



NESTLE LANKA PLC [NEST.N0000]

UPGRADE TO BUY

ECONOMIC STABILITY TO RECUPERATE CONSUMER DEMAND

Fair Value: 2019E – 1,200 [-8%], 2020E – LKR 1,505 [+16%]

Total Return with DPS: 2019E - -8% [AER -51%], 2020E - 19% [AER 17%]

NEST earnings for 3Q2019 dipped by 4%YoY to record at LKR 900Mn on the back of rise in cost of sales. Notably, for the first time in 2019, a quarter witnessed a revenue growth amounting to LKR 9.5Bn, up by 3%YoY. The growth in revenue is resulting from the pick-up in volumes with the gradual recovery in economic activities post Easter Sunday attacks. With tough market conditions coupled with weak consumer demand during 1H2019, we downgrade our earnings targets for 2019E to LKR 2.7Bn (-12% from previous target). On the expectation of rise in business activity post-election, we maintain our earnings target of LKR 3.3Bn for 2020E. We maintain our fair value for 2019E at LKR 1,200 and rollover valuation to 2020E with a target price of LKR 1,505. **UPGRADE TO BUY**

LKR (Mn)	3Q2018	3Q2019	YoY	9M2018	9M2019	YoY
Earnings (LKR 'Mn)						
Revenue	9,302	9,546	+3%	27,950	26,867	-4%
Gross Profit	3,563	3,521	-1%	10,247	9,224	-10%
EBIT	1,375	1,340	-3%	3,882	3,046	-22%
PBT	1,307	1,258	-4%	3,743	2,793	-25%
Net Profit	941	900	-4%	2,620	1,849	-29%
Balance Sheet (LKR 'Mn)						
Borrowings	9,518	12,281	+29%	9,518	12,281	+29%
Shareholder's Equity	4,716	4,798	+2%	4,716	4,798	+2%
NAVPS	87.8	89.3		87.8	89.3	

Bottom line dips by 4%YoY

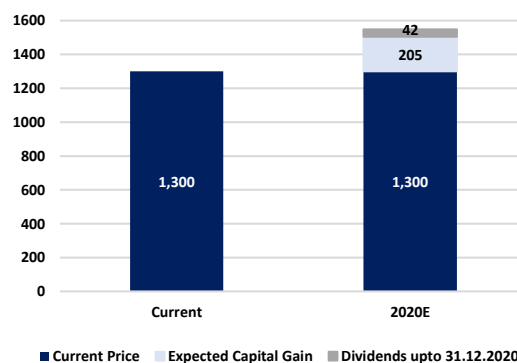
NEST's earnings for 3Q2019 dipped by 4%YoY to record at LKR 900Mn, primarily dragged down by the increase in cost of sales to record at LKR 6.0Bn (up by 8%YoY) stemming from the rise in wheat and sugar prices. During 1H2019, NEST performance weakened due to tepid consumer sentiment resulting from tough economic conditions coupled with the Easter Sunday attacks weighing heavy on the country's economy, thereby, we revise our earnings target for 2019E to LKR 2.7Bn (-12% from previous target). However, we maintain our earnings target for 2020E at LKR 3.2Bn on expectation of the rise in consumer demand. NEST's top line grew by 3%YoY to record at LKR 9.5Bn, recording a YoY growth for the first time in 2019. On the back of weak consumer demand during 1H2019, we revised our revenue targets downwards for 2019E and 2020E to LKR 35.3Bn (-4% from previous target) and LKR 37.8Bn (-1%YoY).

Margins strengthened amidst topline growth of 3%YoY

NEST's GP margins for 3Q2019 strengthened to 37% with a 3%YoY growth in topline (whilst 13%QoQ) on the back of a gradual recovery in economic conditions. The volume growth in 3Q2019 was primary driven by the gradual rise in consumer demand. We expect GP margin to register at 36% for both 2019E and 2020E with expectation of rise in consumer demand beyond Nov 2019.

