

BUY**TP: Rs 22,860 | ▲ 16%****NESTLE INDIA**

Consumer Staples

16 February 2023

Investing for growth

- **CY22 revenue increased 14.5% YoY with broad-based growth across categories**
- **Strategy of penetration-led volume growth along with investment and execution in RURBAN yielding results**
- **We assume coverage with BUY and a TP of Rs 22,860, set at 67x CY24E EPS**

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Robust growth across urban and rural India: NEST's domestic revenue increased 14% YoY in Q4CY22 with a healthy balance between volume and pricing growth. Export revenue grew 17% YoY. In the domestic market, NEST did well in the large metros and mega cities, and continued to see robust growth across smaller towns and rural markets.

Strong performance in key businesses: The prepared dishes and cooking aids businesses continued strong growth momentum in Q4, buoyed by 'Maggi Noodles' and 'Maggi Masala-ae-Magic' which were backed by strong consumer engagement and media campaigns. 'Milkmaid' performed well while milk products continued to face challenges due to the unprecedented rise in milk prices. NEST gained market share and delivered robust growth in the confectionary business driven by 'Kitkat' and 'Munch'.

Margin improves sequentially: NEST's gross profit margin contracted by 200bps YoY in Q4CY22 but expanded sequentially by 220bps QoQ even though prices of key commodities such as cereals, grains and coffee remain at a 10-year high. EBITDA margin at 22.9% expanded 110bps QoQ and remained flat YoY.

Innovation and new product launches: The company has launched over 110 products in the last seven years and has ~30 more in the pipeline. Revenue contribution from new launches has improved gradually, with products introduced since 2015 now contributing 5.4% to sales. Premiumisation remains key for the company and it is accordingly launching millet products under three brands – Ceregrow, A+, and Maggi.

BUY, TP Rs 22,860: NEST's strategy of penetration-led volume growth is yielding results. We expect the company to sustain its growth momentum underpinned by continued investments in innovation and premiumisation, expansion of its direct reach with a focus on rural markets, and forays into newer categories. The stock is trading at 65.8x/57.5x CY23E/CY24E EPS. We assume coverage with BUY and value the stock at 67x CY24E EPS, translating to a TP of Rs 22,860.

Ticker/Price	NEST IN/Rs 19,629
Market cap	US\$ 22.9bn
Free float	37%
3M ADV	US\$ 13.2mn
52wk high/low	Rs 21,050/Rs 16,000
Promoter/FPI/DII	63%/12%/25%

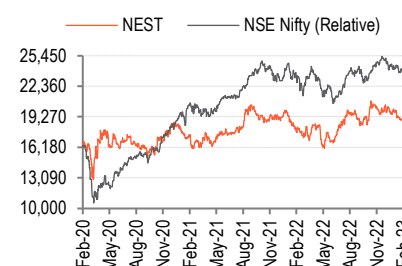
Source: NSE | Price as of 16 Feb 2023

Key financials

Y/E 31 Dec	CY22A	CY23E	CY24E
Total revenue (Rs mn)	1,68,969	1,85,923	2,05,890
EBITDA (Rs mn)	37,125	44,859	51,879
Adj. net profit (Rs mn)	23,905	28,775	32,897
Adj. EPS (Rs)	247.9	298.5	341.2
Consensus EPS (Rs)	247.9	306.6	350.9
Adj. ROAE (%)	97.2	99.2	96.7
Adj. P/E (x)	79.2	65.8	57.5
EV/EBITDA (x)	51.0	42.2	36.5
Adj. EPS growth (%)	1.5	20.4	14.3

