

# Nestle

## Best proxy on great Indian consumption story

We believe Nestle has the potential for double-digit revenue growth in the medium term, unlike peers struggling with high single-digit growth, owing to several factors: (a) ramping up its rural distribution network, currently under-indexed; (b) focusing on substantial growth in its out-of-home channel; (c) prioritizing the salience of NPD and category creation efforts; (d) investing in capacity expansion (with a capex of INR 65bn over CY20-25) to align with long-term penetration-led volume growth objectives; (e) India's prioritization as one of the top 10 markets despite contributing only 2% of global revenue. We also expect the EBITDA margin to expand c100bps from FY24-27 to 25%, despite being at a decadal high, owing to operational scale improvements, premiumization, and cost optimization initiatives. We upgrade Nestle to ADD from REDUCE with a TP of INR 2,750 (70x FY26 EPS) and recommend investors to accumulate the stock amidst any negative news flows. Key near-term risks include (1) elevated RM index (particularly cocoa and coffee); (2) FSSAI probe on Cerelac, which, if unfavourable, could impact customer trust in other consumer infant milk and nutrition-related brands; (3) potential disproportionate increase in royalty/other payouts to the parent company (royalty rate is expected to increase from 4.5% in CY23 to 5.25% in CY28).

- **Emulating distribution strategies of market leader:** Nestle management is following the footsteps of the market leader (HUL) in improving its distribution infrastructure. They're addressing gaps by: a) expanding rural reach (currently covering 0.2 mn villages compared to negligible coverage previously) through increased field personnel, considering its low penetration (20% of total sales); (b) introducing the MIDAS platform, akin to HUL's WIMI Strategy, which divides areas into 15 clusters to tailor product launches to regional tastes; (c) implementing Project Swabhimaan, akin to HUL's Shakti Amma, to empower rural women entrepreneurs and self-help groups, ensuring extensive coverage nationwide.
- **Innovation and category – twin growth engines:** Since Suresh Narayan was appointed MD in August 2015, Nestle has intensified its focus on new product development (NPD) with considerable success. NPD (as a % of revenue) has surged from 1.5% in CY16 to 6% in CY23. At the same time, Nestle management is exerting adequate efforts toward new category development (breakfast cereals, RTD beverages, nutritional science, pet care range, and premium coffee brewing machines) via launching access packs (breakfast cereals, RTD beverages), tying up with pharma companies for nutritional science, setting up differentiated channels for pet care range, and opening up outlets/kiosks (to further improve its visibility for the coffee vending business). In our view, most of these will be margin accretive and get relevant support and adequate insights from Nestle's global R&D team.
- **Putting capacity ahead of demand revival:** Nestle is putting adequate capacity (intends to incur capex worth Rs c65bn over CY20-25) so that it aligns with its larger objective of distribution expansion and category-development initiatives, given the company's focus on driving penetration-led volume growth, which is significantly different from earlier management's focus on profitability. Historically, Nestle has mainly concentrated its plants in either North or South India. To mitigate this geographical risk, the company plans to undertake a brownfield expansion for one of its recently established large plants in West India (Sanand). Further, Nestle is exploring to establish another large plant in East India (Orissa).

## ADD

CMP (as on 30 Apr 2024) INR 2,506

Target Price INR 2,750

NIFTY 22,605

KEY CHANGES	OLD	NEW
Rating	REDUCE	ADD
Price Target	INR 2,100	INR 2,750
EPS %	FY25E 2%	FY26E 2%

### KEY STOCK DATA

Bloomberg code	NEST IN
No. of Shares (mn)	964
MCap (INR bn) / (\$ mn)	2,418/28,986
6m avg traded value (INR mn)	2,421
52 Week high / low	INR 2,771/2,126

### STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	0.1	3.5	15.2
Relative (%)	(3.7)	(13.1)	(6.7)

### SHAREHOLDING PATTERN (%)

	Dec-23	Mar-24
Promoters	62.76	62.76
FIs & Local MFs	9.16	9.00
FPIs	12.09	12.10
Public & Others	15.99	16.14
Pledged Shares	0.00	0.00