New factory fortifies operational efficacies

NEST's OPEX margin recorded 14% in 3Q2019 compared to 15% recorded in 3Q2018. The fall in operating expenses by 28% to record at LKR 42.3Mn, is contributed by the operational efficacies achieved from the new factory



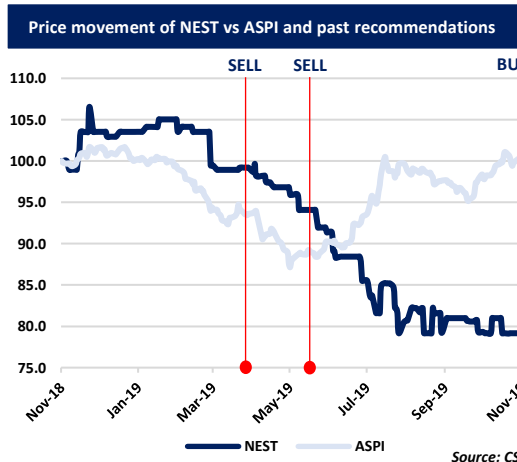
FIRST CAPITAL RESEARCH

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KEY DATA	
CSE Ticker	NEST.N0000
Bloomberg Ticker	NEST SL
Share Price (LKR)	1,300
52w High (LKR)	1,750
52w Low (LKR)	1,299
Avg. Daily Volume (Shares)	825
Avg. Daily Turnover (LKR)	1,130,052
Issued Share Capital (Shares 'Mn)	54
Market Cap (LKR 'Mn)	69,843
Market Cap (USD 'Mn)	388

*1 USD = LKR 180

Price Performance (%)	1 mth	3 mths	12mths
NEST	0%	-2%	-21%
ASPI	3%	2%	1%



Minimum Return for BUY:

Buy Below 2019E - [AER of 16% with DPS]: LKR 1,301.0

NEST categorized as 'Grade B' counter (Refer page 10 for Recommendation criteria of Grade A, B & C Stocks)

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.

(operational since Dec 2018). Marketing, selling and distribution expenses declined by 4%YoY to record LKR 1.5Bn as a result of pledging more focus on digital marketing outweighing the rise in administration expenses by 13%YoY to record LKR 668.3Mn. However, the slowdown in consumer demand affected adversely in production and new orders, limiting revenue growth to 3%YoY.

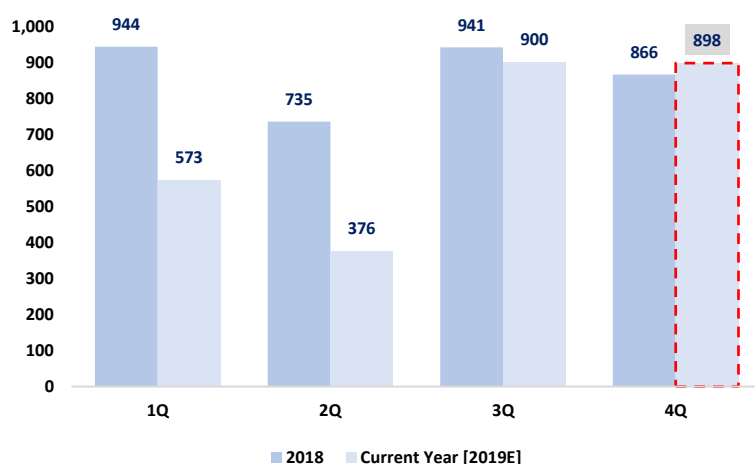
Rise in Finance Expenses YoY

Finance expenses increased by 16%YoY to record at LKR 95.1Mn as a result of the outstanding long tenure loan balance of LKR 2.0Bn. This long-term loan was obtained to partially fund the enhanced capacity for dairy and coconut milk powder which cost a total of LKR 5.0Bn (the balance is financed through short term borrowings). Notably, the long-term loan 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. The higher finance cost is expected to continue in 2020E as well.

