Fundamental Analysis of Nestle Ltd from 2013 to 2017

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ABSTRACT
The fundamental analysis is an important tool for an the investor for making his buy or sell decisions based on the detailed analysis of the financial statements of the company. Fundamental analysis of Nestle India covered operating analysis profit margin, net profit margin, earning per share, dividend per share, dividend payout ratio, price earnings ratio, return on equity, earning yield ratio,price to book value ratios and intrinsic value.The study is based on data obtained from the annual reports of the company. A period of five years from 2013 to 2017 is adopted to draw the meaningful inferences. This paper attempts to evaluate the company to find whether it is a good candidate for investment

Keywords – fundamental analysis, Nestle ltd., intrinsic value

INTRODUCTION

Investment decision is a part of our economic life. Investment decisions in equity shares carry a degree of risk and an investor must undertake a thorough review of the available information. Two main techniques which can assist an investor in his choice of a company are technical and fundamental analysis. This study focuses on fundamental analysis using various tools which help in trading strategies for risk reduction and maximization of return

Nestle India is one of the oldest multinational companies operating in India. It is a subsidiary of Nestle SA of Switzerland. Nestle was founded in 1867 in Geneva, Switzerland by Henri Nestle. Nestle's first product was "FarineLactee Nestle", an infant cereal. In 1905, Nestle acquired the Anglo-Swiss Condensed Milk Company. Nestle's relationship with India started 1912, when it began trading as The Nestle Anglo-Swiss Condensed Milk Company (Export) Limited, importing and selling finished products in the Indian market. The company has its headquarter at Gurgaon, NCR, Delhi and seven factories spread all over India. Nestle India follows a January-December financial year.Figure 1 depicts the overall performance of the company during the period of study

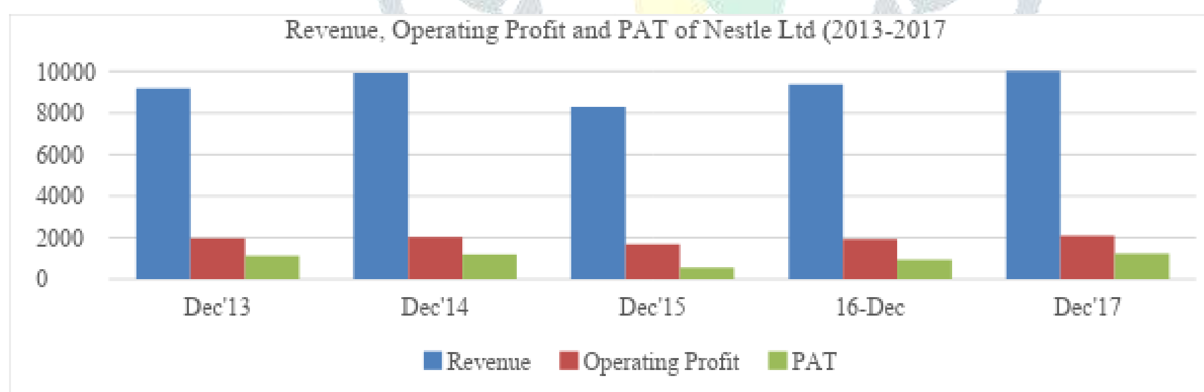

Figure 1Overall Financial Performance of Nestle Lttd from 2013 to 2017
Source: Compiled from Annual reports of Nestle Ltd from /Year 2013 to 2016

LITERATURE REVIEW

MEHMET SARAC (2007) the paper analyzed about the buy and sell decisions of foreign investors are related to financial indicators of the firms listed on the Istanbul Stock Exchange. Foreign investors consider solvency is a major factor whereas, local investors considers the profitability of a firm. **SANDIP MUKHERJI, MANJEET, AND KIM (1997)** found that stock returns are positively related to book-market ratio, sales-price ratio and debt-equity ratio. It is also found that return is negatively related to firm size and not significantly related to earnings price ratio.**JEFFERY ABARBANELL AND BRAIN BUSHEE (1977)** in their study examined the relationship between accounting based fundamental signals and future earnings of security prices. The study found that investors are not completely relying on the information given by the analyst

AN INTRODUCTION TO FUNDAMENTAL ANALYSIS

Fundamental Analysis is done by an interested investor to develop an understanding about the business from .It involves three tiers, viz., Economy Analysis, Industry Analysis and Company Analysis. Also called as EIC analysis , it helps the investor to form a future outlook regarding the company's worth,It enables a long term investor to look ahead of the day to day fluctuations to stay invested for a long term and reap good returns.