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



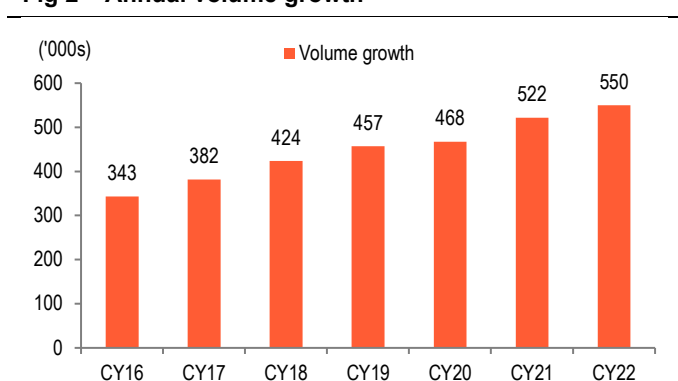
Source: NSE



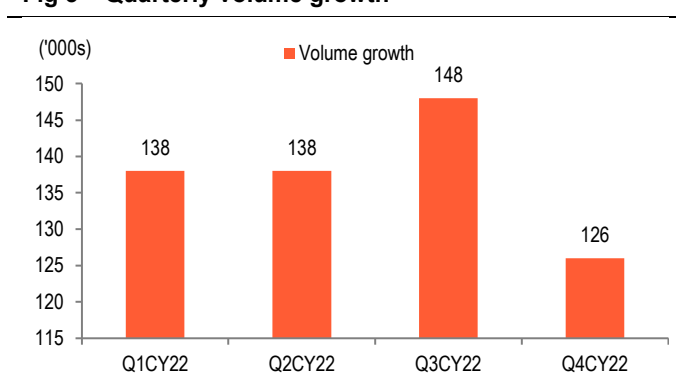
Fig 1 – Quarterly performance

(Rs mn)	Q4CY22	Q3CY22	Q4CY21	QoQ (%)	YoY (%)	Estimates	Variance (%)
Revenue	42,568	46,018	37,480	(7.5)	13.6	43,920	(3.1)
EBIDTA	9,730	10,041	8,587	(3.1)	13.3	10,294	(5.5)
Adj. PAT	6,281	6,615	6,160	(5.0)	2.0	6,653	(5.6)
Gross Margin (%)	54.9	52.7	56.9	220bps	(200bps)	54	90bps
EBIDTA Margin (%)	22.9	21.8	22.9	110bps	0bps	23.4	(50bps)
Adj. PAT Margin (%)	16.4	14.4	14.8	200bps	160bps	15.2	125bps

