

Nestle India

ADD

CMP Rs17,200

Target Rs18,232

Upside 6%

Muted quarter impacted by sharp rise in employee costs; suggest buying into any result-driven weakness; reiterate ADD

- ✓ **Results fell short of expectations** - Nestle numbers were below our expectations with sales/EBITDA/PAT growth of 9%/12%/2% vs our expectation of 11%/21%/18% respectively mainly due to a sharp increase in employee costs, decline in export revenue and higher tax and interest expenses. Adjusting for the sharp increase in employee costs, numbers were not far below expectations.
- ✓ **Management commentary** - Sales growth was broad-based driven by combination of volume and mix with two-thirds of portfolio (brands like Maggi, Kitkat and Nescafe) growing in double-digits, e-commerce grew by 111% and now is 3.7% of sales, focus remain on innovation and renovation in categories like foods, health sciences and breakfast cereals.
- ✓ **Topline** - Revenue came in at Rs 34.3bn, up 9% with broad-based 10.1% increase in domestic sales offset by a 7.7% decline in coffee exports. Demand for out of home channel improved but still remains impacted by COVID.
- ✓ **Margins** - Gross margins improved sharply by 230bps to 59.1% led by lower milk and derivative prices and a superior mix. EBITDA margins improved by only 60bps to 22.6% (our expectation of 24%) given a 25% increase in employee costs due to higher COVID related incentives and long-term compensation increase for factory employees. Other expenses were marginally higher given step up in marketing spends.
- ✓ **Earnings** - PAT growth of 2% was impacted by higher interest costs and lower other income (fall in yields). PAT, however, saw a decline of 1% to Rs 5.87bn due to the tax reversal in the base quarter.
- ✓ **Dividends** - The company maintained its generous dividend payouts with a dividend of Rs 65 in addition to the earlier interim dividend of Rs 135 per share, which would drive up return ratios further.
- ✓ **Valuation and view** - While this muted performance can lead to some correction in the near-term given possibility of some earnings downgrades, it still remains one of our top picks in the staples space given volume growth and premiumization potential of its categories, opportunities for further deepening distribution and aggression on new launches and marketing spends. The stock is currently trading at 57x CY22E earnings and we would review our estimates post the investor meet scheduled on Friday 26th February. For now, we reiterate our ADD rating with a PT of Rs 18,232 based on 60x CY22E earnings, implying an upside of 6%.

HIMANSHU NAYYAR

Lead Analyst

himanshu.nayyar@ysil.in

+91 9920915754



AAKASH FADIA

aakash.fadia@ysil.in

AMAR AMBANI, Sr. President, Head of Research

amar.ambani@ysil.in

YE March (Rs mn)	4QCY20	4QCY19	3QCY20	YoY (%)	QoQ (%)
Net Revenues	34,326	31,493	35,417	9.0	(3.1)
Raw material cost	14,045	13,614	14,843	3.2	(5.4)
(% of sales)	40.9	43.2	41.9		
Gross profit	20,281	17,879	20,574	13.4	(1.4)
(% of sales)	59.1	56.8	58.1		
Employee cost	4,033	3,220	3,697	25.2	9.1
(% of sales)	11.7	10.2	10.4		
Others	8,478	7,718	8,042	9.9	5.4
(% of sales)	24.7	24.5	22.7		
EBITDA	7,770	6,941	8,836	12.0	(12.1)
EBITDA margin (%)	22.6	22.0	24.9		
Other income	306	447	345	(31.5)	(11.2)
PBIDT	8,076	7,388	9,181	9.3	(12.0)
Depreciation	955	936	911	2.1	4.8
Interest	420	311	405	34.9	3.8
PBT	6,702	6,141	7,865	9.1	(14.8)
Tax	1,869	1,415	1,994	32.1	(6.3)
ETR (%)	27.9	23.0	25.4		
Adjusted PAT	4,833	4,726	5,871	2.3	(17.7)
PATAMI margin	14.1	15.0	16.6		
Extraordinary income/ (exp.)	0	0	0		
Reported PAT	4,833	4,726	5,871	2.3	(17.7)
Adj EPS (Rs)	50.1	49.0	60.9		

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YES Securities (India) Limited

Registered Address: Unit No. 602 A, 6th Floor, Tower 1 & 2, One International Center, Senapati Bapat Marg, Elphinstone Road, Mumbai - 400013, Maharashtra, India

Email: research@ysil.in | Website: <https://yesinvest.in>

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