

## Consumer Staples & Discretionary

### Hindustan Unilever vs. Nestle India

We believe Nestle may potentially outperform HUL in long term driven by multiple favourable factors (both extrinsic and intrinsic). In Nestle, we like:

- Penetration-led volume growth on the back of rural expansion (Nestle India has the lowest rural revenue salience (~20%) among peers)
- Lower threat from D2C brands given the inherent challenges in scaling up in Foods category
- Opportunity to bring more from global portfolio in true long term (Nestle India operates in just 4 categories out of 7 categories globally)
- Getting incrementally important for parent (India is outperforming other markets)
- Better operating margin expansion headroom (Nestle India's operating margin has been stable in the range of ~20-24%) vs most in Staples at near-peak margins
- Beneficiary of long-term tailwind of consumer preferring convenience
- ▶ **Nestle's growth to be driven more by volumes; HUL to be (mostly) a premiumisation story:** Nestle India has relatively lower salience from rural areas (20%; one of the lowest in our coverage) compared to HUL which has been a pioneer in driving penetration-led growth in rural areas through smaller packs and brand architecture. We note that rural regions are one of the large drivers of volumes for most of the FMCG companies.

Nestle is implementing a strategy to further drive penetration-led growth through 1) customised portfolio, 2) localized communication, 3) building consumer connect, 4) higher visibility and 5) building infrastructure. We believe Nestle through its strategy will likely drive rural penetration for its products leading to volume growth. It has recently also started disclosing growth for various town classes which continue to witness double-digit growth as compared to decline in overall FMCG sector as it has a low base and is gaining penetration currently.

HUL on the other hand has been a pioneer over the last few years in driving penetration-led volume growth through its LUP strategy and multi-brand architecture. We believe HUL will likely have premiumisation led growth as it has already achieved high penetration for some of its products, and (material) growth going forward will be through upgrading consumer to a premium brand. However, HUL will also likely continue to gain penetration-led growth as consumer shift away from unorganised segment, we believe that benefit will be lower for HUL compared to Nestle India.

- ▶ **Nestle has relatively low threat from D2C brands:** Nestle India is present in food categories while HUL is present in Home care, Beauty and Personal care (BPC) and Foods. We believe, D2C brands have higher presence in BPC categories compared to foods categories due to a) BPC has higher gross margins which allows D2C brands to invest in performance marketing and b) consumer are more open to experiment in BPC (multiple niche opportunities) compared to foods (taste – not easier to change taste preference for consumer). These reasons lead to a longer time to build foods D2C brands compared to foods D2C brands. Given the inherent categories Nestle is present in, we believe Nestle has lower threat from D2C brands compared to HUL which has a large presence in BPC.

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- ▶ **Nestle is less dependent on inorganic success:** Nestle India currently operates in 4 categories out of 7 categories where Nestle SA (parent company) is present. Therefore, Nestle India does not need to look for inorganic opportunities as it can always get some of the brands from the parent to India as and when Nestle feels that there is opportunity in that particular category. Recently, Nestle has introduced two of its global brands - Purina (Pet Care business) and Gerber (premium nutrition range for toddlers) in India.

On the other hand, HUL is largely present in the (relevant) categories where Unilever (parent company) is present. Also, HUL has been active in acquiring companies in India in categories like Health Food Drinks (GSK Consumer – Horlicks, Boost etc.), Ice Creams (Aditya Milk), Ayurvedic Hair Oil (Indulekha), Female Hygiene (VWash) etc.

We believe inorganic growth comes with its risks while organic growth is less risky. Therefore, we prefer Nestle over HUL given the preference for organic growth.

- ▶ **Nestle India has become relatively more important for Nestle SA:** While India is considered as a growth market for most of the MNCs given the immense opportunity, Nestle India, in the past, was (likely) less important for parent (given low revenue salience of India for the parent). However, given the continued outperformance of India market under Suresh, we reckon it has likely increased parent's focus on Nestle India.

While note that HUL continues to be one of the most important markets for Unilever.

- ▶ **Rural journey for Nestle has just started:** As discussed earlier, Nestle India has one of the lowest salience of rural revenues amongst its peers. It is continuously expanding reach into smaller cities and rural areas. It has a target to expand into ~120,000 villages by CY24 (~100,000 villages in CY21). Further, it has already increased its overall distribution reach from 4mn outlets in CY16 to 5mn outlets in CY21 which should further increase given the rural focus.
- ▶ **Consumers prioritising convenience is a tailwind for packaged foods business:** There are clear signs of preference in convenience among consumers over the last few years which has further accelerated post covid. This is a natural tailwind for packaged foods categories which is the domain of Nestle India.
- ▶ **Opportunity / potential for operating margins expansion is higher for Nestle compared to HUL:** We believe there is higher scope for margin expansion for Nestle compared to HUL. This will be likely largely driven by 1) higher volume-led growth (penetration-led growth) leading to operating leverage and 2) premiumisation (launching of premium global brands). HUL has expanded its EBITDA margins by ~550bps and ~950bps in last five and ten years while Nestle has expanded its margins by just ~310bps and ~220bps over the same period. We believe HUL was a beneficiary of both volume-led growth and premiumisation in the last decade which Nestle may witness in next few years.