NEST UPGRADE TO BUY for 2020E with a TP of 1,505

On the expectation of the rise in consumer demand we estimate a TP of LKR 1,505 for 2020E with a total return of 19% and annualized return of 17%. **MAINTAIN BUY**

Quarterly Earnings Forecast for 2019E



Estimate Revision

In LKR Mn	2019E-O	2019E-R	% Change	2020E - O	2020E - R	% Change
Earnings Estimate						
Revenue	36,590	35,283	-4%	38,054	38,106	+0%
Gross Profit	13,246	12,526	-5%	13,699	13,528	-1%
EBIT	4,430	3,928	-11%	4,559	4,607	+1%
Profit before Tax	4,317	3,815	-12%	4,511	4,529	+0%
Net Profit	3,108	2,747	-12%	3,248	3,261	+0%
EPS	57.9	51.1		60.5	60.7	
Growth YoY	-11%	-21%		5%	19%	
Balance Sheet Estimate						
Shareholders' Equity	6,057	5,696	-6%	6,725	6,677	-1%
Borrowings	1,024	1,024	0%	624	824	+32%
NAVPS	112.7	106.0		125.2	124.3	
Ratio Estimate						
ROE (%)	51%	48%		48%	49%	
PER (x)	26.1	25.4		25.0	21.4	
PBV (x)	13.4	12.3		12.1	10.5	

Valuation Table

P/E 31 December	2015	2016	2017	2018	2019E	2020E	2021E
Estimates (LKR 'Mn)							
Revenue	34,703	36,462	37,601	37,337	35,283	38,106	39,630
Net Profit	4,124	4,399	3,636	3,486	2,747	3,261	3,700
EPS (LKR)	76.8	81.9	67.7	64.9	51.1	60.7	68.9
YoY % Growth	9%	7%	-17%	-4%	-21%	19%	13%
Valuations							
PER (x)	16.9	15.9	19.2	20.0	25.4	21.4	18.9
PBV (x)	15.4	12.7	14.5	12.4	12.3	10.5	9.1
DY (%)	5.0%	6.2%	3.8%	3.8%	3.3%	3.9%	4.4%

Valuation Summary

Expected NEST price for 2020E	
PER based valuation target price	1,457
DCF Valuation based target price	1,552
Average Target Price	1,504
Target price after Rounding off	1,505

Return	
Target Price	1,505
Current Price	1,300
Capital Gain (LKR)	205
Dividend upto 31.12.2020 (LKR)	42
Capital Gain %	16%
Dividend Yield %	3%
Total Return %	19%
Annualized Return %	17%

Discounted Cash flow Valuation

DCF based Valuation	
Enterprise Value	84,688
(-) Debt	(1,524)
(+) Cash	218
Total Value of Equity	83,382
No. of shares (Mn)	54
Target Price	1,552

