**PROJECT ON VALUATION OF SHARES OF NESTLE INDIA AND ITS FINANCIAL STATEMENT ANALYSIS**

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**Q1 VALUATION**

**Forecasting Free Cash Flow**

1. **Forecasting Revenue (in million Rs)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** |
| **Growth rate of sales** | 0.106 |  | 0.053 | 0.106 | 0.106 | 0.106 | 0.106 | 0.106 |
| **Sales** | 127756.2 | 76653.7 | 80716.34277 | 89272.28 | 98735.14 | 109201.1 | 120776.4 | 133578.7 |

The average growth rate of revenue for past 5 year excluding year 2015 was **10.57%.** We excluded 2015’s growth rate because of the MAGGI case which led to the fall in revenue. However the FMCG is industry is growing heavily and also having less competitor (oligopoly market) , so we took growth rate as **10.6% for 2019-20.**

As Nestlé’s product mainly includes Dairy, Cereals, and other Food items. The Covid impact of drop in Sales from Domestic Market will be less however the Sales from Export will decrease by much larger extent. Hence we take **revenue of 2020 as 60% of 2019**(pre covid year) .

Although revenue would start increasing after the covid crisis but due to decline in the income of the consumers the growth rate wouldn't jump directly to natural rate of 10.8% hence we assume that it would take 1 year for growth to attain natural rate. Therefore growth rate for **2021 is assumed to be 5.3% and 10.6% for following years.**

1. **Forecasting Variable and Fixed Cost (in million Rs)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** |
| **VC** | 60045.4 | 36027.24 | 37936.6811 | 41957.97 | 46405.51 | 51324.5 | 56764.9 | 62781.97 |
| **FC** | 39604.41 | 26062.26 | 25022.06626 | 27674.41 | 30607.89 | 33852.33 | 37440.68 | 41409.39 |
| **TC** | 99649.81 | 62089.49 | 62958.74736 | 69632.37 | 77013.41 | 85176.83 | 94205.57 | 104191.4 |

It has been observed that VC as % of Sales and FC as % of sales has been nearly constant for the year 2015-2018, hence we take **VC = 0.47\* Sales** and **FC =0.31\*Sales** for year 2019.

Nestle suffered a loss in revenue in 2015 due to MAGGI Case, at that time FC as % of Sales increased but VC as % of sales was constant. Hence we assume a similar impact will occur due to Covid so we take **VC as 0.47\* sales** but **FC as 0.34\*sales**.

1. **Forecasting PAT (in million Rs)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** |
| **tax rate** | 0.338 | 0.318 | 0.318 | 0.338 | 0.338 | 0.338 | 0.338 | 0.338 |
| **PAT** | 18606.41 | 9932.786 | 12110.68007 | 13001.61 | 14379.79 | 15904.04 | 17589.87 | 19454.4 |

Tax rate for year 2019 was taken as **33.8%** which was calculated as the average tax rate for past 6 years. We assume that due to fall in sales we expect policy measures to reduce taxes to support industries and hence we take **tax rate as 31.8%** (2% less than pre covid). After initial tax cut, we assume that tax rate would be back to normal after 2 years that is from 2022

1. **Forecasting Depreciation and Capex (in million Rs)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** |
| **Depreciation** | 3409.6 | 3267.293 | 3260.119316 | 3286.985 | 3316.698 | 3349.561 | 3385.908 | 3426.107 |
| **Capex** | 2014.65 | 1303.113 | 1267.246582 | 1401.575 | 1550.142 | 1714.457 | 1896.189 | 2097.185 |

The Capex was been fluctuating for nestle India over the past few year but Capex as % sales was less fluctuating , so we took average of Capex as % sales for 4 years . For Depreciation Geometric mean of depreciation was taken because of its more or less constant nature.

Capex will decrease as expansion won’t take place. However in FMCG sector majority of Capex is maintenance Capex hence the Capex as % of Sales should increase. We take **Capex / Sales as 0.017.** We created a depreciation function assuming depreciation depends on Capex

Depre(t) = Depre(t-1) + 0.3(Capex(t)- Capex(t-1)).

