RM Headwinds Persist; Valuation Pricey

Nestle India (NEST) reported in-line performance for Q3CY21 versus our estimates. However, clear signs of pressure have been noted on Gross Margins owing to inflationary RM. Reported Revenue grew 10% yoy at Rs. 3,865Cr ~1% above our estimate of Rs. 3,824Cr. Domestic sales reported 10.1% growth driven by ~7%/3% volume/price/mix led growth as per our estimates. Exports which formed ~4.6% of revenues reported an 1.3% growth yoy. EBITDA of Rs. 952Cr (our estimate Rs. 926Cr) was up 6% yoy. However, EBITDA Margin at 24.6% was lower yoy/qoq on the back of 240bps drag on Gross Margin due to increase in fuel prices (packaging costs and transport costs), wheat, coffee and edible oil. Gross Margins stood at 55.5% (lower vs our estimate of 56.4%). Sequentially too GM contracted by 133bps owing to RM headwinds. Management indicated RM headwinds are persisting across agri and non-agri products. Pressure on Operating Profitability due to Gross Margin drag drove recurring PAT to grow at 5.2% yoy at Rs. 617Cr (our estimate of Rs. 586Cr). As per management commentary, key products like Toddler range, Nescafe Classic, Milkmaid, KITKAT, MILKYBAR and MUNCH posted strong double-digit growth, while Maggi Noodles and Masala-ae-magic maintained strong momentum despite high base. Sauces posted muted growth (decline in home consumption, high base and increase in competitive activity). OOH consumption is recovering with opening of restaurants, hotels and malls. Organized trade resurged growing in mid-twenties and ecommerce posted strong acceleration. Sanand factory (ninth plant for Nestle) was commercialized in Q3CY21. **However, in light of emerging RM headwinds (packaging material, wheat, edible oil, coffee) and to bake in modest Q3 we cut our Revenue/EBITDA/PAT estimates for CY21-23E by 1-5%. Maintain HOLD with unchanged TP of Rs. 18,600 as at CMP the risk-reward is unfavourable even as the long term growth trajectory appears fair (40+ projects in pipeline)**

Key result takeaways

- **Overall modest growth:** Although NEST delivered another quarter of double digit growth in topline, QoQ and versus our expectations the Gross Margin performance was muted. Domestic sales grew by 10.1% in Q3CY21 which was broad based and driven by a combination of volume and value (mix/price). Exports reported a 1.3% growth yoy to Rs. 177Cr. In Middle East markets it introduced MAGGI Noodles and POLO while in ASEAN market it introduced Crunch Wafers.
- **Strong brands deliver:** Management indicated that its key brands – Maggie Noodles, Maggi Masala-Ae-Magic (Ready to eat segment) posted healthy growth while KitKat, Milkybar and Munch (confectionary) reported robust performance and grew in high double digits aided by attractive consumer promotions and distribution drives. We believe, this trend would continue further as markets open up and consumers prefer ready to eat and confectionary products. Maggie Sauces reported muted growth owing to delcine in in-home consumption, high base and increased competitive intensity. The beverages segment saw strong double digit growth in NESCAFE Classic led by increased penetration and visibility actions.
- **Channel performance:** E-commerce channel growth is expected to continue and NEST is gaining traction. E-commerce as a channel has led to development of new models like Quick commerce (Hyper-local) leading to lower delivery times and improved shopper experience. In organized trade broad based growth was reported across all food & beverages (coffee & confectionary) as pandemic intensity reduced and vaccination coverage expanded.
- **Out of Home (OOH) seeing rebound:** OOH channel is on a recovery path as hotels , restaurants, offices and malls see gradual opening. Management indicated there are signs of return to pre-COVID levels of business in certain geographies, categories and channels
- **Outlook on Raw Materials:** NEST management highlighted that price outlook for key categories like wheat, coffee, edible oils continue to see inflationary trends while, price of packaging material and transport costs report an increase amid supply constraints and rising fuel prices. Milk prices are expected to remain firm with continued increase in demand and rise in feed costs to farmers. However, to mitigate the RM headwinds management has indicated it would look to bring in operating efficiencies and rationalise costs while taking judicious price increases wherever necessary.