Source : BSE

Pledged shares as % of total shares

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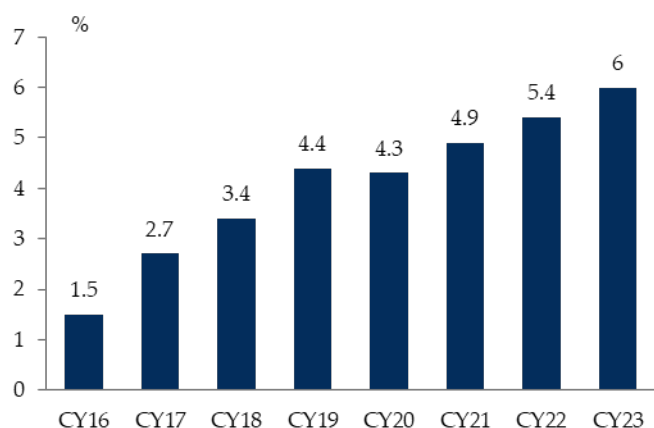
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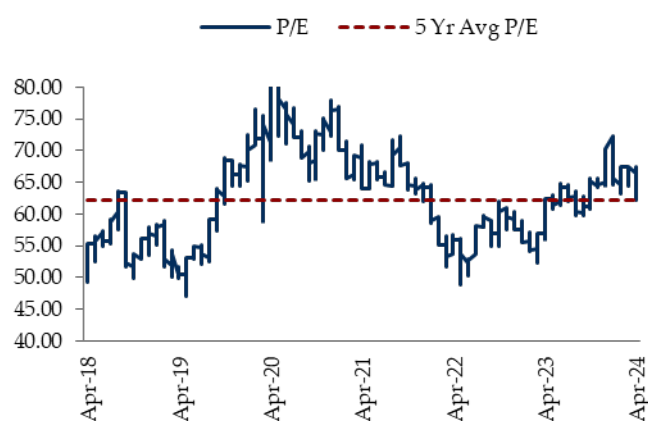
- Rich valuations to hold up in a world where growth remains a scarce commodity:**  
 Although India contributes a mere 2% of Nestle SA's revenue, the country remains a top priority for the company (as it is part of the Top 10 priority markets for the parent), given its potential. We expect Nestle's EBITDA margin to see c100 expansion to 25%, despite being at a decadal high due to improving scale of operations, premiumization and cost optimization initiatives and expect it to see 10/11/ 11% revenue/EBITDA/ PAT CAGRs over FY24-27. Nestle is trading at a rich valuation of 65x FY26 EPS, in line with 3/5-year average forward PE. We upgrade it to ADD with a TP of INR 2,750 (70x FY26EPS) and recommend that investors turn to buyers if there is any negative news flow about the company. In our view, Nestle is poised to command a premium over its historical valuation multiple. This is particularly true given the challenges many large and even mid-cap FMCG companies face in achieving sustainable high single-digit revenue growth. In such a scenario where growth is a precious resource within the consumer basket, companies with robust revenue visibility are expected to receive a valuation premium.

Contribution from NPD



Source: Companies, HSIE Research

PE band chart



Source: Companies, HSIE Research

**Standalone P&L (INR mn)**

Year End	CY22	FY24	FY25E	FY26E	FY27E
<b>Net Revenues</b>	<b>1,67,895</b>	<b>2,42,755</b>	<b>2,12,437</b>	<b>2,33,690</b>	<b>2,57,312</b>
Growth (%)	14%	na	9%	10%	10%
Material Expenses	77,499	1,07,086	94,021	1,02,013	1,10,684
Employee Expense	16,355	23,361	20,557	22,613	24,874
ASP Expense	6,956	9,738	9,446	10,485	11,639
Other expenses	31,035	45,257	38,590	42,588	46,574
<b>EBITDA</b>	<b>37,126</b>	<b>58,498</b>	<b>50,912</b>	<b>57,189</b>	<b>64,859</b>
<b>EBITDA Growth (%)</b>	<b>4%</b>	<b>na</b>	<b>7%</b>	<b>12%</b>	<b>13%</b>
<b>EBITDA Margin (%)</b>	<b>22.1</b>	<b>24.1</b>	<b>24.0</b>	<b>24.5</b>	<b>25.2</b>
Depreciation	4,030	5,678	5,078	6,303	7,003
<b>EBIT</b>	<b>33,095</b>	<b>52,820</b>	<b>45,834</b>	<b>50,886</b>	<b>57,856</b>
Other Income (Including EO Items)	1,010	1,480	1,302	1,432	1,575
Interest	1,546	1,455	1,133	1,133	1,133
<b>PBT</b>	<b>32,560</b>	<b>52,845</b>	<b>46,002</b>	<b>51,185</b>	<b>58,298</b>
Tax	8,655	13,560	11,961	13,308	15,158
<b>RPAT</b>	<b>23,905</b>	<b>39,328</b>	<b>34,042</b>	<b>37,877</b>	<b>43,141</b>
adjustment	-	44	-	-	-
<b>Adjusted PAT</b>	<b>23,905</b>	<b>39,328</b>	<b>34,042</b>	<b>37,877</b>	<b>43,141</b>
<b>APAT Growth (%)</b>	<b>2%</b>	<b>na</b>	<b>7%</b>	<b>11%</b>	<b>14%</b>
<b>Adjusted EPS (Rs)</b>	<b>24.8</b>	<b>40.8</b>	<b>35.3</b>	<b>39.3</b>	<b>44.8</b>
<b>EPS Growth (%)</b>	<b>13%</b>	<b>na</b>	<b>-13%</b>	<b>11%</b>	<b>14%</b>