1. **Forecasting Working Capital (in million Rs)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** |
| **Working Capital** | 31930.38 | 25544.3 | 26898.1479 | 29749.35 | 32902.78 | 36390.48 | 40247.87 | 44514.14 |
| **Change in Working Capital** | 3110.375 | -6386.08 | 1353.8479 | 2851.204 | 3153.431 | 3487.695 | 3857.391 | 4266.274 |

We took Working Capital at **25%** of Sales for 2019 (same as that for 2018). Due to decline in profit we expect decline in Current assets as hence decline in **working capital to 80% of previous year**. After the covid Working Capital would increase, we assume it would increase at the same rate as Sales.

1. **FCF (in million Rs)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **2019** | **2020** | **2021** | **2022** | **2023** | **2024** | **2025** | **2026** |
| **FCF** | 16890.98 | 18283.04 | 12749.7049 | 12035.82 | 12992.91 | 14051.45 | 15222.2 | 16517.05 |

Free cash flow was calculated using the formula

FCF = PAT + Depreciation – Change in Working Capital – Capex

**Weighted Average Cost of Capital**

1. **Cost of Equity**

Cost of Equity was calculated using CAPM Model.

Ke = Rf + B(Rf-Rm)

Ke = Cost of Equity

Rf = Risk free rate

Rm = Market Return

B = beta

Rf was taken as **6.57%** which is the bond rate of 10 year Indian Government bond.

B was calculated using weekly returns from 2009-2018 of Nestle and SENSEX. The formula used was Covariance(Nestle, SENSEX)/Variance(SENSEX). Which came out to be **0.65**

Rm was calculated using SENSEX as benchmark index and the formula

Rf= [ Index(2018)/Index(2009) ]^(1/9) -1

Rf= 14.4%

**Ke = 14.4 + 0.65\*(14.4-6,5)**

**Ke = 11.6%**

1. **Cost of Debt**

Kd = Interest Paid/ Long-term debt

**Kd = 3.3**

**WACC = kd\*(Debt/Total Capital) + ke\*( Equity/Total Capital)**

**WACC = 11.7%**

**Present Value Of Free Cash Flow**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **FCF** | 16890.98 | 18283.04 | 12749.7049 | 12035.82 | 12992.91 | 14051.45 | 15222.2 | 16517.05 |
| **WACC** | 11.70% | 11.70% | 11.70% | 11.70% | 11.70% | 11.70% | 11.70% | 11.70% |
|  | 1.117 | 1.247689 | 1.393668613 | 1.556728 | 1.738865 | 1.942312 | 2.169563 | 2.423402 |
| **Disc factor** | 0.895255 | 0.801482 | 0.717530689 | 0.642373 | 0.575088 | 0.51485 | 0.460922 | 0.412643 |
| **FCF (post disc)** | 15121.74 | 14653.52 | 9148.304543 | 7731.487 | 7472.064 | 7234.394 | 7016.252 | 6815.645 |

|  |  |  |
| --- | --- | --- |
| **Sum of PV of FCF** | 75193.41 | (in million Rs) |
| **Terminal Value** | 1660714 | (in million Rs) |
| **PV of Terminal Value** | 685282.1 | (in million Rs) |
|  |  |  |
| **Enterprise Value** | 7,60,476 | (in million Rs) |
| **Debt** | 351.4 | (in million Rs) |
| **Value to Equity** | 7,60,124 | (in million Rs) |
|  |  |  |
| **No. of Shares** | 96.42 | (in million ) |
|  |  |  |
| **Intrinsic Value of Share** | 7883.47 | (in Rs) |
| **Value in march 2019** | 10029 | (in Rs) |

**Q2 Ratio Analysis**

The following ratios are calculated in order to analyze Nestle India’s performance and also to compare it with the rest of the companies in the industry.

The industry average was calculated by taking an average of top 6 companies namely Nestle India, Britannia, Varun Beverages, KRBL, Tasty Bite Eatables and Heritage foods under the food industry.

**Current Ratio:**

Current Ratio = Current Assets

Current Liabilities

This ratio reflects the number of times short-term assets cover short-term liabilities and is a fairly accurate indication of a company's ability to service its current obligations. A higher number is preferred because it indicates a strong ability to service short-term obligations. The composition of current assets is a key factor in the evaluation of this ratio. Depending on the type of business or industry, current assets may include slow-moving inventories that could potentially affect analysis of a company's liquidity.

