13.5)	22.7	61.7	27.3	(3.7)	(3.7)
EBITDA Margin (%)	19.2	16.4	18.9	22.9	20.5	19.6	20.7	20.2	18.5
YoY expansion (bps)	-99bps	-453bps	-325bps	-111bps	129bps	315bps	189bps	-269bps	-202bps
PBT before exceptional	3,331	2,041	2,907	4,329	3,909	3,967	3,219	4,496	3,946
YoY Growth	(21.8)	(55.8)	(39.8)	(11.0)	17.3	94.4	10.7	3.8	0.9
PBT	(1,185)	1,795	2,661	4,531	3,589	3,967	3,229	4,496	3,946
Reported PAT	(644)	1,242	1,832	2,873	2,402	2,694	1,954	3,068	2,634
YoY Growth	(122.4)	(60.1)	(43.9)	(10.3)	(473.2)	116.9	6.7	6.8	9.7
Adjusted PAT	4,613	1,555	2,126	2,966	2,654	2,793	2,566	3,032	2,590
YoY Growth	60.3	(50.8)	(35.2)	(15.0)	(42.5)	79.6	20.7	2.2	(2.4)

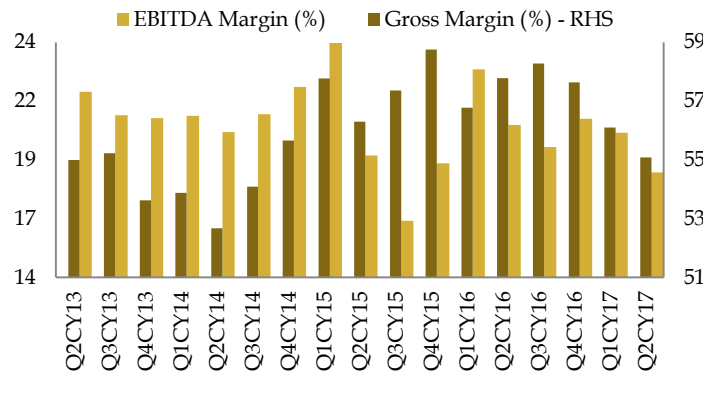
Source: Company, Trust

Exhibit 2: Sales and EBITDA Growth (%)



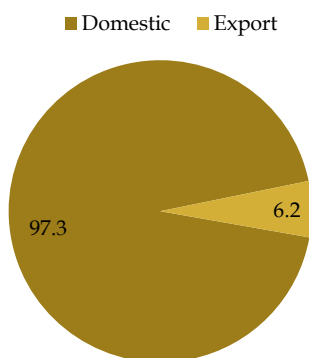
Source: Company, Trust

Exhibit 3: Gross Margin and EBITDA Margin Trend



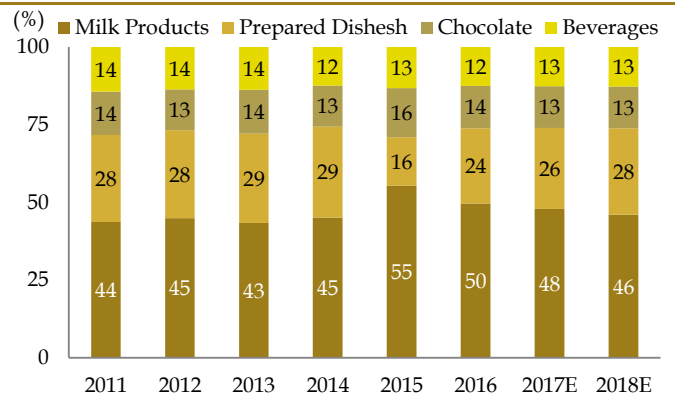
Source: Company, Trust

Exhibit 4: Domestic/Export Mix(Q2CY17)