Our Take

Although, Nestle India reported double digit growth for yet another quarter in a row, we do think the near term operating perofmance is likley to be under pressure given rising concerns on RM inflation particularly across agri (wheat, edible oil, coffee, milk) and non-agri (fuel costs, packaging costs) commodities. While cost savings and judicious pricing action could likely offset the emerging RM inflation, we do think it is a key near term risk to margins and profitability. **We thus lower our Revenue/EBITDA/PAT estimates for CY21-23E by 1-5%. Maintain HOLD with an unchanged TP of Rs. 18,600 and await better entry points.**

Key Financials (Standalone)

(Rs. Cr)	CY20	CY21E	CY22E	CY23E
Net Sales	13,350	14,803	16,561	18,450
EBITDA	3,216	3,447	4,017	4,554
Net Profit	2,083	2,267	2,681	3,072
EPS (Rs.)	216.0	235.1	278.1	318.7
PER (x)	89.7	82.4	69.7	60.8
EV/EBITDA (x)	57.6	53.3	45.4	39.7
P/BV (x)	92.5	60.3	54.1	44.5
ROE (%)	105.4	88.6	81.8	80.3

Source: Company, Axis Research

	(CMP as of Oct 19, 2021)
CMP (Rs)	19,378
Upside /(Downside (%))	(-4%)
High/Low (Rs)	20,600 / 15,435
Market cap (Cr)	1,86,942
Avg. daily vol. (6m) Shrs.	37,771
No. of shares (Cr)	9.6

Shareholding (%)

	Dec-20	Mar-21	June-21
Promoter	62.8	62.8	62.8
FIIs	12.8	12.3	12.4
MFs / UTI	3.8	3.8	3.7
Banks / FIs	0.0	0.0	0.1
Others	20.6	21.1	21.1

Financial & Valuations

Y/E Mar (Rs. bn)	2020	2021E	2022E
Net Sales	148.0	165.6	184.5
EBITDA	34.5	40.2	45.5
Net Profit	22.7	26.8	30.7
EPS (Rs.)	235.1	278.1	318.7
PER (x)	82.4	69.7	60.8
EV/EBITDA (x)	53.3	45.4	39.7
P/BV (x)	60.3	54.1	44.5
ROE (%)	88.6	81.8	80.3

Growth Drivers (%)

Y/E Mar	2021E	2022E	2023E
Sales	10.9	11.9	11.4
EBITDA	7.2	16.5	13.4
PAT	8.9	18.3	14.6

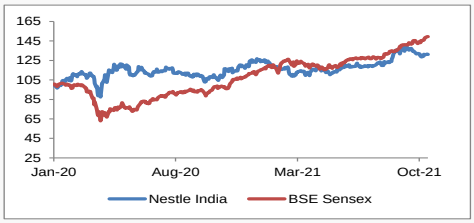
ESG Disclosure Score**

Particulars	Score
Environmental	NA
Social	NA
Governance	NA
Total ESG Score	**NA**

Source: Bloomberg, Scale: 0.1-100

**Note: This score measures the amount of ESG data a company reports publicly, and does not measure the company's performance on any data point. All scores are based on 2020 disclosures

Relative performance



Source: Capitaline, Axis Securities

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Q3CY21 Financial Highlights (Standalone)