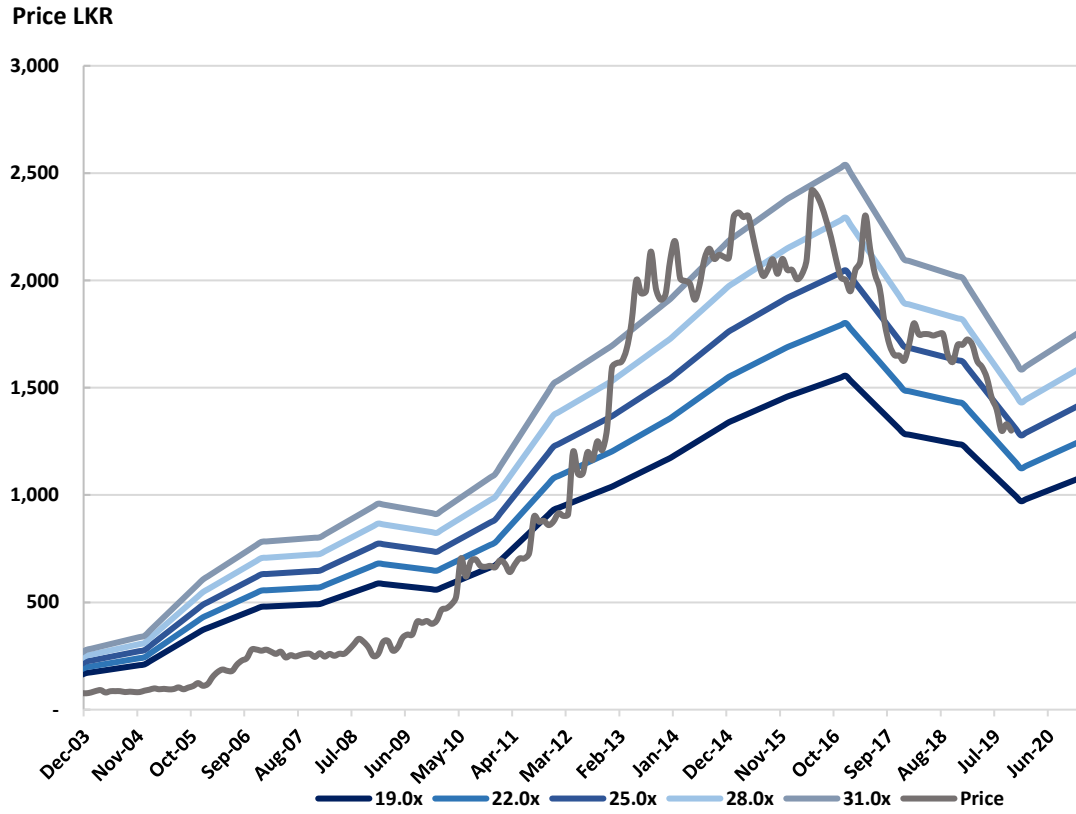
WACC	
Ke	13%
Kd	10%
D/E Assumption	40/60
Terminal Growth (%)	3.0%
WACC	11%

COE	
R _f	8.4%
R _m	16.4%
Growth %	3.0%
β	0.58
K_e = R_f + β (R_m - R_f)	13%

PER Valuation

PER based Valuation	
2020E Earnings (LKR 'Mn)	3,261
No. of Shares ('Mn)	54
2020E EPS	60.7
Expected PER	24x
Price at 24x 2020E Earnings	1,457

PER Chart



Source : CSE, Company Annual Reports, First Capital Research Estimates

Appendix I: Statement of Income and Expenses

Income Statement (LKR Mn)	2015	2016	2017	2018	2019E	2020E	2021E
Y/E 31st December							
Revenue	34,703	36,462	37,601	37,337	35,283	38,106	39,630
Cost of Sales	-21,381	-22,275	-24,525	-23,487	-22,758	-24,578	-24,967
Gross Profit	13,322	14,187	13,076	13,850	12,526	13,528	14,663
Other Operating Income / (Expense)	-13	-13	-45	-135	-135	-135	-135
Marketing, Selling and Distribution Expenses	-5,766	-6,263	-5,828	-6,086	-5,892	-6,097	-6,579
Administrative Expenses	-2,125	-2,188	-2,315	-2,483	-2,571	-2,689	-2,805
Results from Operating Activities	5,418	5,723	4,888	5,147	3,928	4,607	5,145
Finance Income	38	33	30	46	46	46	46
Finance Expenses	-31	-44	-183	-252	-159	-124	-52
Net Finance Expense	8	-11	-153	-206	-113	-78	-7
Profit Before Taxation	5,426	5,712	4,735	4,941	3,815	4,529	5,138
Income Tax Expense	-1,301	-1,313	-1,099	-1,456	-1,068	-1,268	-1,439
Profit for the Year	4,124	4,399	3,636	3,486	2,747	3,261	3,700
EPS	76.8	81.9	67.7	64.9	51.1	60.7	68.9