Source: Company, Trust

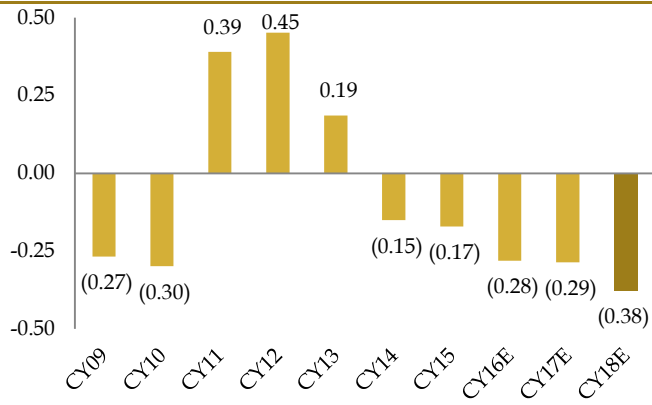
Exhibit 5: Category Revenue Mix



Source: Company, Trust

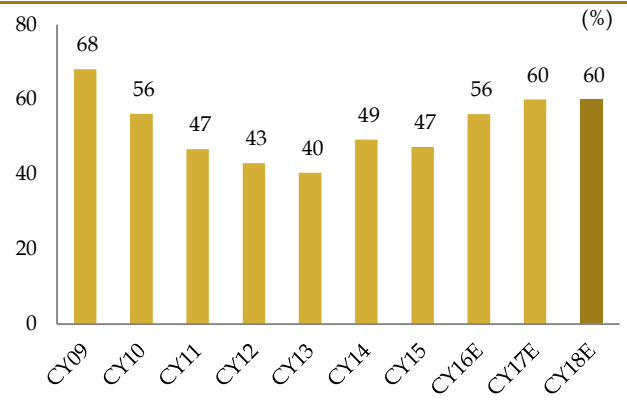


Exhibit 6: Net Debt/Equity (x)



Source: Company, Trust

Exhibit 7: Dividend Payout Ratio (%)



Source: Company, Trust



Financials

P&L Statement

Y/E Dec (₹mn)	CY14	CY15	CY16	CY17E	CY18E
Net Revenues	98,329	81,609	92,058	102,965	116,309
% Growth	8.3	(17.0)	12.8	11.8	13.0
Raw Material	45,239	34,689	38,798	43,247	48,227
Staff	8,371	9,128	10,734	11,003	12,377
Other Expenses	23,840	21,264	23,790	26,471	29,992
Total Expenditures	77,450	65,081	73,322	80,722	90,596
EBITDA	20,879	16,528	18,736	22,243	25,713
% Growth	4.4	(20.8)	13.4	18.7	15.6
EBITDA Margins (%)	21.2	20.3	20.4	21.6	22.1
Other Income	1,093	1,245	1,674	1,911	2,444
Interest	142	33	35	49	56
Depreciation	3,375	3,473	3,536	3,680	3,873
Profit Before Tax	17,745	8,136	14,415	18,659	22,446
Provision for tax	5,897	2,504	5,150	6,437	7,744
Effective tax rate (%)	33.2	30.8	35.7	34.5	34.5
Reported PAT	11,848	5,633	9,265	12,222	14,702
% Growth	6.1	(52.5)	64.5	31.9	20.3
Adjusted Net Profit	12,322	9,877	10,823	13,177	15,668
% Growth	6.6	(19.8)	9.6	21.7	18.9

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	41.8
BV (₹)	294.3	292.2	312.6	340.6	375.8
P/BV (x)	20.7	19.9	19.7	20.1	18.1
EV/EBITDA (x)	27.6	32.9	30.4	28.3	24.1
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	5.3



Institutional Equity Team

Names	Designation	Sectors	Email ID's	Desk-Number
Naren Shah	Head Of Equity		naren.shah@trustgroup.in	+91-22-4084-5074
Sales Trading & Dealing				
Rajesh Ashar	Sales Trader		rajesh.ashar@trustgroup.in	+91-22-4224-5123
Dealing Desk			trustfin@bloomberg.net	+91-22-4084-5089
Research Team				
BinyamTaddese	Analyst	Rates & Credit Research	binyam.taddese@trustgroup.in	+91-22-4224-5037
Naushil Shah	Analyst	Technology, Media & Telecom	naushil.shah@trustgroup.in	+91-22-4224-5125
TusharChaudhari	Analyst	Commodities, Auto & Mid-caps	tushar.chaudhari@trustgroup.in	+91-22-4224-5119
RituChaudhary	Associate	FMCG & Consumer Durable	ritu.chaudhary@trustgroup.in	+91-22-4224-5183

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Hold 15% to -15%

Sell Less than -15%

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