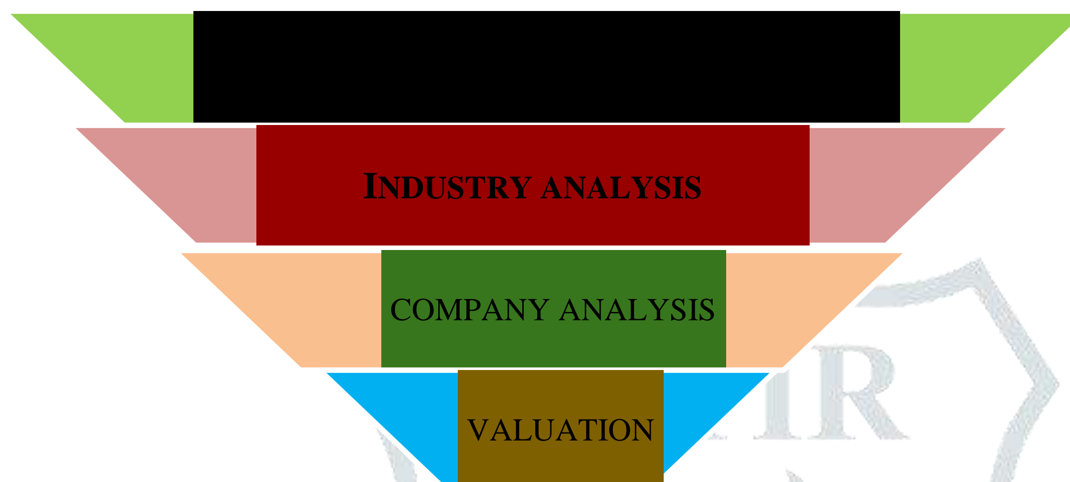

Fig 2: Steps in Fundamental Analysis

ECONOMY ANALYSIS

Economy analysis is done to understand the macro factors affecting the economy which are bound to have effect on all the companies functioning in the economy.

The economic variables listed below indicate the general state of the economy

- Gross National Product (GNP)
- Gross Domestic Product (GDP)
- Inflation Rates
- Interest Rates
- Government policies affecting the businesses such financial reforms introduced in the economy which have a bearing on the earning capacity of the businesses

India has emerged as the fastest growing major economy in the world as per the Central Statistics Organisation (CSO) and International Monetary Fund (IMF), backed by its strong democracy and partnerships. India's GDP is estimated to have increased 6.6 per cent in 2017-18 and is expected to grow 7.3 per cent in 2018-19.India's gross domestic product (GDP) is expected to reach US$ 6 trillion by FY27 and achieve upper-middle income status on the back of digitisation, globalisation, favourable demographics, and reforms.

India is expected to be the third largest consumer economy as its consumption may triple to US$ 4 trillion by 2025, owing to shift in consumer behaviour and expenditure pattern, according to a Boston Consulting Group (BCG) report; and is estimated to surpass USA to become the second largest economy in terms of purchasing power parity (PPP) by the year 2040, according to a report by PricewaterhouseCoopers.

INDUSTRY ANALYSIS

The industry analysis moves from macroeconomic analysis to micro economic analysis. The process normally includes conducting thorough study of its three sub-heads, namely structural framework, industry lifecycle and competitive environment.

Fast moving consumer goods (FMCG) is the 4th largest sector in the Indian economy. There are three main segments in the sector – food and beverages which accounts for 19 per cent of the sector, healthcare which accounts for 31 per cent and household and personal care which accounts for the remaining 50 per cent.

The FMCG sector has grown from US$ 31.6 billion in 2011 to US$ 49 billion in 2016. The sector is further expected to grow at a Compound Annual Growth Rate (CAGR) of 20.6 per cent to reach US$ 103.7 billion by 2020. FMCG revenue grew 14.8 per cent during October-December 2017. FMCG sector is expected to register net revenue growth of 11.8 per cent in Q4 March 2018

A SWOT analysis of the FMCG industry is shown below:

Strengths	Weaknesses
1. Low operational costs 2. Presence of established distribution networks in both urban and rural areas 3. Presence of well-known brands in FMCG sector 4. Deep roots in local culture & great understanding of consumer needs	1. Lower scope of investing in technology and achieving economies of scale, especially in small sectors 2. Low exports levels 3. Counterfeit Products. These products narrow the scope of FMCG products in rural and semi-urban market.
Opportunities	**Threats**
1. Untapped rural market 2. Rising income levels, i.e. increase in purchasing power of consumers 3. Large domestic market- a population of over one billion. 4. Export potential 5. High consumer goods spending	1. Removal of import restrictions resulting in replacing of domestic brands 2. Slowdown in rural demand 3.Tax and regulatory structure

Fig 3: SWOT Analysis of FMCG industry in India: Source Confederation of Indian Industry (CII)

The government has allowed 100 per cent Foreign Direct Investment (FDI) in food processing and single-brand retail and 51 per cent in multi-brand retail. This would bolster employment and supply chains, and also provide high visibility for FMCG brands in organised retail markets, bolstering consumer spending and encouraging more product launches. The sector witnessed healthy FDI inflows of US$ 13.07 billion, during April 2000 to December 2017.

