

OCTOBER 26, 2018

RESULT

Coverage view: **Cautious**

Price (₹): **9,540**

Target price (₹): **10,600**

BSE-30: **33,349**

Sustains strong momentum. Nestle reported another solid quarter with revenue, EBITDA and PAT growing 17%, 26% and 30%, respectively, 2-6% ahead of our estimates. Nestle has stepped up marketing expenses to support its active new launch pipeline even as there are emerging pockets of COGS inflation; we like the volume growth focus. We raise estimates marginally and raise our September 2019 DCF-based fair-value target to ₹10,600 (from ₹9,950). Remains one of our top picks. ADD.

Company data and valuation summary

Nestle India

Stock data

52-week range (Rs) (high,low) 11,705-6,887

Market Cap. (Rs bn) 919.8

Shareholding pattern (%)

Promoters 62.8

FIs 12.2

MFs 2.3

Price performance (%)

Absolute (1.9) (7.6) 33.5

Rel. to BSE-30 7.4 2.5 32.7

Forecasts/Valuations

EPS (Rs) 171.0 199.7 229.7

EPS growth (%) 34.5 16.8 15.1

P/E (X) 55.8 47.8 41.5

Sales (Rs bn) 112.1 127.5 143.5

Net profits (Rs bn) 16.5 19.3 22.2

EBITDA (Rs bn) 27.7 31.8 36.4

EV/EBITDA (X) 31.9 27.6 23.8

ROE (%) 46.2 49.4 51.9

Div. Yield (%) 1.2 1.4 1.6

2QFY19 another strong, ahead-of-expectations quarter

- Revenues grew 16.8% yoy to ₹29.22 bn, 5% ahead of our estimate. Domestic revenues grew 17.5% (2-year CAGR: 12.6%) while export revenues grew 7.9% yoy. This was the strongest domestic revenue growth print for the company in the past many years, ignoring the initial couple of Maggi-revival quarters.
- Gross margins expanded 285 bps to 59.5%, 97 bps ahead of our estimate.
- EBITDA grew 26% yoy to ₹7.25 bn, 2% ahead of our estimate. We note that this was despite the company stepping up marketing expenses substantially, reflected in the sharp 24% yoy increase in other expenses. EBITDA margin stood at 24.8%, +171 bps yoy and 58 bps below our estimate. 2-year CAGR on EBITDA was a healthy and industry-leading 22%.
- Recurring PAT for the quarter stood at ₹4.46 bn, +30% yoy and 4% above our estimate. EPS for the quarter was ₹46.3/share. Two-year CAGR on EPS stood at 27%.
- 9MCY18 – revenues up 13%, EBITDA up 35%, and PAT up 39% yoy; EPS: ₹131.2/share.

Strong commentary in the press release

Nestle CEO's comments in the press release emphasized (1) delivery of strong broad-based volume-driven growth and (2) continued focus on innovation and renovation. Some of the recent new launches mentioned were Maggi special masala noodles, Maggi dip and spread, Kitkat delight brownie cubes, Nescafe E coffee machine, and Nesplus breakfast cereals. The company did caution on rising input cost pressure led by crude price inflation and depreciating INR. We do note that RM inflation for F&B categories remains much lower than the HPC ones.

Performance tracking in line with our estimates; we remain constructive

Shift in focus to volume-led growth and margin expansion potential were the two key drivers of our upgrade in early-CY2018. 9MCY18 performance has ticked both the boxes. We expect strong volume-growth-led EPS growth ahead even as margin expansion potential is now limited. Reiterate ADD with a revised fair-value target of ₹10,600/share (from ₹9,950).