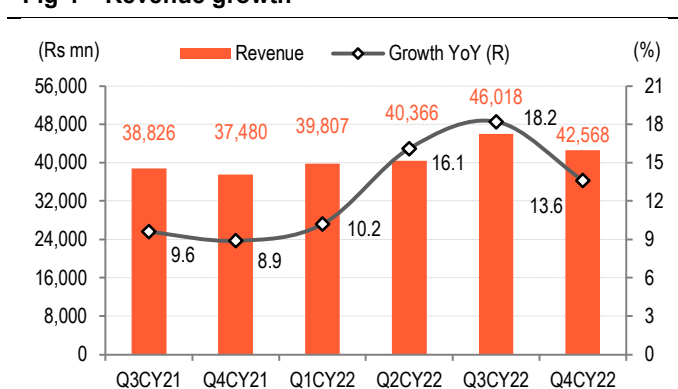
Source: Company, BOBCAPS Research

Fig 2 – Annual volume growth

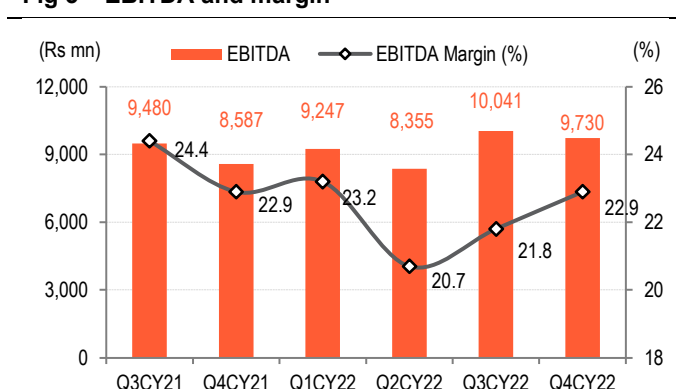
Source: Company, BOBCAPS Research

Fig 3 – Quarterly volume growth

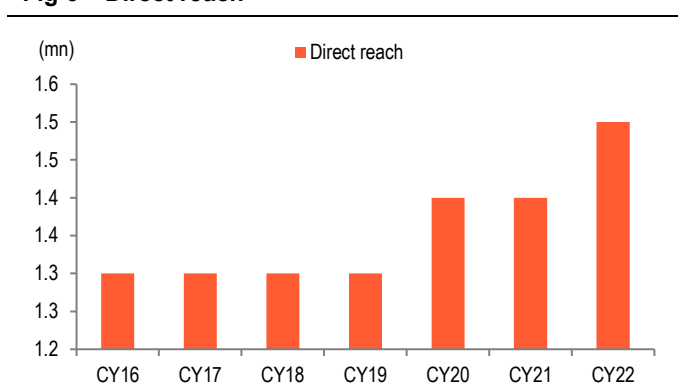
Source: Company, BOBCAPS Research

Fig 4 – Revenue growth

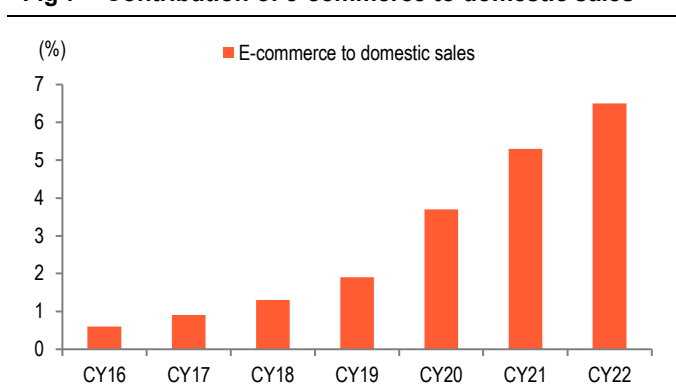
Source: Company, BOBCAPS Research

Fig 5 – EBITDA and margin

Source: Company, BOBCAPS Research

Fig 6 – Direct reach

Source: Company, BOBCAPS Research

Fig 7 – Contribution of e-commerce to domestic sales

Source: Company, BOBCAPS Research

Earnings call highlights

- NEST has clocked sustained domestic volume growth, at an 8.2% CAGR between CY16 and CY22. Volumes grew 6-7% in CY22 and 3-4% YoY in Q4CY22.
- Growth in megacities continues to be in double digits but the rate has declined in Q4CY22 due to price hikes in some smaller packs, especially noodles. The same was true in Town Class 2-6. However, metros, Town Class 1, and villages have seen an acceleration in growth.
- The trends are secular across town classes and management expects growth in Town Class 2-6 and megacities to bounce back.
- As many as 8 out of 13 commodities are reaching 10-year highs. During CY18-CY20, commodity inflation was 3%. Inflation in CY22 was 6x of those levels at 18.5%. The commodity cost pressure has been to the tune of 800bps in CY22.
- NEST has navigated the commodity headwinds by economies of scale, strong partnerships, global bandwidth which helps it read the market better, and sharp procurement strategies. Its SHARK program that deconstructs the entire value chain has yielded 150-160bps in cost savings in CY22. Insight-based pricing across categories have also helped to mitigate the sharp commodity headwinds.
- Operating margins hit a low in Q2CY22 but have been on an increasing trend for the last two quarters. In Q4CY22, all four of NEST's categories have seen double-digit revenue growth.
- In CY22, liquid beverages had the best year with the highest market share. Prepared dishes and cooking aids grew by 15.6% YoY despite tough pricing decisions in small packs.
- As per NEST's estimate, the confectionary market has grown by 10-12% in CY22 while the company has grown by 25% YoY. NEST had market share gains in chocolates and wafers. Of the forthcoming capex plans, confectionary is the second focus area after noodles.
- The company's professional business in CY22 was 20% higher than pre-Covid sales and is going from strength to strength.
- The price hike in the 'Maggi Chotu' pack has been to the tune of 40%. NEST has managed to maintain prices in other parts of the portfolio. Except noodles, all other categories have seen volume growth.
- The loss in momentum in categories that have seen a high pricing impact has been in volume share and not value share. The premium portfolio has seen better growth. Lower volumes of smaller packs have led to a better margin mix.
- NEST launched 110 new products over the last seven years. In the last two years, the focus has been on the core 12-15 brands. NPDI increased to 5.4% in CY22 from 4.9% in CY21. The NPD pipeline is full, but the company will continue to focus on stabilising the core over the next couple of quarters.

- CY23 has been declared as the international year of millets. As much as 20% of the global production of millets is from India. NEST will launch millet products under three brands: Ceregrow, A+, and Maggi.
- NEST had a consistent strategy on media spends, but spends declined in CY22 due to tough macro conditions. The company moved away from consistent dependence on consumer promotions to building brand equity.
- E-commerce has grown more than 10x for NEST in the last 10 years. Management believes e-commerce is an important vector for growth but not at the expense of other channels like modern trade and traditional mom-and-pop stores.
- RURBAN growth has remained in double digits in the last five years, but saw a slight growth moderation in CY22. NEST has continued to deepen its rural reach. As of CY22, it has a reach of 91k+ villages with 2,000+ population vs. ~41k in CY20. Its ambition is to reach 120k villages with 2,000+ population till CY24E. Total village coverage has increased to ~165k in CY22 from ~69k in CY20. Distribution touchpoints in RURBAN have increased to 14k+ in CY22 from 10k in CY20.
- Several of NEST's plants are at high utilisation levels. The capex plan is at Rs 50bn over the next three years. Of this, Rs 13bn and Rs 20bn are planned for CY23 and CY24 respectively and the balance for CY25. This is compared to a capex spend of Rs 5bn in CY22. The capex plan excludes any mergers/acquisitions.
- The royalty agreement with Nestle SA is due for renewal in CY24. The rationale for royalty has not changed.
- The Board of Directors have recommended a final dividend for CY22 of Rs 75/sh. The total dividend for CY22 aggregates to Rs 220/sh.