Government initiatives

Some of the major initiatives taken by the government to promote the FMCG sector in India are as follows:

- In the Union Budget 2017-18, the Government of India has proposed to spend more on the rural side with an aim to double the farmer's income in five years; as well as the cut in income tax rate targeting mainly the small tax payers, focus on affordable housing and infrastructure development will provide multiple growth drivers for the consumer market industry.
- The Government of India's decision to allow 100 per cent Foreign Direct Investment (FDI) in online retail of goods and services through the automatic route has provided clarity on the existing businesses of e-commerce companies operating in India.
- With the demand for skilled labour growing among Indian industries, the government plans to train 500 million people by 2022 and is also encouraging private players and entrepreneurs to invest in the venture. Many governments, corporate and educational organisations are working towards providing training and education to create a skilled workforce.
- The Government of India has drafted a new Consumer Protection Bill with special emphasis on setting up an extensive mechanism to ensure simple, speedy, accessible, affordable and timely delivery of justice to consumers.
- The Goods and Services Tax (GST) is beneficial for the FMCG industry as many of the FMCG products such as Soap, Toothpaste and Hair oil now come under 18 per cent tax bracket against the previous 23-24 per cent rate.

COMPANY ANALYSIS

Company analysis attempts to study the various factors affecting and indicating the performance of a company, such as, competitive position of the company, quality of management, technology, product analysis, brand image and market share, marketing strategy, etc. The major part of company Analysis is done through studying the relationship between the items of balance sheet, profit and loss account and other financial statements. The most powerful tools of financial analysis is ratio analysis. This study used the different ratios and a equity valuation model based on earning Price method.
The following Table depicts various ratios calculated to assess the liquidity, profitability, efficiency, and solvency of the firm.

Liquidity Ratios: These ratios show the firm's ability to meet the commitments as and when they fall due. The aim to check whether the company's current assets can be converted into cash in order to pay off its short term liabilities.Current Ratios and quick ratios five year of the company had been worked out for the study period to analyse the liquidity position of the company. Quick ratio is a ratio of quick assets to current liabilities wherein quick assets is derived after excuding inventory from the current assets.

Table1: **Liquidity Ratios of Nestle Ltd from year ending 2013 to 2017**

Liquidity Ratios						
Current Ratio	Current Assets/Current Liabilities	0.65	0.54	0.50	0.57	0.91
Quick Ratio	CA-Inventories/CL	0.61	0.32	0.25	0.25	0.39

A current ratio less than are acceptable and normal for FMCG companies who can negotiate longer period of credit from the suppliers while giving less period of credit to the consumers. Since the nature of the goods is fast moving, the inventory requirements are also at the minimum. The current ratio of Nestle is just above fifty percent in the period of study excluding year 2017 , the year in which the ratio increased to 0.91, i.e., almost 1%. The quick ratio is is 0.61% in year 2013 but thereafter it falls to 0.32 and remains 0.25% in year 2015 and 2016. It moved upward to 0.39 in year 2017. The rate is quite low and hence the company must look at this area with a little concern.

Activity Ratios or Efficiency Ratios: Activity ratios are used to measure how efficiently a company utilizes its assets. The ratios provide investors with an idea of the overall operational performance of a firm.The activity ratios are, ion essence, 'turnover' ratios which measure the rate at which the company is turning over its assets or liabilities. Various turnovers of the assets of Nestle Ltd. are given in the table below:

Table 2:**Activity Ratios of Nestle Ltd from year ending 2013 to 2017**

Asset Management Ratios						
Inventory Turnover	Annual cost of goods /Avg. Inventory	10.03	10.22	8.09	8.51	8.75
Debtors Turnover	Annual Sales/Avg. Debtors	108.00	95.17	94.19	96.02	108.22
Fixed assets turnover	Annual Sales/Avg. IF A	2.70	3.01	2.69	3.28	3.74
Total assets turnover	Annual Sales/Avg. T A	2.84	3.07	2.87	3.14	2.67