On the other hand, HUL expects margin expansion to be moderate in medium term given there will be increase in ad-spends and investment for market development activities.

**Valuation and risks**

We value stocks on DCF (WACC and TG ranging from 10-13%, 3-6% respectively) except Adani Wilmar, Godrej Cons. and Tata Cons. which we value on SoTP basis. Key upside risk is better-than-expected gross margins due to correction in input prices. Key downside risk is unexpected irrational competition due to deceleration in general consumption demand.

Chart 1: Growth across cities and town classes for Nestle India



Source: Company Data, I-Sec research

Chart 2: Categories of Nestle SA

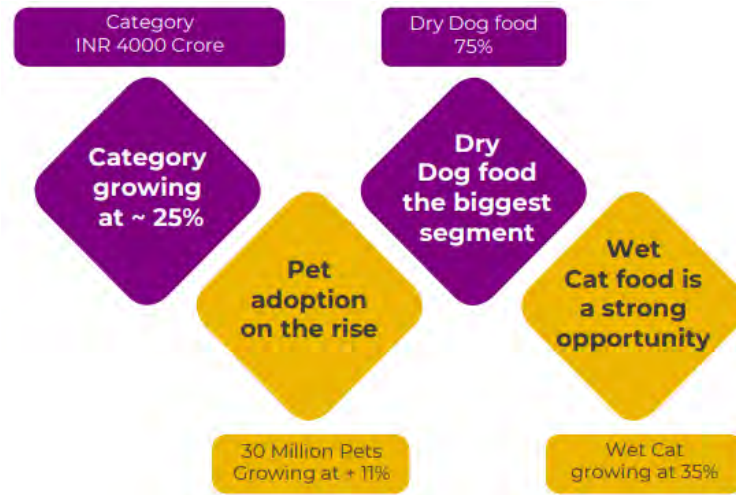




Source: Company Data, I-Sec research



