

**NESTLE LANKA PLC [NEST.N0000]****MAINTAIN BUY****CONSUMPTION EXPANDS POST NEW NORMAL****Fair Value: 2021E – LKR 1,500 [+29%]**

Total Return with DPS: 2021E - 33% [AER 31%]

NEST's earnings for 3Q2020 up by 13%YoY to record at LKR 1.0Bn on the back of strong topline growth. Topline grew by 10%YoY to LKR 10.5Bn, the growth in revenue is supported by the rise in volumes as consumers adapt to the new normal. Amidst the faster than anticipated recovery in consumer demand we upgrade our earnings to pre Covid-19 levels. Hence, we are reinstating our earnings upwards to the same levels we forecasted for 2020E in the report published on 15th Nov 2019. We upgrade our profitability targets for 2020E and 2021E to LKR 3.1Bn and LKR 3.3Bn, respectively. Thereby, we upgrade our fair value for 2021E to LKR 1,500 from previous FV of LKR 1,200. **MAINTAIN BUY**

LKR (Mn)	3Q2019	3Q2020	YoY	9M2019	9M2020	YoY
Earnings (LKR 'Mn)						
Revenue	9,546	10,497	+10%	26,867	27,927	+4%
Gross Profit	3,360	3,512	+4%	8,819	9,056	+3%
EBIT	1,340	1,481	+11%	3,046	3,477	+14%
PBT	1,257	1,406	+12%	2,793	3,287	+18%
Net Profit	900	1,017	+13%	1,849	2,256	+22%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	5,510	5,307	-4%	5,510	5,307	-4%
Borrowings	2,972	2,514	-15%	2,972	2,514	-15%
NAVPS	102.6	98.8		102.6	98.8	

Bottom line up by 13%YoY

NEST's earnings for 3Q2020 up by 13%YoY to record at LKR 1.0Bn, primarily driven by the growth in top line by 10%YoY to LKR 10.5Bn as consumer demand improves along with the recovery in export sales. With stronger than expected quarterly performance, we upgrade our revenue targets to pre Covid-19 levels for 2020E and 2021E to LKR 38.2Bn (25% from previous target) and LKR 39.9Bn (14% from previous target) respectively. Furthermore, in line with the expected growth in topline, we revised our earnings targets for 2020E and 2021E to LKR 3.1Bn and LKR 3.3Bn, respectively.

Margins steady amidst topline growth of 10%YoY

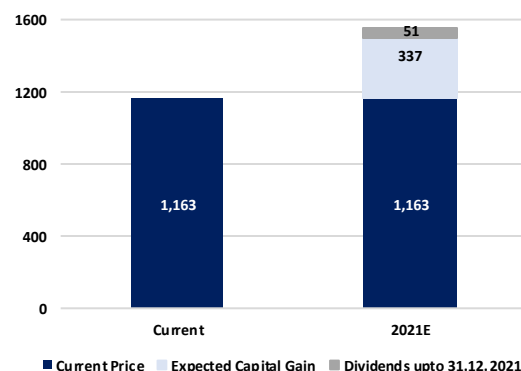
Despite the strong revenue growth, GP margin records at 33% for 3Q2020 compared to 35% for 3Q2019. GP margin records lower YoY, owing to the rise in cost of sales by 13%YoY due to the increase in raw material costs such as sugar and coconut. Sugar prices increased as a result of import restrictions while coconut had high exposure to supply and demand shocks during the quarter prior to the maximum retail price being imposed in Sep. We expect GP margin to register at 34% for both 2020E and 2021E with expectation of a gradual rise in consumer demand. Moreover, OPEX margin records at 14% same as 3Q2019, contributed by the operational efficiency measures undertaken.