Source: Company annual reports, First Capital Research Estimates

Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2015	2016	2017	2018	2019E	2020E	2021E
As at 31st December							
Non-Current Assets							
Property, Plant and Equipment	5,477	5,525	5,366	9,210	9,264	9,295	9,235
Capital Work-in-Progress	144	456	2,486	673	873	823	673
	5,621	5,980	8,170	10,237	10,491	10,472	10,262
Current Assets							
Inventories	3,322	3,935	2,870	2,988	2,470	2,858	2,972
Trade and Other Receivables	2,107	2,730	3,647	3,362	2,435	2,477	2,576
Amounts Due from Related Parties	204	248	761	854	854	854	854
Cash and Cash Equivalents	868	393	129	218	791	1,284	1,099
	6,501	7,306	7,406	7,422	6,549	7,473	7,501
Total Assets	12,122	13,287	15,577	17,659	17,041	17,945	17,763
EQUITY AND LIABILITIES							
Equity							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	3,984	4,945	4,264	5,098	5,158	6,140	7,133
Total Equity	4,522	5,483	4,801	5,635	5,696	6,677	7,670
Non-Current Liabilities							
Retirement Benefit Obligations	522	465	454	391	391	391	391
Deferred Tax Liabilities	699	802	839	1,001	1,001	1,001	1,001
	1,222	1,267	1,496	3,689	3,689	3,689	3,689
Current Liabilities							
Trade and Other Payables	4,137	4,368	4,770	4,635	4,438	4,473	3,495
Amounts Due to Related Parties	714	899	1,220	1,313	1,313	1,313	1,313
Income Tax Payable	942	806	529	681	700	787	890
Dividends Payable	137	151	168	182	182	182	182
Bank Overdrafts	448	313	2,592	1,524	1,024	824	524
	6,379	6,537	9,280	8,335	7,656	7,579	6,405
Total Liabilities	7,600	7,804	10,776	12,024	11,345	11,268	10,093
Total Equity and Liabilities	12,122	13,287	15,577	17,659	17,041	17,945	17,763
NAVPS	84.2	102.0	89.4	104.9	106.0	124.3	142.8

Source: Company annual reports, First Capital Research Estimates

Appendix III: Statement of Cash flow

Cash flow Statement (LKR Mn) Y/E 31st December	2015	2016	2017	2018	2019E	2020E	2021E
Profit Before Tax	5,426	5,712	4,735	4,941	3,815	4,529	5,138
Adjustments for;							
(Gain) / Loss on Sale of Property, Plant and Equipment	-31	-15	8	-13	0	0	0
Amortisation of Staff Loan Interest	18	17	27	30	0	0	0
Interest Expense	31	44	183	252	159	124	52
Interest Income	-29	-27	-29	-31	-46	-46	-46
Provision for Obsolete Inventories and	120	153	193	270	0	0	0
Provision for Impairment of Trade Receivables	8	12	13	16	0	0	0
	6,243	6,627	5,957	6,323	4,701	5,426	6,005
Changes in Working Capital							
Inventories	-462	-764	873	-388	518	-388	-114
Receivables	-197	-678	-1,250	314	927	-42	-99
Payables	310	414	402	-181	-197	36	-978
Cash Generated From Operations	5,894	5,598	5,789	6,043	5,949	5,031	4,814
Interest Paid	-31	-44	-185	-226	-159	-124	-52
Income Tax Paid	-1,000	-1,357	-1,146	-1,057	-1,050	-1,181	-1,336
Retirement Benefit Obligations Paid	-115	-125	-121	-119	0	0	0
Net Cash Generated from Operating Activities	4,110	4,073	4,337	4,641	4,833	3,727	3,426
Purchase of Property, Plant and Equipment	-813	-1,008	-2,466	-2,609	-1,200	-800	-650
Proceeds from Sale of Property, Plant and Equipment	35	38	4	31	0	0	0
Interest Received	11	10	2	1	46	46	46
Net Cash Used in Investing Activities	-767	-960	-2,459	-2,611	-1,154	-754	-604
Dividends Paid	-3,001	-3,451	-4,281	-2,672	-2,686	-2,280	-2,707
Net Cash Used in Financing Activities	-3,001	-3,451	-4,366	-848	-2,686	-2,280	-2,707
Net Decrease in Cash and Cash Equivalents	342	-339	-2,488	1,182	992	693	115
Cash and Cash Equivalents at Beginning of Year	77	419	81	-2,408	-1,225	-233	459
Cash and Cash Equivalents at End of Year	419	81	-2,408	-1,225	-233	459	575