**Chart 3: Pet care market**



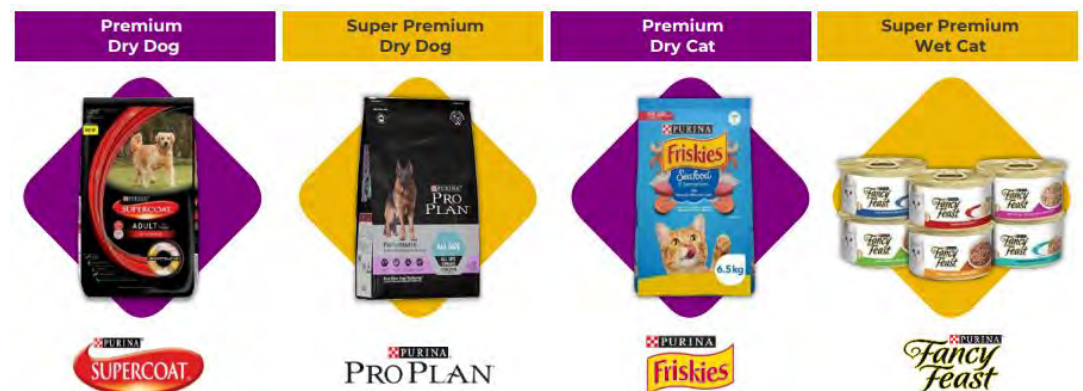
Source: Company Data, I-Sec research

**Chart 4: Revenue progression of Pet care business of Nestle India**



Source: Company Data, I-Sec research

**Chart 5: Brand offering under Pet Care business of Nestle India**



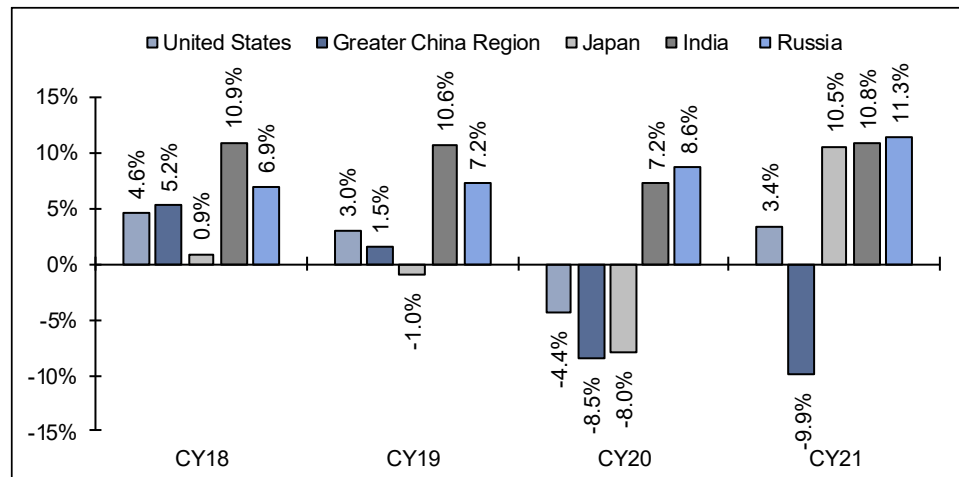
Source: Company Data, I-Sec research

Chart 6: Global brand Gerber launched in India



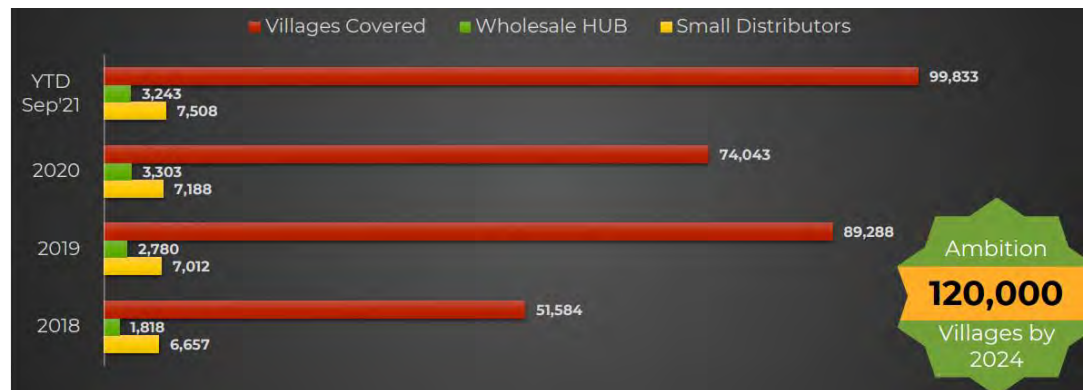
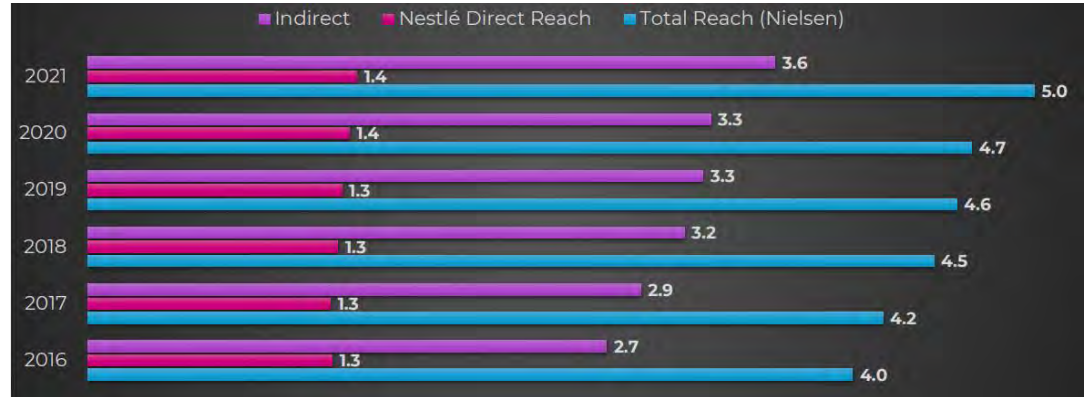
Source: Company Data, I-Sec research

Chart 7: Nestle India outperforming other geographies of Nestle SA



Source: Company Data, I-Sec research

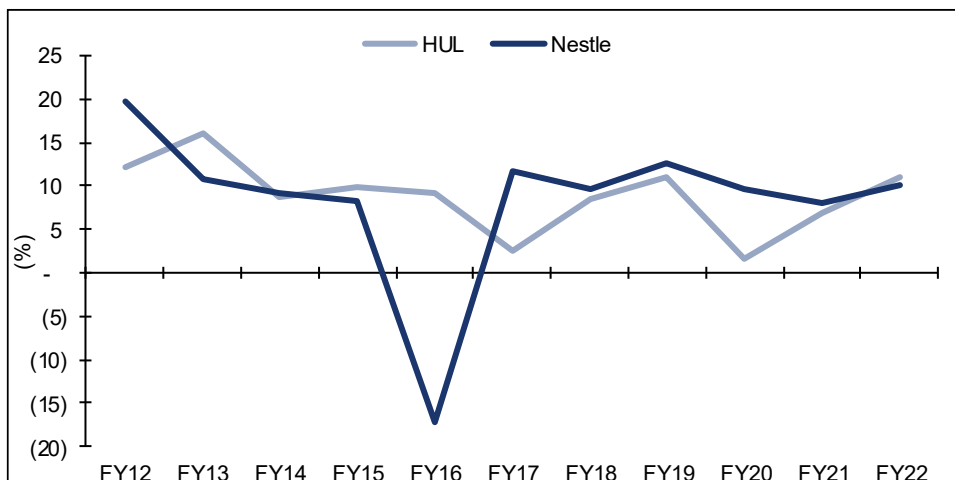
**Chart 8: Distribution expansion by Nestle India**