The current ratio for Nestle India was 2.554, 2.637 and 2.402 for the years 2018, 2017 and 2016 respectively; which shows that the current ratio has been falling for the past three years. Also the current ratio was way below the industry average of 1.702, 1.669 and 1.51 for the years 2018, 2017 and 2016 respectively, indicating that the company's ability to service short-term obligations is satisfactory.

**Quick Ratio:**

Quick ratio = Cash + Marketable Securities + Accounts Receivable

Current Liabilities

This ratio, also known as the acid test ratio, measures immediate liquidity - the number of times cash, accounts receivable, and marketable securities cover short-term obligations. A higher number is preferred because it suggests a company has a strong ability to service short-term obligations. This ratio is a more reliable variation of the Current ratio because inventory, prepaid expenses, and other less liquid current assets are removed from the calculation.

The quick ratio for Nestle India was 2.0331, 2.0331 and 2.402 for the years 2018, 2017 and 2016 respectively; which shows that the quick ratio has been increasing for the past three years. Also the quick ratio was way below the industry average of 0.967, 0.967 and 0.884 for the years 2018, 2017 and 2016 respectively, indicating that the company's ability to service short-term obligations is above satisfactory.

**Asset Turnover Ratio:**

Asset Turnover Ratio = Sales .

Average Assets

This ratio measures a company's ability to produce sales in relation to average assets to determine the effectiveness of the company's asset base in producing sales. A higher number is preferred, indicating that a company is using its assets to successfully generate sales.

Asset Turnover Ratio for Nestle India is 1.462, 1.439 and 1.4692 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 1.419, 1.469 and 1.651 indicates the company's performance in this area is above par and the management is effectively using its assets.

**Return on Equity:**

Return on Equity = Earnings Before Taxes

Total Equity

This ratio measures how effectively a company's Equity are being used to generate profits. It is one of the most important ratios when evaluating the success of a business. A higher number reflects a well-managed company with a healthy return on Equity.

Return on Equity for Nestle India is 43.741, 35.818 and 33.227 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 24.75, 24.189 and 33.896 indicates the company's performance in this area is above par and the management is effectively using its Equity, also the effectiveness has been increasing every year which indicates in either an decrease in Equity or increase in sales over the past three years.

**Total Debt to Equity (Gearing Ratio):**

Debt to Equity = Total Debt t

Total Equity

This ratio measures the financial leverage of a company by indicating what proportion of debt and equity a company is using to finance its assets. A lower number suggests there is both a lower risk involved for creditors and strong, long-term, financial security for a company.

Debt to Equity ratio for Nestle India is 0.01, 0.01 and 0.01 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 0.378, 0.468 and 0.542 indicates the company's performance in this area is outstanding the company is running mostly on equity capital making it almost debt free when compared to the industry.

**Net Profit Margin:**

Net Profit Margin = Net Income

Revenue

Net profit margin is one of the most important indicators of a company's financial health. By tracking increases and decreases in its net profit margin, a company can assess whether current practices are working and forecast profits based on revenues.

Net Profit Margin for Nestle India is 14.23, 12.021 and 10.569 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 9.263, 8.783 and 10.129 indicates the company's performance in this area is above par with a continuous increase in net profit margin despite a continuous decrease in that of the industry.

**Interest Coverage Ratio:**

Interest Coverage Ratio = EBIT .

Interest Expense

The interest coverage ratio measures how many times a company can cover its current interest payment with its available earnings. In other words, it measures the margin of safety a company has for paying interest on its debt during a given period.

Interest Coverage Ratio for Nestle India is 22.724, 21.012 and 18.001 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 41.959, 43.262 and 52.56 indicates the company's performance in this area is not satisfactory as the ability of the company to pay its interest is less than that of the industry.

But the high industry average is due to exceptionally good Interest coverage ratio of Britannia. If it is not considered, Nestle India’s Interest coverage ratio is above par.

**Inventory Turnover Ratio:**

Inventory Turnover Ratio = Sales .

Average Inventory

Inventory turnover measures how fast a company sells inventory and how analysts compare it to industry averages. A low turnover implies weak sales and possibly excess inventory, also known as overstocking. It may indicate a problem with the goods being offered for sale or be a result of too little marketing.

A high ratio implies either strong sales or insufficient inventory. The former is desirable while the latter could lead to lost business. Sometimes a low inventory turnover rate is a good thing, such as when prices are expected to rise (inventory pre-positioned to meet fast-rising demand) or when shortages are anticipated.