(Rs. Cr)	Q3CY21	Axis Sec Estm	Axis Sec (Var)	Q2CY21	QoQ growth (%)	Q3CY20	YoY growth (%)
Volume growth (% yoy)	*7*	*6*	*100 bps*	*11*	*-400 bps*	*7*	*0 bps*
Net Sales	**3,865**	**3,824**	**1.1**	**3,462**	**11.6**	**3,525**	**9.6**
Gross Profits	2,145	2,157	(0.5)	1,968	9.0	2,041	5.1
Gross Margin (%)	55.5	56.4	-90 bps	56.8	-133 bps	57.9	-240 bps
Staff costs	388	398	(2.4)	378	2.6	370	5.0
Other operating expenses	812	837	(3.1)	755	7.6	780	4.1
EBITDA	**952**	**926**	**2.8**	**834**	**14.2**	**899**	**5.9**
EBITDA margin (%)	**24.6**	**24.2**	**41 bps**	**24.1**	**56 bps**	**25.5**	**-86 bps**
Depreciation	96	99	(3.9)	95	0.3	91	4.9
Interest Cost	52	57	(9.6)	52	0.4	40	28.3
Other Income	34	27	25.7	29	14.2	34	(2.3)
PBT	834	787	6.0	730	14.2	787	6.1
Tax	217	201	8.1	192	13.0	199	8.8
Tax rate (%)	26.0	25.5	50 bps	26.3	-28 bps	25.4	64 bps
PAT	**617**	**586**	**5.3**	**539**	**14.6**	**587**	**5.2**
EPS (Rs.)	**64**	**61**	**5.3**	**56**	**14.6**	**61**	**5.2**

	Q3CY21	Axis Sec Estm	Axis Sec (Var)	Q2CY21	QoQ growth (%)	Q3CY20	YoY growth (%)
Profitability Analysis (%)							
Gross Margin	*55.5*	*56.4*	*-90 bps*	*56.8*	*-133 bps*	*57.9*	*-240 bps*
EBITDA Margin	*24.6*	*24.2*	*41 bps*	*24.1*	*56 bps*	*25.5*	*-86 bps*
PAT Margin	*16.0*	*15.3*	*64 bps*	*15.6*	*42 bps*	*16.7*	*-68 bps*
Cost Analysis (%)							
COGS	*44.5*	*43.6*	*90 bps*	*43.2*	*133 bps*	*42.1*	*240 bps*
Staff Costs	*10.0*	*10.4*	*-35 bps*	*10.9*	*-88 bps*	*10.5*	*-44 bps*
Other Expenses	*21.0*	*21.9*	*-90 bps*	*21.8*	*-79 bps*	*22.1*	*-112 bps*
Effective Tax Rate (% of PBT)	*26.0*	*25.5*	*50 bps*	*26.3*	*-28 bps*	*25.4*	*64 bps*

Source: Company; Axis Securities

Financials (consolidated)

Profit & Loss (Rs Cr)

Y/E Dec	CY20	CY21E	CY22E	CY23E
Net sales	**13,350**	**14,803**	**16,561**	**18,450**
Growth, %	8.6	10.9	11.9	11.4
Total income	13,350	14,803	16,561	18,450
Raw material expenses	-5,674	-6,411	-7,097	-7,838
Employee expenses	-1,501	-1,531	-1,684	-1,852
Other Operating expenses	-2,960	-3,414	-3,763	-4,206
EBITDA (Core)	**3,216**	**3,447**	**4,017**	**4,554**
Growth, %	14.2	7.2	16.5	13.4
Margin, %	**24.1**	**23.3**	**24.3**	**24.7**
Depreciation	-370	-403	-426	-446
EBIT	**2,845**	**3,044**	**3,591**	**4,108**
Growth, %	13.8	7.0	18.0	14.4
Margin, %	21.3	20.6	21.7	22.3
Interest paid	-164	-169	-174	-179
Other Non-Operating Income	146	156	167	179
Pre-tax profit	**2,813**	**3,031**	**3,584**	**4,107**
Tax provided	-730	-764	-903	-1,035
Profit after tax	2,083	2,267	2,681	3,072
Net Profit	**2,083**	**2,267**	**2,681**	**3,072**
Growth, %	5.7	8.9	18.3	14.6
Unadj. Shares (cr)	9.6	9.6	9.6	9.6

Source: Company, Axis Securities

Balance Sheet (Rs Cr)