Source: Company Data, I-Sec research

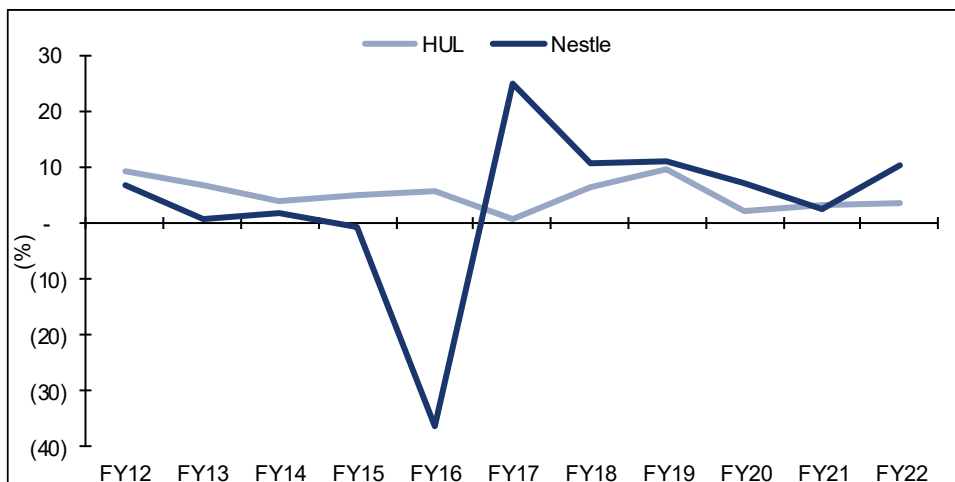


**Chart 9: Revenue growth (HUL vs Nestle)**



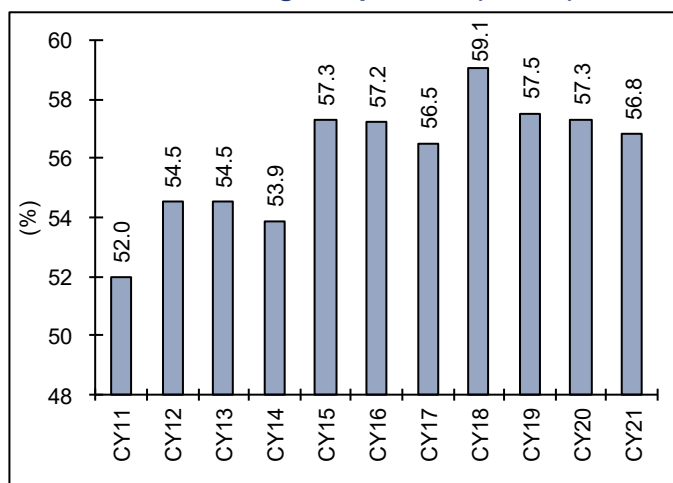
Source: Company Data, I-Sec research

**Chart 10: Volume growth (HUL vs Nestle)**



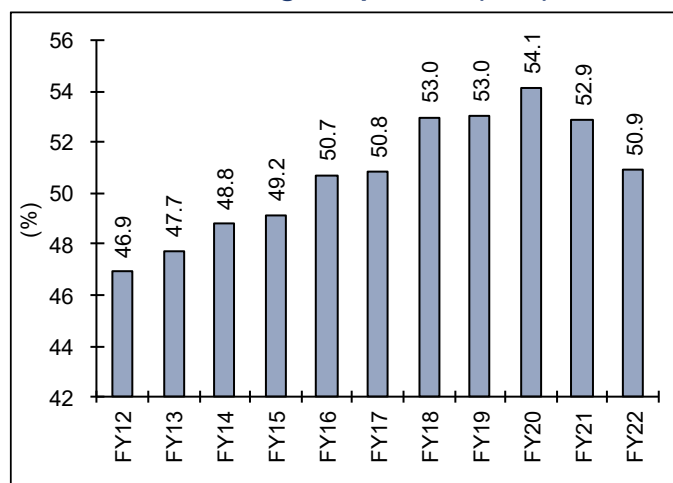
Source: Company Data, I-Sec research

**Chart 11: Gross margin expansion (Nestle)**



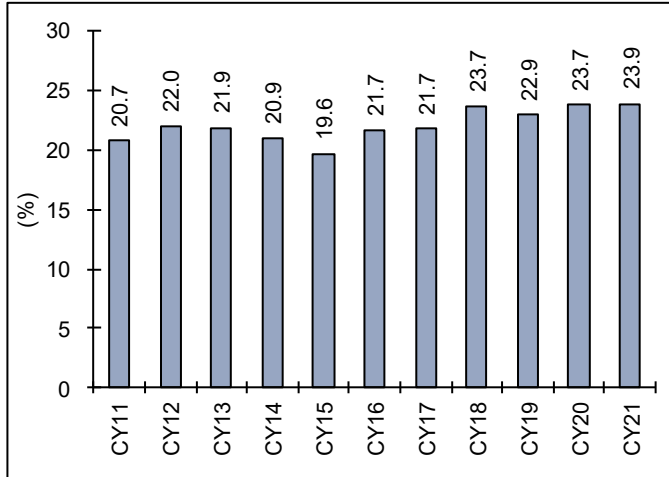
Source: Company data, I-Sec research

**Chart 12: Gross margin expansion (HUL)**



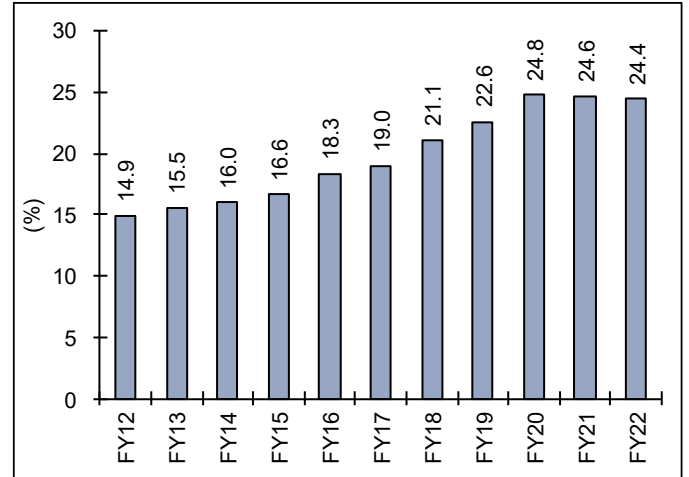
Source: Company data, I-Sec research

**Chart 13: EBITDA margin expansion (Nestle)**



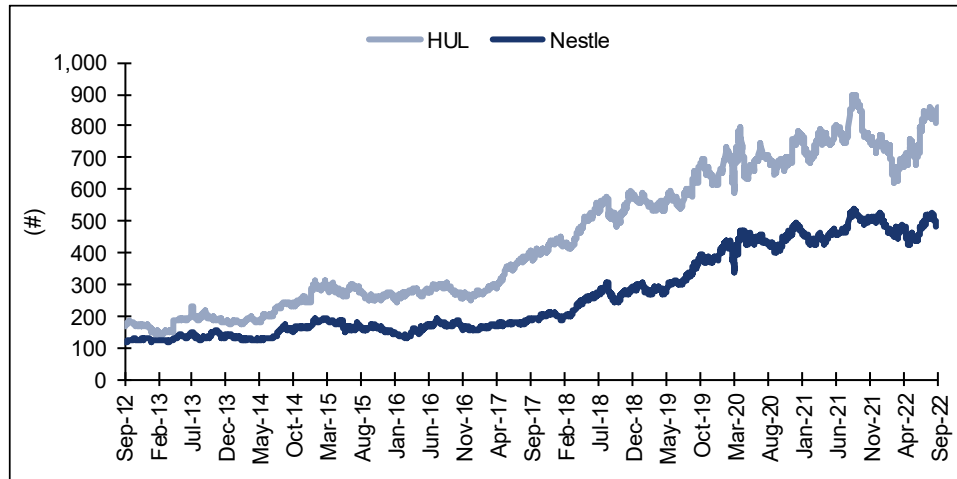
Source: Company data, I-Sec research

**Chart 14: EBITDA margin expansion (HUL)**



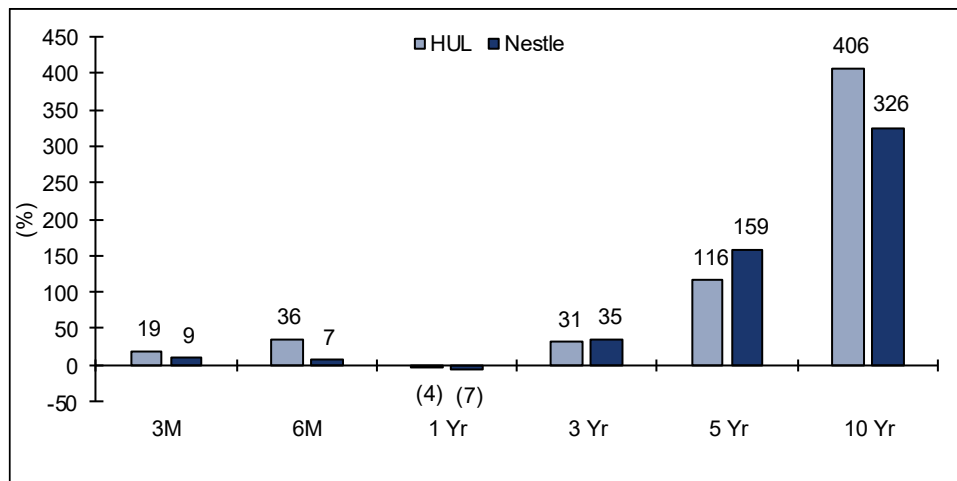
Source: Company data, I-Sec research

**Chart 15: Stock Price Performance (HUL vs Nestle)**



Source: Company Data, I-Sec research

**Chart 16: Stock Price Performance (HUL vs Nestle)**



Source: Company Data, I-Sec research