Low interest rate environment favours bottom line

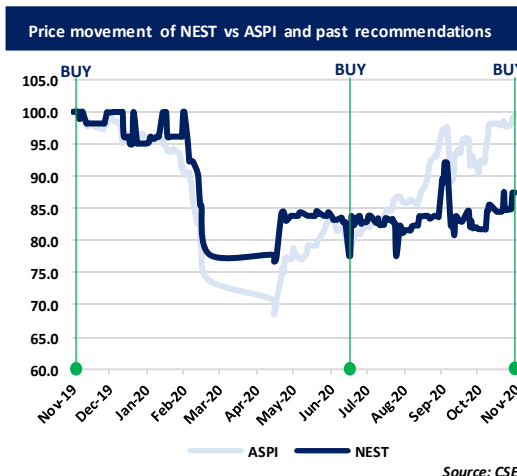
Finance expenditure decreased by 9%YoY to record at LKR 75Mn because of the low interest rate environment. The long-term loan amounting to LKR 1.9Bn was obtained from Nestle Treasury Centre - Middle East and Africa Ltd, which is free from any foreign currency exposure and is for a duration of three years with a renewal option. Notably, the low interest rate environment is expected to favour in the short to mid-term.

NEST MAINTAIN BUY for 2021E with a TP of 1,500

On the back of strong revival in consumer demand we upgrade our TP to LKR 1,500 for 2021E with a total return of 33% and annualised return of 31%. **MAINTAIN BUY**

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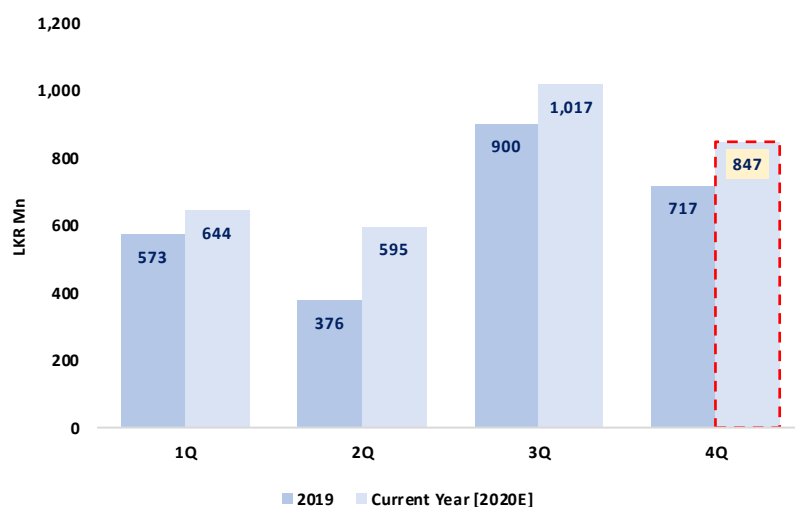
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Buy Below 2021E - [AER of 13% with DPS]: LKR 1,363
NEST categorized as 'Grade B' counter

Disclosure on Shareholding:

First Capital Group does not hold shares in NEST and will not trade in this share for three trading days following the issue of this document.

Quarterly Earnings



Estimate Revision

In LKR Mn	2020E-O	2020E-R	% Change	2021E - O	2021E - R	% Change
Earnings Estimate						
Revenue	30,538	38,173	+25%	35,119	39,891	+14%
Gross Profit	10,502	13,128	+25%	12,078	13,719	+14%
EBIT	2,989	4,428	+48%	3,738	4,637	+24%
Profit before Tax	2,872	4,311	+50%	3,685	4,585	+24%
Net Profit	2,068	3,104	+50%	2,653	3,301	+24%
Adjusted EPS	38.5	57.8		49.4	61.4	
Growth YoY	-19%	21%		+28%	6%	
Balance Sheet Estimate						
Shareholders' Equity	4,891	5,927	+21%	5,828	6,652	+14%
Borrowings	1,488	1,488	-0%	1,588	1,588	-0%
Adjusted NAVPS	91.0	110.3		108.5	123.8	
Ratio Estimate						
ROE (%)	42%	52%		46%	50%	
PER (x)	28.2	20.1		22.0	18.9	
PBV (x)	11.9	10.5		10.0	9.4	