Valuation methodology

NEST's strategy of penetration-led volume growth is yielding results. We expect the company to sustain its growth momentum underpinned by continued investments in innovation and premiumisation, expansion of its direct reach with a focus on rural markets, and forays into newer categories. The stock is trading at 65.8x/57.5x CY23E/CY24E EPS. We assume coverage with BUY and value the stock at 67x CY24E EPS, in line with the long-term mean, translating to a TP of Rs 22,860.

Key risks

Key downside risks to our estimates are:

- continued rise in food inflation, and
- slowdown in rural markets.

Financials

Income Statement

Y/E 31 Dec (Rs mn)	CY20A	CY21A	CY22A	CY23E	CY24E
Total revenue	1,33,500	1,47,406	1,68,969	1,85,923	2,05,890
EBITDA	32,015	35,664	37,125	44,859	51,879
Depreciation	3,704	3,910	4,030	5,166	6,766
EBIT	28,311	31,754	33,095	39,693	45,113
Net interest inc./(exp.)	(1,642)	(2,017)	(1,546)	(2,132)	(2,132)
Other inc./(exp.)	1,459	1,202	1,010	1,116	1,235
Exceptional items	0	2,365	0	0	0
EBT	28,128	28,573	32,560	38,677	44,216
Income taxes	7,304	7,389	8,655	9,901	11,319
Extraordinary items	0	0	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	20,824	21,184	23,905	28,775	32,897
Adjustments	0	2,365	0	0	0
Adjusted net profit	20,824	23,549	23,905	28,775	32,897

Balance Sheet

Y/E 31 Dec (Rs mn)	CY20A	CY21A	CY22A	CY23E	CY24E
Accounts payables	15,166	17,482	19,338	22,533	24,337
Other current liabilities	1,588	1,703	2,310	2,310	2,310
Provisions	33,742	34,240	33,659	43,044	47,494
Debt funds	348	341	300	300	300
Other liabilities	7,959	9,112	9,589	9,667	9,694
Equity capital	964	964	964	964	964
Reserves & surplus	19,229	18,500	23,627	28,030	33,064
Shareholders' fund	20,193	19,464	24,592	28,995	34,028
Total liab. and equities	78,997	82,341	89,787	1,06,849	1,18,164
Cash and cash eq.	17,548	7,185	9,266	13,000	7,015
Accounts receivables	1,649	1,660	1,919	2,038	2,256
Inventories	14,165	15,927	19,288	20,634	22,286
Other current assets	976	1,942	1,963	2,211	2,449
Investments	14,638	7,740	7,775	7,775	7,775
Net fixed assets	19,680	26,530	27,058	34,892	48,125
CWIP	6,386	2,462	3,584	3,584	3,584
Intangible assets	0	0	0	0	0
Deferred tax assets, net	199	258	256	256	256
Other assets	3,756	18,638	18,679	22,460	24,418
Total assets	78,997	82,341	89,787	1,06,849	1,18,164

Cash Flows

Y/E 31 Dec (Rs mn)	CY20A	CY21A	CY22A	CY23E	CY24E
Cash flow from operations	24,545	22,360	27,374	45,826	44,706
Capital expenditures	(4,784)	(7,348)	(5,499)	(13,000)	(20,000)
Change in investments	20	(13,523)	1,288	1,475	0
Other investing cash flows	1,549	1,668	294	(2,587)	(695)
Cash flow from investing	(3,215)	(19,203)	(3,917)	(14,112)	(20,695)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(602)	0	0	0	0
Interest expenses	(90)	(917)	(980)	(2,132)	(2,132)
Dividends paid	(18,898)	(19,283)	(20,247)	(24,373)	(27,863)
Other financing cash flows	31	0	0	0	0
Cash flow from financing	(19,559)	(20,200)	(21,227)	(26,504)	(29,995)
Chg in cash & cash eq.	1,771	(17,043)	2,229	5,209	(5,985)
Closing cash & cash eq.	17,548	7,102	7,791	13,000	7,015