\*Like to like base of FY24

**Standalone Balance Sheet (INR mn)**

Year End	CY22	FY24	FY25E	FY26E	FY27E
<b>SOURCES OF FUNDS</b>					
Share Capital - Equity	964	964	964	964	964
Reserves	23,628	34,474	39,596	44,697	52,169
<b>Total Shareholders' Funds</b>	<b>24,592</b>	<b>35,438</b>	<b>40,560</b>	<b>45,661</b>	<b>53,134</b>
Minority Interest	-	-	-	-	-
Long Term Debt	2,173	2,173	2,173	2,173	2,173
Short Term Debt	532	532	532	532	532
<b>Total Debt</b>	<b>2,705</b>	<b>2,705</b>	<b>2,705</b>	<b>2,705</b>	<b>2,705</b>
Net Deferred Taxes	(256)	(256)	(256)	(256)	(256)
Long Term Provisions & Others	32,225	56,705	49,645	54,594	60,095
<b>TOTAL SOURCES OF FUNDS</b>	<b>59,266</b>	<b>94,593</b>	<b>92,655</b>	<b>1,02,705</b>	<b>1,15,678</b>
<b>APPLICATION OF FUNDS</b>					
<b>Net Block</b>	<b>30,437</b>	<b>37,760</b>	<b>52,681</b>	<b>61,378</b>	<b>59,374</b>
CWIP	3,584	5,584	7,584	9,584	11,584
Other Non-current Assets	20,609	20,609	20,609	20,609	20,609
<b>Total Non-current Assets</b>	<b>54,630</b>	<b>63,952</b>	<b>80,874</b>	<b>91,571</b>	<b>91,567</b>
<b>Goodwill</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Inventories	19,288	23,278	19,207	21,128	23,264
Debtors	1,919	2,660	2,328	2,561	2,820
Other Current Assets	4,239	4,239	4,239	4,239	4,239
Cash & Equivalents	9,456	38,382	20,354	20,057	33,422
<b>Total Current Assets</b>	<b>34,902</b>	<b>68,559</b>	<b>46,128</b>	<b>47,985</b>	<b>63,745</b>
Creditors	19,338	26,603	23,281	25,610	28,199
Other Current Liabilities & Provns	10,927	11,316	11,066	11,241	11,435
<b>Total Current Liabilities</b>	<b>30,265</b>	<b>37,919</b>	<b>34,347</b>	<b>36,851</b>	<b>39,634</b>
<b>Net Current Assets</b>	<b>4,636</b>	<b>30,641</b>	<b>11,781</b>	<b>11,134</b>	<b>24,111</b>
<b>TOTAL APPLICATION OF FUNDS</b>	<b>59,266</b>	<b>94,593</b>	<b>92,655</b>	<b>1,02,705</b>	<b>1,15,678</b>