Table 1: Valuation summary

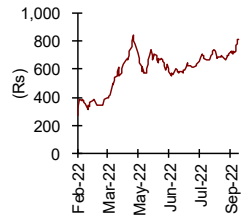
Company	TP (Rs)	Rating	PE (x)		EV/EBITDA (x)		ADTV (US\$ mn)	Market Cap		
			FY23E	FY24E	FY23E	FY24E		(Rs bn)	(US\$ bn)	
<b>Staples</b>										
Adani Wilmar	595	REDUCE	93	72	47	40	25.4	1,053	13.0	
Bajaj Consumer	250	BUY	14	12	10	8	1.4	24	0.3	
Britannia	3,650	HOLD	56	44	39	31	17.4	915	11.3	
Colgate	1,750	ADD	40	36	27	24	6.4	429	5.3	
Dabur	670	BUY	51	44	42	36	11.1	1,007	12.4	
Emami	480	ADD	29	25	23	20	1.8	219	2.7	
GCPL	950	ADD	52	40	37	29	16.2	911	11.2	
HUL	2,750	ADD	64	55	45	39	56.9	6,302	77.6	
ITC	350	ADD	24	22	19	17	53.5	4,294	52.8	
Jyothy Labs	200	BUY	30	22	22	17	1.2	66	0.8	
Marico	550	ADD	51	43	36	30	9.0	702	8.6	
Mrs. Bector's Foods	380	ADD	33	24	15	12	0.9	21	0.3	
Nestle	20,500	ADD	74	60	48	40	14.3	1,788	22.0	
Tata Consumer	925	BUY	59	50	36	31	20.5	720	8.9	
Varun Beverages	900	HOLD	71	55	35	30	17.7	753	9.3	
Zydus Wellness	2,000	BUY	29	22	28	22	1.4	102	1.3	
<b>Discretionary</b>										