As at 31st Dec	CY20	CY21E	CY22E	CY23E
Cash & bank	1,770	3,250	4,388	5,847
Debtors	165	122	136	152
Inventory	1,416	1,541	1,588	1,769
Total current assets	3,491	5,728	6,927	8,583
Investments	1,464	1,464	1,464	1,464
Net fixed assets	2,789	2,141	1,915	1,669
Total assets	**7,900**	**9,488**	**10,461**	**11,871**
Current liabilities	2,492	2,760	2,972	3,200
Total current liabilities	5,761	6,271	6,887	7,550
Non-current liabilities	120	120	120	120
Total liabilities	5,880	6,391	7,007	7,669
Paid-up capital	96	96	96	96
Reserves & surplus	1,923	2,350	2,707	3,455
Shareholders' equity	2,019	3,098	3,454	4,202
Total equity & liabilities	**7,900**	**9,488**	**10,461**	**11,871**

Source: Company, Axis Securities

Cash Flow (Rs Cr)

Y/E Dec, Rs. Cr	CY20	CY21E	CY22E	CY23E
Pre-tax profit	2,813	3,031	3,584	4,107
Depreciation	370	403	426	446
Chg in working capital	533	-247	555	466
Total tax paid	-748	-764	-903	-1,035
Cash flow from operating activities	**2,968**	**2,424**	**3,662**	**3,984**
Capital expenditure	-790	245	-200	-200
Chg in investments	287	0	0	0
Cash flow from investing activities	**-490**	**245**	**-200**	**-200**
Free cash flow	2,479	2,669	3,462	3,784
Debt raised/(repaid)	-21	0	0	0
Dividend (incl. tax)	-1,743	-2,092	-2,324	-2,324
Cash flow from financing activities	**-2,017**	**-1,189**	**-2,324**	**-2,324**
Net chg in cash	462	1,480	1,138	1,459
Opening cash balance	1,308	1,770	3,250	4,388
Closing cash balance	1,770	3,250	4,388	5,847

Source: Company, Axis Securities

Ratio Analysis (%)

	CY20	CY21E	CY22E	CY23E
Per Share data				
EPS (INR)	216.0	235.1	278.1	318.7
Growth, %	5.7	8.9	18.3	14.6
Book NAV/share (INR)	209.4	321.3	358.3	435.8
FDEPS (INR)	216.0	235.1	278.1	318.7
CEPS (INR)	254.4	277.0	322.2	364.9
DPS (INR)	150.0	180.0	200.0	200.0
Return ratios				
Return on assets (%)	29.2	27.2	27.9	28.4
Return on equity (%)	105.4	88.6	81.8	80.3
Return on capital employed (%)	41.9	39.0	39.1	39.3
Turnover ratios				
Asset turnover (x)	7.2	8.0	10.5	14.7
Sales/Total assets (x)	1.8	1.7	1.7	1.7
Sales/Net FA (x)	5.2	6.0	8.2	10.3
Working capital days	(21.1)	(7.0)	(9.5)	(9.2)
Liquidity ratios				
Current ratio (x)	1.4	2.1	2.3	2.7
Quick ratio (x)	0.8	1.5	1.8	2.1
Interest cover (x)	17.3	18.0	20.6	22.9
Dividend cover (x)	1.4	1.3	1.4	1.6
Total debt/Equity (%)	1.6	1.0	0.9	0.8
Valuation				
PER (x)	89.7	82.4	69.7	60.8
Price/Book (x)	92.5	60.3	54.1	44.5
Yield (%)	0.8	0.9	1.0	1.0
EV/Net sales (x)	13.9	12.4	11.0	9.8
EV/EBITDA (x)	57.6	53.3	45.4	39.7

Source: Company, Axis Securities

Nestle India Chart and Recommendation History

Date	Reco	TP	Research
06-Aug-20	BUY	18,310	Initiating Coverage
26-Oct-20	BUY	18,310	Result Update
17-Feb-21	BUY	18,600	Result Update
29-Jul-21	HOLD	18,600	Result Update
20-Oct-21	HOLD	18,600	Result Update

Source: Axis Securities

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