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Exhibit 1: Key changes to estimates, Nestle India, CY2018-20E

	Revised			Earlier			Change (%)		
	2018E	2019E	2020E	2018E	2019E	2020E	2018E	2019E	2020E
Revenues (Rs mn)	112,132	127,524	143,509	111,871	124,722	139,009	0.2	2.2	3.2
EBITDA (Rs mn)	27,697	31,753	36,351	27,713	31,832	35,928	(0.1)	(0.2)	1.2
EBITDA margin (%)	24.7	24.9	25.3	24.8	25.5	25.8			
Net income (Rs mn)	16,485	19,253	22,151	16,445	19,031	21,548	0.2	1.2	2.8
EPS (Rs/share)	171.0	199.7	229.7	170.6	197.4	223.5	0.2	1.2	2.8

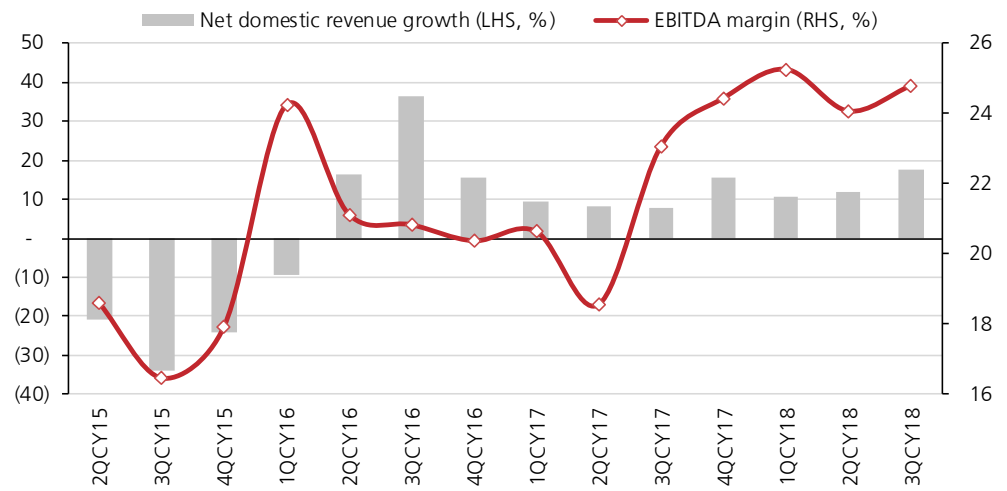
Source: Kotak Institutional Equities estimates

Exhibit 2: Interim standalone results of Nestle India, calendar year-ends (Rs mn)

					(% chg.)					
	3QCY18	3QCY18E	3QCY17	2QCY18	vs KIE	yoy	qoq	9MCY18	9MCY17	%yoy
Net domestic revenues	27,495	26,216	23,408	25,073	5	17	10	78,170	68,886	13
Export revenues	1,725	1,711	1,599	1,712	1	8	1	5,204	4,743	10
Net sales	29,220	27,928	25,007	26,786	5	17	9	83,374	73,629	13
Material cost	(11,841)	(11,590)	(10,847)	(10,890)	2	9	9	(34,008)	(32,576)	4
Gross Profit	17,379	16,338	14,160	15,896	6	23	9	49,366	41,053	20
Gross margin (%)	59.5	58.5	56.6	59.3	97 bps	285 bps	13 bps	59.2	55.8	345 bps
Employee cost	(2,904)	(2,858)	(2,575)	(2,849)	2	13	2	(8,443)	(7,567)	12
Other expenditure	(7,228)	(6,394)	(5,813)	(6,598)	13	24	10	(20,313)	(18,174)	12
Total expenditure	(21,973)	(20,842)	(19,234)	(20,337)	5	14	8	(62,763)	(58,317)	8
EBITDA	7,247	7,086	5,773	6,449	2	26	12	20,611	15,312	35
EBITDA Margin (%)	24.8	25.4	23.1	24.1	-58 bps	171 bps	72 bps	24.7	20.8	392 bps
Other income	670	508	430	602	32	56	11	1,837	1,258	46
Other operating income	174	175	134	198	(1)	30	(12)	576	453	27
Interest	(275)	(300)	(229)	(283)	(8)	20	(3)	(868)	(685)	27
Depreciation	(930)	(840)	(864)	(817)	11	8	14	(2,573)	(2,585)	(0)
Pretax profits	6,886	6,628	5,244	6,150	4	31	12	19,583	13,753	42
Tax	(2,257)	(2,230)	(1,746)	(2,003)	1	29	13	(6,416)	(4,485)	43
PAT	4,629	4,398	3,498	4,147	5	32	12	13,168	9,268	42
Impairment of fixed assets	—	(75)	(67)	(41)	—	—	—	(41)	(67)	—
Provision for contingencies	(168)	(50)	1	(156)	236	NM	8	(475)	(67)	611
Recurring PAT	4,461	4,273	3,432	3,950	4	30	13	12,652	9,134	39
EO item	—	—	—	—	—	—	—	—	—	—
Reported PAT	4,461	4,273	3,432	3,950	4	30	13	12,652	9,134	39
Recurring EPS (Rs/share)	46.3	44.3	35.6	41.0	4	30	13	131.2	94.7	39
Income tax rate (%)	33.6	34.3	33.7	33.6	-70 bps	-14 bps	-6 bps	33.6	32.9	71 bps
Costs as a % of sales										
Material cost	40.5	41.5	43.4	40.7	-98 bps	-286 bps	-14 bps	40.8	44.2	-346 bps
Employee cost	9.9	10.2	10.3	10.6	-30 bps	-36 bps	-70 bps	10.1	10.3	-16 bps
Other expenditure	24.7	22.9	23.2	24.6	184 bps	149 bps	10 bps	24.4	24.7	-32 bps