Avenue Supermarts	4,200	ADD	104	81	73	57	21.7	2,829	34.8	
Bata	2,000	HOLD	55	46	38	31	9.0	238	2.9	
Burger King India	125	ADD	NM	151	42	27	3.8	61	0.8	
FSN E-Commerce Ventures	1,400	HOLD	555	225	194	105	6.3	620	7.6	
Go Fashion (India)	1,450	BUY	68	52	51	39	1.1	70	0.9	
Jubilant Foodworks	750	BUY	72	57	43	36	27.9	410	5.0	
Kalyan Jewellers	100	BUY	23	18	11	9	3.6	96	1.2	
Metro Brands	850	BUY	65	57	35	31	4.3	239	2.9	
Page Industries	52,000	ADD	80	66	55	46	11.1	592	7.3	
Sapphire Foods	1,700	BUY	66	42	19	14	3.2	92	1.1	
Sheela Foam	3,500	BUY	48	39	33	27	0.5	148	1.8	
Titan	2,700	ADD	75	60	51	42	40.4	2,373	29.2	
United Spirits	940	ADD	61	55	43	38	18.7	633	7.8	
Westlife Development	640	BUY	101	64	45	33	1.6	105	1.3	
<b>Paints</b>										
Akzo Nobel	2,050	ADD	27	24	17	15	0.5	99	1.2	
Asian Paints	3,200	HOLD	74	62	50	42	48.1	3,257	40.1	
Berger Paints	626	REDUCE	59	50	37	32	8.5	616	7.6	
Indigo Paints	1,620	HOLD	57	45	38	29	1.5	72	0.9	
Kansai Nerolac	520	HOLD	49	36	29	22	2.9	258	3.2	