Inventory Coverage Ratio for Nestle India is 12.09, 11.063 and 10.761 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 10.7033, 10.795 and 10.686 indicates the company's performance in this area is on par as the company’s inventory turnover ratio is near to that of the industry.

**Inventory Days**

Inventory Days = 365 .

Inventory Turnover Ratio

Inventory days shows for how long on average the finished goods are kept at the warehouses. The lower the inventory days implies the lesser working capital is stuck in inventory.

Inventory days for Nestle India is 30.19, 32.992 and 33.918 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 67.39, 67.267 and 62.254 indicates the company's performance in this area is above par as the company’s inventory days is way less than that of the industry.

**Working Capital Turnover Ratio**

Working Capital Turnover Ratio = Sales .

Net Working Capital

Working capital turnover is a ratio that measures how efficiently a company is using its working capital to support a given level of sales.

Working Capital Turnover Ratio for Nestle India is 3.92, 4.17 and 4.94 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 0.973, 1.999 and 3.384 indicates the company's performance in this area is above par as the company’s Working Capital Turnover Ratio is more than that of the industry implying a better use of working capital.

**Earnings per share (EPS)**

Earnings per share (EPS) = Net Profit .

No. of Outstanding Shares

Earnings per share (EPS) are calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

EPS for Nestle India is 166.66, 127.073 and 96.098 for the years 2018, 2017 and 2016 respectively which compared to the industry average of 64.53, 52.44 and 50.431 indicates the company's performance in this area is above par as the company’s EPS is way more than that of the industry.

|  |  |  |  |
| --- | --- | --- | --- |
| **(in million Rs)** | **2018** | **2017** | **2016** |
| **Current Assets** |  |  |  |
| Inventories | 9655.5 | 9024.7 | 9431.8 |
| Financial Assets |  |  |  |
| Investments | 19251.3 | 13935.9 | 12750.4 |
| Trade Receivable | 1245.9 | 889.7 | 979.3 |
| Cash and Equivalents | 15987.7 | 14476.9 | 8800 |
| Unpaid dividend Accounts | 112.9 | 97.3 |  |
| Loans | 178.9 | 288 | 570.2 |
| Other Financial Assets | 524.9 | 427.9 |  |
| Current Tax Assets | 188.5 | 63.9 |  |
| other Current Assets | 223.9 | 169.6 | 258.2 |
| **Total** | **47369.5** | **39373.9** | **32789.9** |
|  |  |  |  |
| **Current Liabilities** |  |  |  |
| Trade Payable |  |  |  |
| In micro and small enterprises | 107.7 | 52.5 | 48.8 |
| Other payables | 12296 | 9793.9 | 7942.8 |
| Provisions | 1572.6 | 874.6 | 3207 |
| other Liabilities | 4573.2 | 4206.1 | 5128.4 |
| **Total** | **18549.5** | **14927.1** | **16327** |

The reason for drop in inventories in 2017 was lesser raw material pile up which indicates that nestle sold more than expected hence the Cash Equivalents went up also the trade receivables decrease which further added to Cash Equivalents. The sudden increase in Investments was due to purchase of government securities (11668, 5958.8, and 3950.8 for 2018, 2017, and 2016 respectively) because of excessive cash accumulation in 2017.

Due to their good Working Capital Management, Current Assets have increased significantly as compare to Current Liabilities. However too much increase in Cash and Equivalents suggest that the further reinvestment of profits can be under taken.

**DuPont Analysis**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2018** | **2017** | **2016** |
| **Net Profit Margin** | 14.23% | 12.02% | 10.57% |
| **Asset Turnover Ratio** | 146.17% | 143.87% | 146.92% |
| **Financial Leverage** | 210.29% | 207.11% | 213.90% |
| **ROE** | 43.74% | 35.82% | 33.22% |

The company exhibited a decent ROE of 43.75% as of 2018, which was a significant increase from the ROE of previous years. A 3 part duPont analysis has been done to analyse this increase in ROE. Over the 3 years, it is observed that the equity multiple i.e. the financial leverage has been at a stable level, although it rose in 2018, it is lesser than the leverage used in 2016. The asset turnover ratio too has remained comparatively stable throughout the years, falling in 2017 and rising back up in 2018. The company is able to efficiently churn its assets nearly 1.5 times consistently over the past 3 years, which is a good sign. Lastly, the net profit margin is notable as it is seen to be consistently rising over the past 3 years, from 10.57% in 2016, 12.02% in 2017 and 14.23% in 2018. This is again another very positive sign , because it shows the company is able to effectively grow its profits. The increase in ROE in 2018 is most notably due to the increase in net profit margin and asset turnover while the financial leverage remains in consistent levels. Overall, this indicates the company has strong fundamentals and is able to manage itself well.