The inventory turnover ratios show a declining trend which may indicate a slow down in the pace of movement of the products. Debtors turnover ratio is very high which indicates that the level of debtors is very less and the company is able to realize the sale proceeds quickly in cash..The fixed assets turnover has moved from 2.7 in the year 2013 to 3.74 in year 2017, which shows the efficiency of utilization of fixed assets has increased, which is a good sign. The same applies to the total assets turnover

Table 3:Debt Management Ratios (Solvency Ratios)of Nestle Ltd from year ending 2013 to 2017

Debt Management Ratios						
Debt ratio	Total Debt/Total Assets	0.33	0.01	0.01	0.01	0.23
Debt/Equity Ratio	Total Debt/Net Worth	0.5	0.01	0.01	0.01	0.29
Interest coverage	EBIT/Interest charges	30.07	125.20	438.86	490.39	21.01

The debt ratio which indicates the gearing of the company is very low and almost negligible in the case of Nestle Ltd.. This indicates the absence of financial risk for the company as it is almost all equity firm.The Debt to Equity ratio is also much lower

in comparison to the maximum permissible ratio of 2:1. This is reflected in the interest coverage ratio which indicates that the earnings are far more than sufficient to cover interest charges.

Profitability Ratios: The profitability ratios express the profit in relation to revenue ,m assets or equity.Various ratios like gross profit margin, net profit margin, gross and net return on assets, return on net worth, dividend payout ratio and growth rate of the company are profitability ratios which indicate the performance of the firm.Table 4 depicts the profitability ratios for the company for the study period.

Table 4: Profitability Ratios of Nestle Ltd from year ending 2013 to 2017

Profitability Ratios						
Operating Margin	Operating Profit/Total Op. Revenue	21.39	20.61	19.01	18.55	20.94
Net profit margin =	Net income/Total op. revenue	12.2	12.02	6.88	10.04	12.24
Gross profit margin	EBIT/Total operating revenue	17.77	17.19	14.77	14.72	17.52
Net return on assets	Net Income/Total average assets	0.63	0.37	0.20	0.32	0.33
Gross return on assets	EBIT/Total average assets	0.48	0.56	0.51	0.59	0.52
Return on Net Worth	Net income to stokholders/Net Worth	47.16	41.75	19.98	30.74	35.81
Dividend payout ratio	Total cash dividends/Net income	41.85	51.27	83.01	65.55	67.67
Dividend payout ratio	Total cash dividends/Cash Profit (%)	32.31	39.9	51.35	47.44	52.9
Growth rate	RONW*Retention ratio (%)	27.42	20.34	3.39	10.59	11.58

The operating margin and net profit margins show a constant trend except in the year 2015 in which the company's profits took a hit due to Maggi issue.The gross profit margin reduced from around 18% in the year 2013 to 14.77% in year 2015 and 2016 before showing a recovery in hte year 2017. the return on net worth has reduced from 47% in the year 2013 to 19.98% in 2015 but it is showing a recovery from year 2016 when it has risen to 30% and further to 35.81% in the year 2017.The company has increased its dividend payout rate and in fact the dividend payout has been increased from 27.42 % in year 2013 to 51.35 % in year 2015, the year of Maggi issue. Though this marginally reduced next year, the payout again increased to 52.9% in the year 2017.

Valuation: The value of the company can be expressed in terms of the ratio of its market value to book value. Valuation is also done through earnings-price model

Table 5: Valuation of the company

Market Value:						
MV/BV Ratio	Market value/Book Value	1.55	2.12	2.07	2.12	3.32
P/E Raio		67.93	49.06	99.76	66.44	41.62

CONCLUSION

The economy analysis predicts robust growth in the Indian economy. The rural consumption is expected to boom As a result it is expected that there will be huge push in consumption which is expected to benefit the FMCG sector. The government policies such as FDI policy, skill development initiatives, introduction of GST and consumer protection measures are favorable to the industry and the industry is expected to grow at a Compound Annual Growth Rate (CAGR) of 20.6 per cent to reach US$ 103.7 billion by 2020.All this indicate a favourable scenario for the FMCG companies operating in India

The company analysis bring out the strengths and weaknesses of the company. The profitability has taken a beating in the year 2015 but the company has withered the Maggi issue and has come out stronger which reflects in the improvement in the profitability of the company and in the expected growth rate. The liquidity and asset management ratios are also showing a strengthening trend.

The company's financial position is strong and it is an almost all equity firm and hence there is absolutely no leverage related financial risk . The company has a good record of dividend pay out and it has the capacity to pay out more dividend even during the troubled period. However, the price earnings ratio is quite high which indicates that the market has high future expectations from the company

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