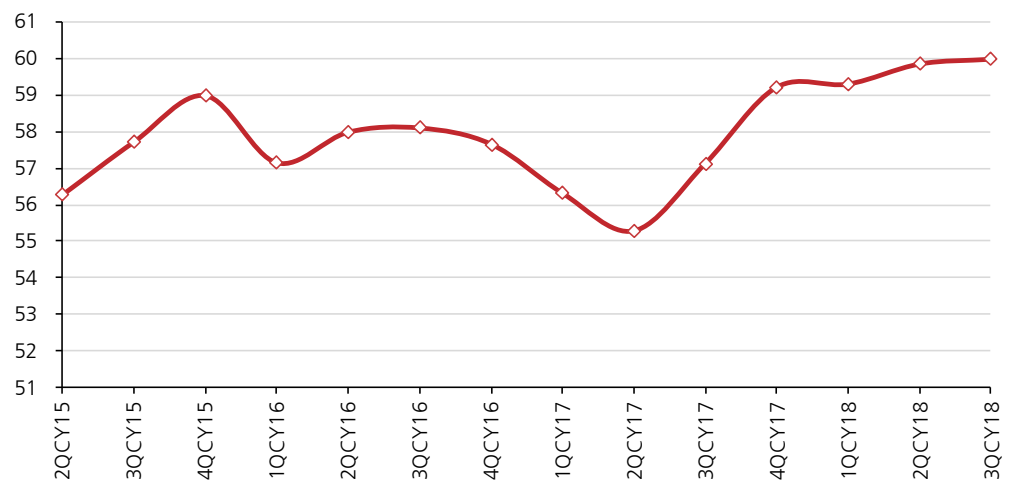
Source: Company, Kotak Institutional Equities estimates

Exhibit 3: Nestle's net domestic revenue growth and EBITDA margin (%)



Source: Company, Kotak Institutional Equities

Exhibit 4: Nestle's 2QCY18 gross margins expanded 285 bps yoy



Source: Company, Kotak Institutional Equities

Exhibit 5: Nestle: Profit model, balance sheet, December calendar year-ends, 2014-20E (Rs mn)