**Q3 ANALYSING CASH FLOW PATTERN**

**Cash flow from operating activities:**

For the years ending December 2016, 2017 and 2018, the cash flow from operating activities were 14,659.1, 18,177.9, 20,524.5 (Rupees in million) respectively. We observe that there has been a steady increase in cash flow generated from the operating activities. The main reason for this is the increase in profits generated before tax year on year. This indicates the amount of money Nestle is bringing in from its ongoing, regular business **activities**, such as manufacturing and selling goods has been rising which is a good sign for investors as it means that the company is able to sufficiently capitalize on its core business activities. While in 2016 and 2017, the profit from operations is quite close to the cash flow from operations, we can infer that the company is able to sufficiently turn its profit into cash meaning it may not face too many problems in the face of short-term liquidity. Coming to 2018, there is a larger disparity between the profit and actual cash generated from operations. This is due to a comparatively large increase in inventories and trade receivables as compared to the previous year’s decrease in the same. The increase in inventories signifies that the company has acquired more goods than it has been able to sell. An increase in receivables again implies a drain on its cash reserves with the added risk of defaulting from the debtors. Overall, the company has significant positive cash coming in from operations which is an indication that the company can handle its day to day business adequately while also being able to cover core payments such as tax and interest payments without taking on additional debt. However, the increase in inventories and receivables is worth noting.

**Cash flow from investing activities:**

For the years ending December 2016, 2017 and 2018, the cash flow used in investing activities were 1,274.1, 1,305.6, 524.1 (Rupees in million) respectively. 2017 saw a slight increase in cash flow used in investing but there were no abnormal investing activities that led to a significant difference in the cash flow from 2016. However, in 2018, there was a substantial decline in cash used in investing activities. This was because interest received on bank deposits, investments, tax free bonds, employee loans etc. offset the other investing activities to a greater extent. The presence of greater interest received, may be due to recurring cash flows arising from new investments the entity holds. Overall, there seems to be a positive signal in this respect.

**Cash flow from financing activities:**

For the years ending December 2016, 2017 and 2018, the cash flow used in financing activities were 6,665.5, 9,966.2, 13,174.2 (Rupees in million) respectively. We see that there is an overall increasing trend in cash used in financing activities. The reason for this is a higher total dividend payment by the company to its shareholders year on year. It can be assumed that this dividend increase is due to improved cash flows generated by the company, mainly as a result of higher profits generated year on year that the company is able to convert into cash. While an increase in dividends may signify the shift in focus of the company from investing in growth and expansion, overall it can be viewed as a positive sign of the cash strength of the company.

**Q4 CAPITAL STRUCTURE**

The capital structure of a company refers to the combination of debt and equity that is used to finance its assets. Hence we have taken Debt/Equity ratio to compare the Capital structures.

For the purpose of the analysis, we consider each company’s total shareholder’s equity and its debt obligations.

NESTLE India Ltd.:

(All numbers are in thousands of rupees except the ratios)

|  |  |  |  |
| --- | --- | --- | --- |
|  | 30/12/2018 | 30/12/2017 | 30/12/2016 |
| Net Shareholder’s Equity | 3,67,37,400 | 3,42,05,900 | 3,01,37,000 |
| Debt obligations  (Long term debt + short term/ current debt) | 3,51,400 | 3,51,400 | 3,31,500 + 11,500 = 3,43,000 |
| Debt to Equity ratio | 0.0096 | 0.0102 | 0.0113 |

Debt to Equity ratios:

|  |  |  |  |
| --- | --- | --- | --- |
|  | 31/3/2018 | 31/3/2017 | 31/3/2016 |
| Dabur India Ltd. | 0.1 | 0.15 | 0.19 |
| Hindustan Unilever Ltd. | 0.01 | 0.00 | 0.04 |
| Britannia Industries Ltd. | 0.03 | 0.05 | 0.04 |

Source: Moneycontrol.in

We have analysed the capital structure of each company by comparing the respective debt to equity ratios with each other which helps to analyse the degree to which a company is financing its operations through debt compared to wholly-owned funds.