Company	EV/ sales (x)		P/B (x)		P/CEPS (x)		RoE (%)		RoCE (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
<b>Staples</b>										
Adani Wilmar	1.9	1.7	12	11	70	57	13	15	10	11
Bajaj Consumer	1.8	1.7	3	3	14	11	19	21	18	21
Britannia	6.0	5.4	32	26	49	39	58	59	31	38
Colgate	7.9	7.4	25	26	34	31	64	73	79	92
Dabur	8.3	7.5	11	10	45	39	22	23	16	17
Emami	6.4	5.9	10	8	30	25	34	36	42	46
GCPL	7.1	6.4	7	7	46	35	14	18	13	16
HUL	10.8	10.1	13	12	58	50	20	22	16	18
ITC	5.9	5.7	7	6	22	20	28	30	31	33
Jyothy Labs	2.8	2.5	4.3	3.9	24	18	15	19	15	19
Marico	6.8	6.0	20	19	46	39	41	46	36	40
Mrs. Bector's Foods	1.8	1.6	4	4	18	14	12	15	13	16
Nestle	10.6	9.6	82	76	63	52	113	130	40	44
Tata Consumer	5.0	4.4	5	4	48	41	8	9	9	10
Varun Beverages	6.8	5.9	14	12	45	36	22	23	21	25
Zydus Wellness	4.7	4.2	2	2	27	20	7	9	7	9
<b>Discretionary</b>										
Avenue Supermarts	6.6	5.2	17	14	87	69	18	19	23	25
Bata	6.7	5.9	16	12	33	28	26	31	38	44
Burger King India	3.2	2.5	8	8	28	20	(0)	5	5	9
FSN E-Commerce Ventures	11.3	8.1	43	36	251	136	8	16	10	20
Go Fashion (India)	10.1	8.2	13	11	38	30	19	21	27	30
Jubilant Foodworks	7.5	6.3	14	12	40	33	23	22	19	19
Kalyan Jewellers	0.9	0.8	3	2	14	12	12	13	10	11
Metro Brands	11.4	9.7	16	13	45	39	24	23	32	31
Page Industries	11.6	10.1	41	31	73	60	58	54	41	39
Sapphire Foods	3.8	2.9	8	7	23	17	12	16	18	24
Sheela Foam	4.4	3.9	9	7	37	30	20	20	17	20
Titan	6.7	5.6	20	16	66	54	30	30	34	34
United Spirits	6.5	6.2	10	8	49	45	18	16	21	20
Westlife Development	4.8	4.0	19	14	41	31	20	25	31	37
<b>Paints</b>										
Akzo Nobel	2.4	2.2	8	8	22	19	29	33	28	33
Asian Paints	9.0	7.7	20	17	62	52	29	30	26	27
Berger Paints	5.7	4.9	13	11	47	41	24	24	20	21
Indigo Paints	32.7	30.3	14	11	20	20	17	18	19	20
Kansai Nerolac	3.3	2.9	6	5	36	28	12	15	12	14

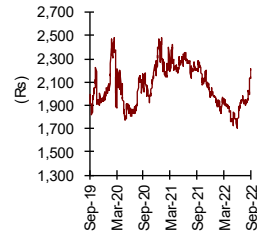
Source: Bloomberg, Company data, I-Sec research

Price charts

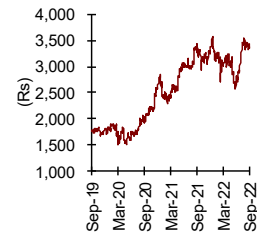
Adani Willmar



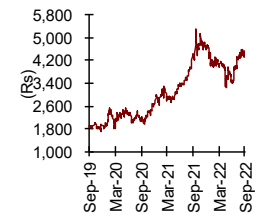
Akzo Nobel



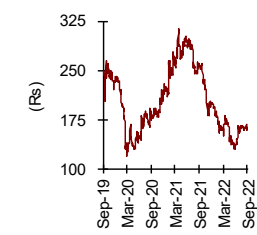
Asian Paints



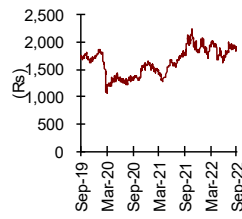
Avenue Supermarts



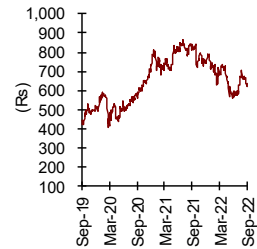
Bajaj Consumer



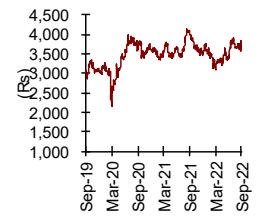
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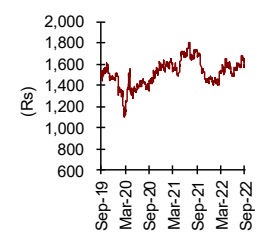
Berger Paints



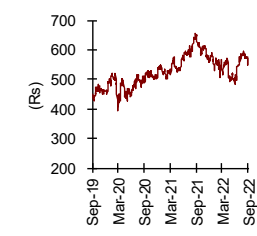
Britannia



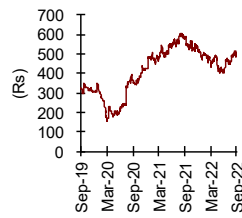
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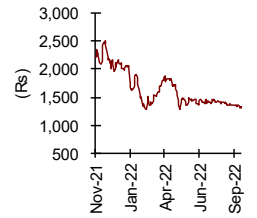
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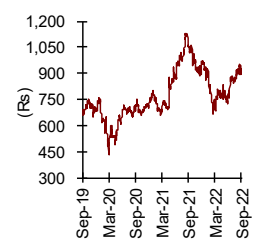
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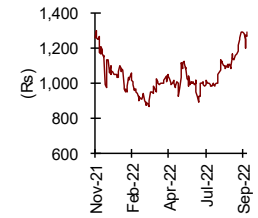
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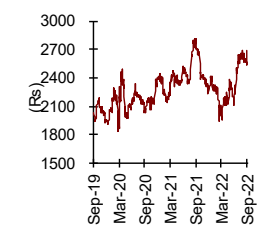
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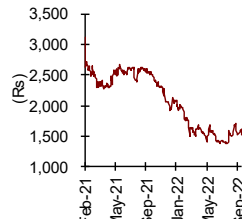
Go Fashion India