Valuation Table

P/E 31 December	2016	2017	2018	2019	2020E	2021E	2022E
Estimates (LKR 'Mn)							
Revenue	36,462	37,601	37,337	36,355	38,173	39,891	41,686
Operating Profit	5,723	4,888	5,147	4,089	4,428	4,637	4,858
Net Profit	4,399	3,636	3,486	2,566	3,104	3,301	3,453
EPS (LKR)	81.9	67.7	64.9	47.8	57.8	61.4	64.3
YoY % Growth	7%	-17%	-4%	-26%	21%	6%	5%
Valuations							
PER (x)	14.2x	17.2x	17.9x	24.3x	20.1x	18.9x	18.1x
PBV (x)	11.4x	13.0x	11.1x	11.3x	10.5x	9.4x	8.5x
DY (%)	5.5%	6.9%	4.3%	4.3%	1.5%	4.1%	4.4%

Valuation Summary

Expected NEST price for 2021E	
PER based target price	1,475
DCF Valuation based target price	1,512
Average Target Price	1,493
Target Price after Rounding off	1,500

Return	
Target Price	1,500
Current Price	1,163
Capital Gain (LKR)	337
Dividend upto 31.12.2021 (LKR)	51
Capital Gain %	29%
Dividend Yield %	4%
Total Return %	33%
Annualized Return %	31%

Discounted Cash flow Valuation

DCF based Valuation	
Enterprise Value	81,734
(-) Debt	(1,588)
(+) Cash	1,079
Total Value of Equity	81,225
No. of shares (Mn)	54
Target Price	1,512

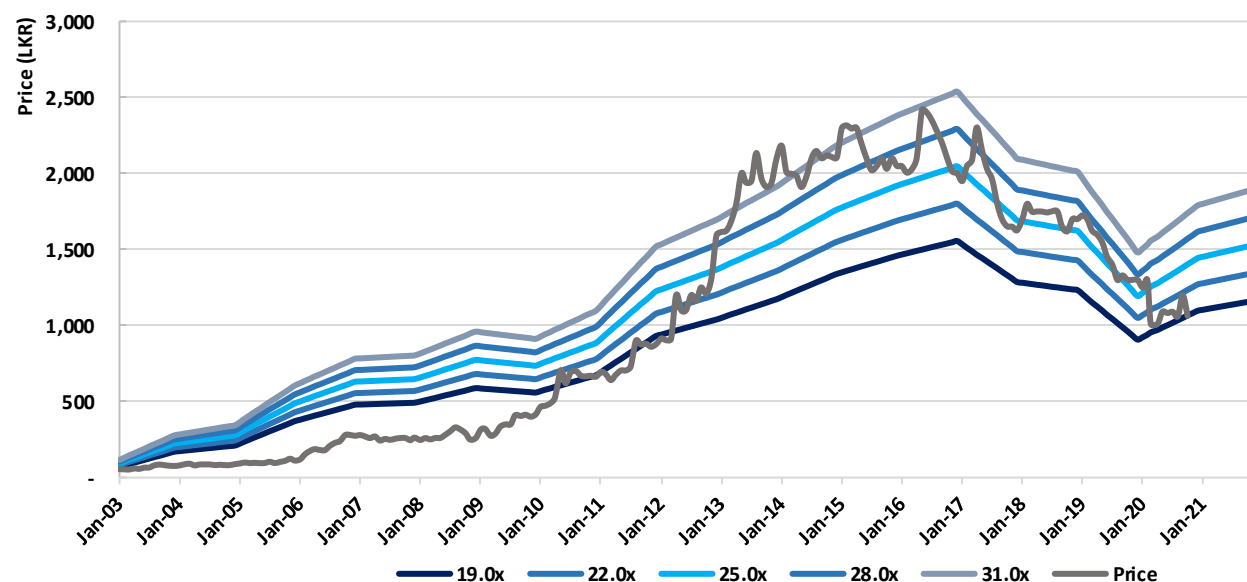
COE	
R_f	4.9%
R_m	16.9%
Growth %	3.0%
β	0.3
$K_e = R_f + \beta (R_m - R_f)$	9.0%