It can be seen that in the case of Nestle India, the ratio has been decreasing slightly but overall remains comparatively low, allowing us to state that the company is virtually debt free. In other words, the company finances a majority of its assets through its equity that has been growing over the past 3 years, while the debt which is mainly long term is substantially smaller. The fact that the company relies less on outside loans to finance its operations is a good sign of a strong balance sheet as the higher level of equity provides a healthy cushion in the case of business decline, where debt obligations would not be too forbearing. Overall, equity financing benefits the company as it is less risky, leads to lesser credit problems, helps in maintaining a healthy cash flow (as this kind of financing would not take funds out of the business in terms of interest payments) and is also good for long-term planning of the company. The company does not have to deal much with the problem of fixed payments of interests and principal nor does it face the issue of stating assets as collateral. However, a large portion of equity financing can also prove to be costly in addition to issues such as loss of control of ownership and potentials for conflict amongst partners.

When compared with industry peers, Nestle is seen to have more of its financing from equity compared to companies such as Dabur India and Britannia Industries that have shown recent D/E ratios of 0.1 and 0.035 respectively. Its capital structure on the other hand is comparable with HUL, which is also virtually debt free. Based on risk associated with debt financing, an analysis of capital structure amongst industry peers would yield that investors would favour Nestle and HUL due to their low D/E ratios.

The effect of the capital structures on P/E ratios:

Nestle:

|  |  |  |  |
| --- | --- | --- | --- |
|  | 31/3/2018 | 31/3/2017 | 31/3/2016 |
| P/E ratio | 64.9 | 65.9 | 59.7 |

Source: Screener.in

As of 31st December, the PE ratio of Nestle is comparatively higher than the industry average of 57.5. One main reason for this is its capital structure, more notably the low debt to equity ratio. Lower debt tends to increase the cost of capital. This increases net income but decreases earnings per share and so results in a comparatively higher PE ratio. The reason for this is that by having less borrowing to fund the business there is a decrease in the expected returns to equity investors, which is seen in EPS decrease, and the riskiness of the equity returns ultimately pushing the PE ratio up. As can be observed in the trend, as the D/E ratio has been decreasing over the past three years, there has been an upward trend in the PE ratio of the company, which is thus also greater than the industry peers that have greater D/E ratios.

**Q5 AGENCY COST**

The cost incurred by the companies due to its hiring of managers and employees is known as agency cost.

Company needs to analyze how much cost can it bear on hiring people. To do so, companies try to compare the return from hiring the people by calculating Remuneration is to EBIT ratio which gives an idea of what percentage of EBIT is given out as remuneration. Lower the ratio, lesser is the cost to the firm.

The ratio was calculated using the following formula:

Remuneration (executive + non-executive directors)

EBIT

In the analysis performed on Nestle India, the remuneration to EBIT ratio was found to be 0.863, 1.081, 1.326, 1.427 and 1.03 for the years 2018, 2017, 2016, 2015 and 2014.

We also found the industry average of the ratio by taking an average of the ratio of its competitor in the industry (Britannia, Dabur, ITC and HUL) .The industry average came out to be 0.666, 0.701, 0.745 and 0.839 for the years 2018, 2017, 2016 and 2015.

When compared with the industry average, the ratio is higher for Nestle India which implies that Nestle is paying a higher percentage of its income as remuneration to its employees, hence increasing the agency cost.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **2018** | **2017** | **2016** | **2015** |
| **Nestle** | 0.863336 | 1.080846 | 1.32608 | 1.42748 |
| **HUL** | 0.544971 | 0.602051 | 0.50129 | 0.695614 |
| **Britannia** | 0.698312 | 0.637089 | 0.646122 | 0.650797 |
| **Dabur** | 1.020713 | 1.110283 | 1.099381 | 1.237721 |
| **ITC** | 0.204423 | 0.073505 | 0.149897 | 0.18326 |
| **Industry Avg** | 0.666351 | 0.700755 | 0.744554 | 0.838975 |