Source: Company, HSIE Research

### Standalone Cash Flow (INR mn)

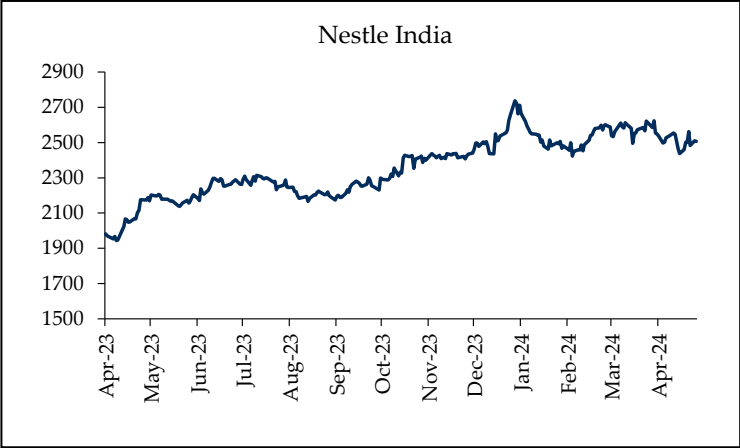
Year End	CY22	FY24	FY25E	FY26E	FY27E
Reported PBT	32,560	52,845	46,002	51,185	58,298
Non-operating & EO Items	-	-	-	-	-
Interest Expenses	-	-	-	-	-
Depreciation	4,030	5,678	5,078	6,303	7,003
Working Capital Change	(302)	27,402	(6,228)	5,299	5,889
Tax Paid	(8,412)	(13,560)	(11,961)	(13,308)	(15,158)
<b>OPERATING CASH FLOW ( a )</b>	<b>27,374</b>	<b>72,364</b>	<b>32,892</b>	<b>49,479</b>	<b>56,033</b>
Capex	(5,499)	(15,000)	(22,000)	(17,000)	(7,000)
Free Cash Flow (FCF)	21,875	57,364	10,892	32,479	49,033
Investments & Acquisition	(1,071)	-	-	-	-
Non-operating Income	2,653	-	-	-	-
<b>INVESTING CASH FLOW ( b )</b>	<b>(3,917)</b>	<b>(15,000)</b>	<b>(22,000)</b>	<b>(17,000)</b>	<b>(7,000)</b>
Debt Issuance/(Repaid)	-	-	-	-	-
Interest Expenses	(181)	-	-	-	-
FCFE	21,694	57,364	10,892	32,479	49,033
Share Capital Issuance	-	-	-	-	-
Dividend	(20,247)	(28,438)	(28,920)	(32,776)	(35,668)
Others	(67)	-	-	-	-
<b>FINANCING CASH FLOW ( c )</b>	<b>(21,227)</b>	<b>(28,438)</b>	<b>(28,920)</b>	<b>(32,776)</b>	<b>(35,668)</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>2,230</b>	<b>28,926</b>	<b>(18,028)</b>	<b>(297)</b>	<b>13,365</b>
EO Items, Others	128	-	-	-	-
Closing Cash & Equivalents	9,456	38,382	20,354	20,057	33,422

### Ratios

Year End	CY22	FY24	FY25E	FY26E	FY27E
<b>PROFITABILITY (%)</b>					
GPM	55.9	56.5	55.7	56.3	57.0
EBITDA Margin	24.1	24.3	24.0	24.5	25.2
EBIT Margin	21.8	22.0	21.6	21.8	22.5
APAT Margin	16.2	16.4	16.0	16.2	16.8
RoE	172.9	106.2	89.6	87.9	87.3
RoIC (or Core RoCE)	51.0	76.8	54.4	49.8	53.2
RoCE	43.2	52.4	37.2	39.5	40.2
<b>EFFICIENCY</b>					
Tax Rate (%)	25.7	25.7	26.0	26.0	26.0
Fixed Asset Turnover (x)	3.4	3.9	2.6	2.4	2.5
Inventory (days)	41.9	35.0	33.0	33.0	33.0
Debtors (days)	4.2	4.0	4.0	4.0	4.0
Other Current Assets (days)	9.2	6.4	7.3	6.6	6.0
Payables (days)	42.0	40.0	40.0	40.0	40.0
Other Current Liab & Provns (days)	23.8	17.0	19.0	17.6	16.2
Cash Conversion Cycle (days)	(10.5)	(11.6)	(14.7)	(13.9)	(13.2)
Net D/E (x)	(0.3)	(1.0)	(0.4)	(0.4)	(0.6)
<b>PER SHARE DATA (Rs)</b>					
EPS	24.8	40.8	35.3	39.3	44.8
CEPS	29.0	46.7	40.6	45.8	52.0
Dividend	22.0	29.5	30.0	34.0	37.0
Book Value	25.5	36.8	42.1	47.4	55.1
<b>VALUATION</b>					
P/E (x)	101.9	61.9	71.6	64.3	56.5
P/BV (x)	99.1	68.7	60.1	53.4	45.8
EV/EBITDA (x)	65.3	40.9	47.4	42.2	37.0
EV/Revenues (x)	14.4	9.9	11.4	10.3	9.3
OCF/EV (%)	55.9	56.5	55.7	56.3	57.0
FCF/EV (%)	24.1	24.3	24.0	24.5	25.2
FCFE/Mkt Cap (%)	21.8	22.0	21.6	21.8	22.5
Dividend Yield (%)	16.2	16.4	16.0	16.2	16.8

Source: Company, HSIE Research

1 Yr Price Movement



**Rating Criteria**  
BUY: >+15% return potential  
ADD: +5% to +15% return potential  
REDUCE: -10% to +5% return potential  
SELL: > 10% Downside return potential

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