PER Valuation

PER based Valuation	
2021E Earnings (LKR 'Mn)	3,301
No. of Shares ('Mn)	54
2021E EPS	61.4
Expected PER	24x
Price at 24.0x 2021E Earnings	1,475

WACC	
K_e	9.0%
K_d	5.8%
D/E Assumption	40 / 60
Terminal Growth (%)	3%
WACC	7%

PER Chart



Appendix I: Statement of Income and Expenses

Income Statement (LKR Mn)	2016	2017	2018	2019	2020E	2021E	2022E
Y/E 31st December							
Revenue	36,462	37,601	37,337	36,355	38,173	39,891	41,686
Cost of Sales	-22,275	-24,525	-23,630	-23,852	-25,045	-26,172	-27,350
Gross Profit	14,187	13,076	13,707	12,503	13,128	13,719	14,336
Other Operating Income / (Expense)	-13	-45	-135	-149	-149	-149	-149
Marketing, Selling and Distribution Expenses	-6,263	-5,828	-6,056	-5,651	-5,934	-6,201	-6,480
Administrative Expenses	-2,188	-2,315	-2,369	-2,614	-2,617	-2,732	-2,849
Results from Operating Activities	5,723	4,888	5,147	4,089	4,428	4,637	4,858
Finance Income	33	30	46	37	106	106	106
Finance Expenses	-44	-183	-252	-356	-223	-159	-169
Net Finance Expense	-11	-153	-206	-319	-117	-52	-62
Profit Before Taxation	5,712	4,735	4,941	3,770	4,311	4,585	4,796
Income Tax Expense	-1,313	-1,099	-1,456	-1,204	-1,207	-1,284	-1,343
Profit for the Year	4,399	3,636	3,486	2,566	3,104	3,301	3,453
EPS	81.9	67.7	64.9	47.8	57.8	61.4	64.3

Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2016	2017	2018	2019	2020E	2021E	2022E
As at 31st December							
ASSETS							
Non-Current Assets							
Property, Plant and Equipment	5,525	5,366	9,210	9,012	8,946	8,916	8,895
Capital Work-in-Progress	456	2,486	673	377	327	177	27
	5,980	8,170	10,237	9,756	9,639	9,459	9,288
Current Assets							
Inventories	3,935	2,870	2,988	3,486	3,660	3,825	3,997
Trade and Other Receivables	2,730	3,647	3,362	2,687	2,821	2,948	3,081
Amounts Due from Related Parties	248	761	854	434	434	434	434
Cash and Cash Equivalents	393	129	218	508	1,131	1,079	1,165
	7,306	7,406	7,422	7,115	8,047	8,287	8,677
Total Assets	13,287	15,577	17,659	16,871	17,686	17,746	17,966
EQUITY AND LIABILITIES							
Equity							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	4,945	4,264	5,098	4,972	5,390	6,115	6,828
	5,483	4,801	5,635	5,510	5,927	6,652	7,365
Non-Current Liabilities							
Retirement Benefit Obligations	465	454	391	369	369	369	369
Deferred Tax Liabilities	802	839	1,001	997	997	997	997
Non Current Financial Liabilities		12	2,008	1,984	1,984	1,984	1,984
	1,267	1,496	3,689	3,772	3,772	3,772	3,772
Current Liabilities							
Trade and Other Payables	4,368	4,770	4,635	4,951	4,759	3,926	3,282
Amounts Due to Related Parties	899	1,220	1,313	805	805	805	805
Income Tax Payable	806	529	681	653	744	811	862
Dividends Payable	151	168	182	193	193	193	193
Bank Overdrafts	313	2,592	1,524	988	1,488	1,588	1,688
Total Current Liabilities	6,537	9,280	8,335	7,589	7,988	7,322	6,829
Total Liabilities	7,804	10,776	12,024	11,361	11,760	11,094	10,601
Total Equity and Liabilities	13,287	15,577	17,659	16,871	17,687	17,746	17,966
NAVPS	102.0	89.4	104.9	102.6	110.3	123.8	137.1



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