Per Share

Y/E 31 Dec (Rs)	CY20A	CY21A	CY22A	CY23E	CY24E
Reported EPS	216.0	222.5	247.9	298.5	341.2
Adjusted EPS	216.0	244.2	247.9	298.5	341.2
Dividend per share	196.0	200.0	210.0	252.8	289.0
Book value per share	209.4	201.9	255.1	300.7	352.9

Valuations Ratios

Y/E 31 Dec (x)	CY20A	CY21A	CY22A	CY23E	CY24E
EV/Sales	14.2	12.8	11.2	10.2	9.2
EV/EBITDA	59.1	53.1	51.0	42.2	36.5
Adjusted P/E	90.9	80.4	79.2	65.8	57.5
P/BV	93.7	97.2	77.0	65.3	55.6

DuPont Analysis

Y/E 31 Dec (%)	CY20A	CY21A	CY22A	CY23E	CY24E
Tax burden (Net profit/PBT)	74.0	74.1	73.4	74.4	74.4
Interest burden (PBT/EBIT)	99.4	90.0	98.4	97.4	98.0
EBIT margin (EBIT/Revenue)	21.2	21.5	19.6	21.3	21.9
Asset turnover (Rev./Avg TA)	169.0	179.0	188.2	174.0	174.2
Leverage (Avg TA/Avg Equity)	3.9	4.2	3.7	3.7	3.5
Adjusted ROAE	103.1	108.8	97.2	99.2	96.7

Ratio Analysis

Y/E 31 Dec	CY20A	CY21A	CY22A	CY23E	CY24E
YoY growth (%)					
Revenue	7.9	10.4	14.6	10.0	10.7
EBITDA	10.8	11.4	4.1	20.8	15.6
Adjusted EPS	4.4	13.1	1.5	20.4	14.3

Profitability & Return ratios (%)

EBITDA margin	24.0	24.2	22.0	24.1	25.2
EBIT margin	21.2	21.5	19.6	21.3	21.9
Adjusted profit margin	15.6	16.0	14.1	15.5	16.0
Adjusted ROAE	103.1	108.8	97.2	99.2	96.7
ROCE	137.8	160.3	133.0	135.5	131.4

Working capital days (days)

Receivables	5	4	4	4	4
Inventory	91	92	91	92	92
Payables	98	101	91	100	100

Ratios (x)

Gross asset turnover	2.8	2.4	6.2	5.3	4.3
Current ratio	1.7	1.0	1.1	1.2	1.0
Net interest coverage ratio	17.2	15.7	21.4	18.6	21.2
Adjusted debt/equity	1.7	1.7	1.2	1.0	0.9

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

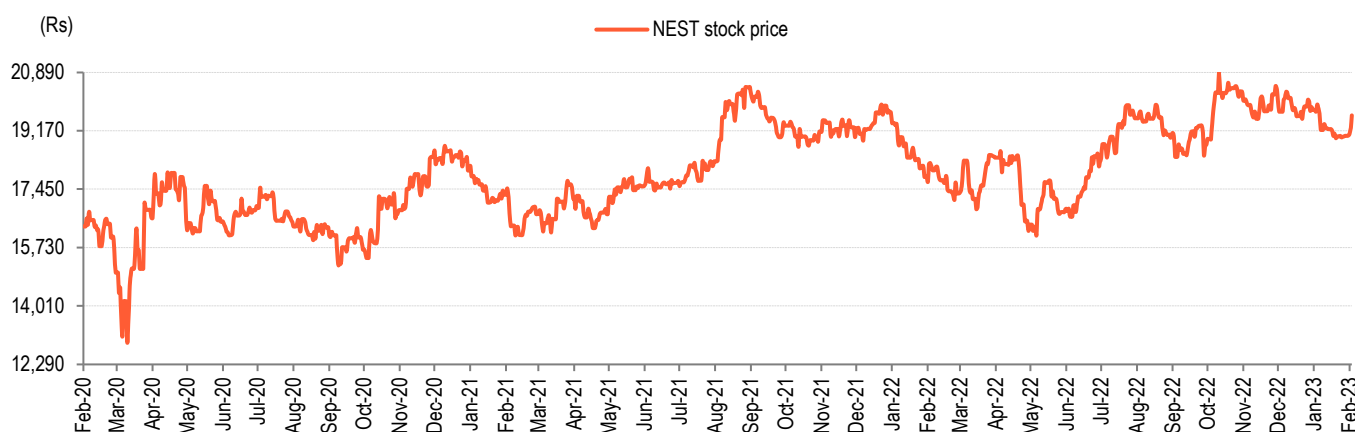
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): NESTLE INDIA (NEST IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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