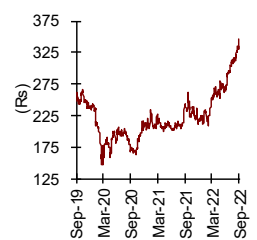
HUL



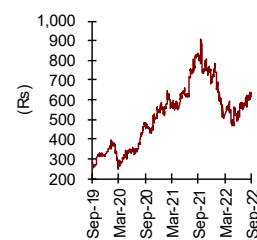
Indigo Paints



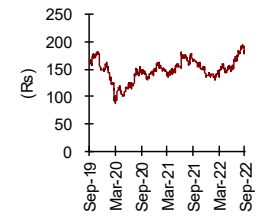
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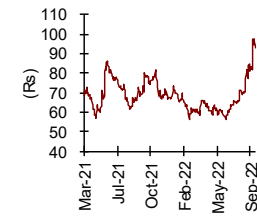
Jubilant Foodworks



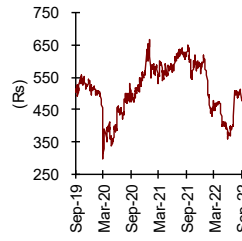
Jyothy Labs



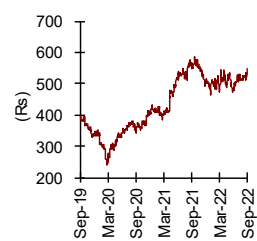
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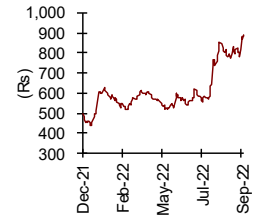
Kansai Nerolac



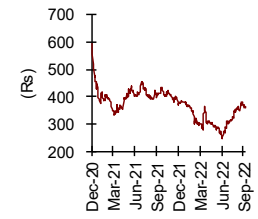
Marico



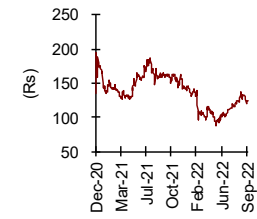
Metro Brands



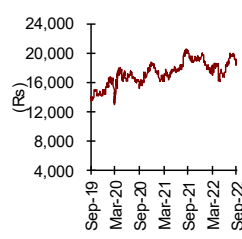
Mrs. Bector's



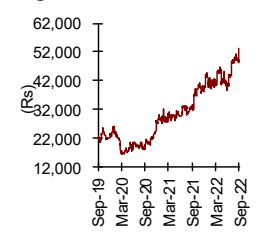
Restaurant Brands Asia



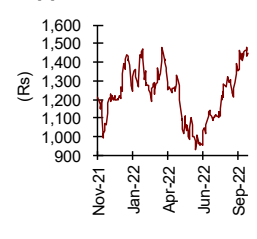
Nestle



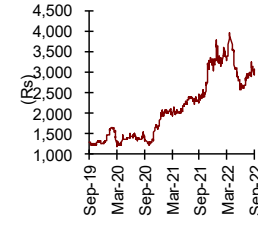
Page Industries



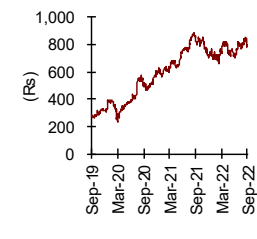
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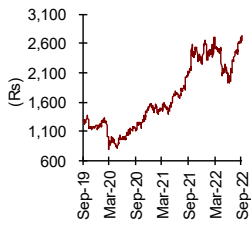


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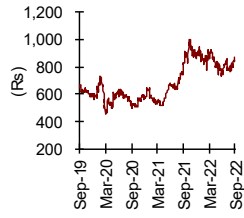




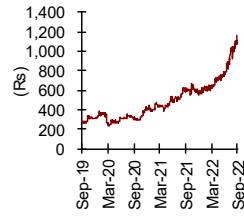
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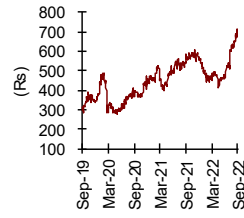
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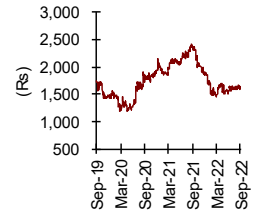
**Varun Beverages**



**Westlife Development**



**Zydus Wellness**



Source: Bloomberg

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