Source: Company annual reports, First Capital Research Estimates

Appendix IV: Top 20 Shareholders

Top 20 shareholders - (% held)	3Q2019	2Q2019	QoQ	3Q2018	YoY
Nestle S.A	90.8%	90.8%	-	90.8%	-
Citi Bank New York S/A Norges Bank Account 2	0.9%	0.9%	-	0.9%	-
RBC Investor Services Bank - Coeli Sicav I-Frontier Markets Fund	0.6%	0.6%	0.0%	0.6%	0.0%
Sri Lanka Insurance Corporation Ltd - Life Fund	0.5%	0.3%	0.2%	0.3%	0.2%
Deutsche Bank AG-London	0.5%	0.5%	-	0.5%	-
Miss Harnam Neesha Joint Mrs. Jasbinderjit Kaur Piara Singh	0.4%	0.4%	-	0.4%	-
SSBT - Deutsche Bank AG Singapore A/C 01	0.3%	0.3%	-	0.3%	-
SSBT - Al Mehwar Commercial Investments L.L.C	0.3%	0.3%	0.0%	0.2%	0.1%
SEB AB-Tundra Sustainable Frontier Fund	0.2%	0.4%	-0.2%	0.2%	0.0%
Employees Provident Fund	0.2%	0.2%	-	0.2%	-
BNYM RE - GHI Holdings Maruitius	0.1%	0.1%	-	0.1%	-
Union Assurance PLC / Account No.5 (Unit-Linked Life Insurance Fund - Et	0.1%	0.1%	-	0.1%	0.0%
SSBT - Frank Russel Trust Company Comingled Benefit Funds Trust GNA -	0.1%	0.1%	-	0.1%	-
Mrs. Jasbinderjit Kaur Piara Singh	0.1%	0.1%	-	0.1%	-
Colombo Investment Trust PLC	0.1%	0.1%	-	0.1%	-
Mr. Udeshi Morarji Meghji Joint Mrs. Asha Ajay Merchant	0.1%	0.1%	-	0.1%	-
Mr. Hirdaramani Anil Kumar Lalchand	0.1%	0.1%	-	0.1%	-
Mr. Maheswaran Radhakrishnan	0.1%	0.1%	-	0.0%	0.1%
Miss Radhakrishnan Meenambigai Priyadarshini	0.1%	0.0%	0.1%	0.0%	0.1%
Miss Radhakrishnan Andal	0.1%	0.1%	-	0.0%	0.1%

Appendix V: Recommendation criteria

Categorization	Company Category	Buy	Hold	Sell
Grade A	S&P SL20 Companies	T.Bill + 5% & Above	T.Bill + 1% & Above	Below T.Bill + 1%
Grade B	Rest of the Companies	T.Bill + 8% & Above	T.Bill + 3% & Above	Below T.Bill + 3%
Grade C	Companies less than LKR 1Bn Market Cap	T.Bill + 11% & Above	T.Bill + 6% & Above	Below T.Bill + 6%

Weighted Average 1-year T-bill rate during Oct 2019: 8.38%

Categorization	Company Category	Buy	Hold	Sell
Grade A	S&P SL20 Companies	13.38%	9.38%	9.38%
Grade B	Rest of the Companies	16.38%	11.38%	11.38%
Grade C	Companies less than LKR 1Bn Market Cap	19.38%	14.38%	14.38%



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Anushi Ranawaka	+94 77 3876 819		

CORPORATE DEBT SALES

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EQUITY SALES

CEO	Jaliya Wijeratne	+94 70 2910 042	Negombo	
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Colombo			Priyantha Wijesiri	+94 70 2910 036
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Isuru Jayawardana		+94 70 2910 034		
Ifadh Marikar		+94 77 9625 679		
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Anushka Buddhika		+94 70 2910 030		

UNIT TRUST SALES

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BRANCHES

Kandy	Kurunegala	Matara	Negombo
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