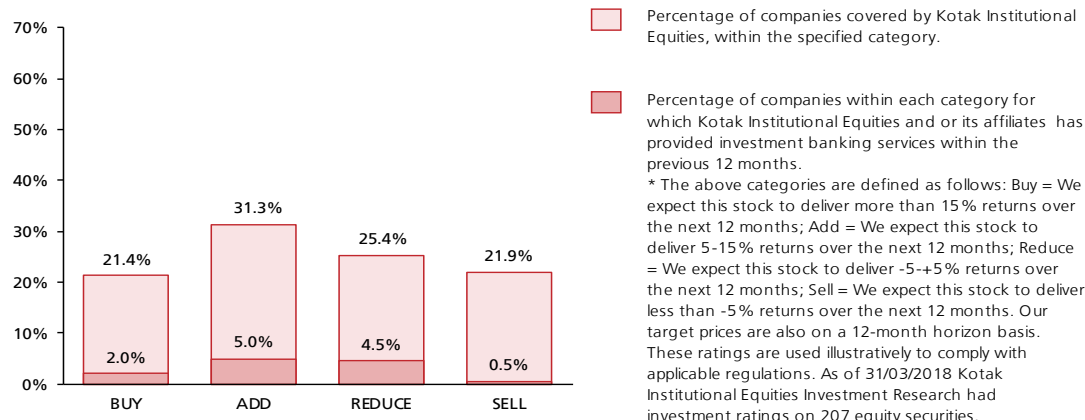
	IGAAP		Ind-AS				
	2014	2015	2016	2017	2018E	2019E	2020E
Profit model							
Net sales	98,063	81,233	90,764	99,525	112,132	127,524	143,509
EBITDA	20,527	15,946	19,652	21,643	27,697	31,753	36,351
Other income	1,359	1,621	2,159	2,340	3,155	3,999	4,714
Interest expense	(142)	(33)	(909)	(919)	(1,150)	(1,295)	(1,443)
Depreciation	(3,375)	(3,473)	(3,537)	(3,423)	(3,528)	(3,756)	(4,012)
Pretax profits	18,368	14,062	17,365	19,642	26,173	30,701	35,610
Tax	(5,897)	(4,206)	(5,440)	(6,141)	(8,379)	(9,918)	(11,668)
Net income	12,472	9,855	11,924	13,500	17,794	20,783	23,942
Provision for contingencies/impairment losses	(695)	(917)	(1,803)	(1,248)	(1,309)	(1,530)	(1,791)
Net income after contingencies/impairment	11,777	8,938	10,121	12,252	16,485	19,253	22,151
EO items	70	(3,306)	(108)	—	—	—	—
Reported net income	11,847	5,633	10,014	12,252	16,485	19,253	22,151
Earnings per share (Rs)	122.1	92.7	105.0	127.1	171.0	199.7	229.7
Balance sheet							
Total equity	28,372	30,359	32,823	34,206	37,229	40,701	44,633
Total borrowings	196	177	332	351	—	—	—
Deferred tax liability	2,227	1,747	1,553	1,220	1,220	1,220	1,220
Total liabilities and equity	30,795	32,283	34,708	35,777	38,449	41,920	45,852
Cash	4,458	4,996	8,800	14,574	21,904	30,613	39,899
Investments	8,118	13,297	17,557	19,789	19,789	19,789	19,789
Net current assets (excl cash)	(15,996)	(17,296)	(20,832)	(25,689)	(29,173)	(33,334)	(37,689)
Net fixed assets (incl CWIP)	34,214	31,286	29,183	27,103	25,930	24,852	23,853
Total assets	30,795	32,283	34,708	35,777	38,449	41,920	45,852
Free cash flow							
Operating cash flow, excl. working capital	14,623	7,665	12,618	14,428	18,743	21,114	23,782
Working capital	1,818	3,316	2,040	3,750	3,484	4,161	4,355
Capital expenditure	(4,146)	(1,508)	(2,070)	(1,986)	(2,355)	(2,678)	(3,014)
Free cash flow	12,294	9,473	12,589	16,192	19,872	22,597	25,123
Key assumptions							
Revenue growth (%)	8.2	(17.2)	11.7	9.7	12.7	13.7	12.5
EBITDA Margin (%)	20.9	19.6	21.7	21.7	24.7	24.9	25.3
EPS Growth (%)	6.7	(24.1)	13.2	21.1	34.5	16.8	15.1
RoE (%)	45.2	30.4	32.0	36.6	46.2	49.4	51.9
RoCE (%)	24.3	18.3	20.4	21.5	26.1	27.3	28.2

Source: Company, Kotak Institutional Equities estimates

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