



NESTLE LANKA PLC [NEST.N0000]

MAINTAIN BUY

“EARNINGS POTENTIAL TRIMMED BY THE CRISIS”

Fair Value: 2022E - LKR 1,160.0 [+16%]

Total Return with DPS: 2022E - 24% [AER 43%]

2023E - LKR 1,320.0 [+32%]

2023E - 49% [AER 28%]

NEST's earnings reported a decline of 52.6%YoY to LKR 0.8Bn for 1Q2022 as a result of the massive increase in other operating expenses, mainly comprising of forex losses, which were fueled by the massive plunge in LKR against USD upon the free float of exchange rate since 7th Mar 2022. This move has further impacted the debt servicing on NEST's dollar denominated foreign borrowings and is exhibited by the notable increase net finance expenses. Revenue growth of 31.4%YoY for the quarter was largely a result of the upward revision in product prices amidst the persistent cost pressures. Considering the current economic impact on the profitability drivers, we broadly maintain our earnings target at LKR 4.9Bn for 2022E and LKR 5.7Bn for 2023E despite the increase in revenue targets. Considering the current foreseen macroeconomic uncertainties, we have assigned a higher risk-free rate in our valuations, thus lowering the target prices to LKR 1,160.0 for 2022E (from previous TP of 1,300.0) and LKR 1,320.0 for 2023E. **MAINTAIN BUY**

LKR (Mn)	1Q2021	1Q2022	YoY	2020	2021	YoY
Earnings (LKR 'Mn)						
Revenue	11,455	15,052	+31%	37,866	45,420	+20%
Gross Profit	4,079	5,352	+31%	12,219	14,669	+20%
EBIT	1,721	1,432	-17%	4,497	6,263	+39%
PBT	1,817	921	-49%	4,264	6,147	+44%
Net Profit	1,742	825	-53%	2,947	5,329	+81%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	5,796	8,185	+41%	5,934	8,435	+42%
Borrowings	4,037	8,049	+99%	2,138	5,519	+158%
NAVPS	107.9	152.4		110.4	157.0	

Two-fold reduction in earnings amidst top line growth by 31.4%YoY

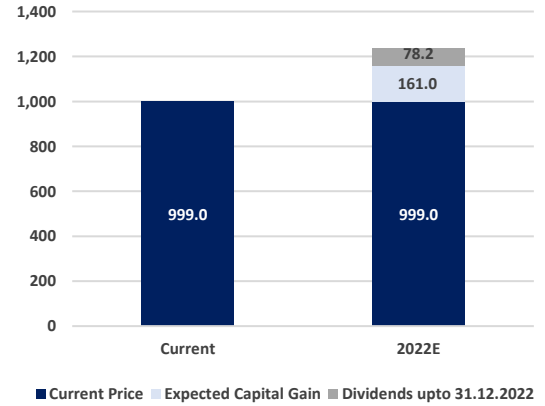
NEST's earnings for 1Q2022 contracted by 52.6% to LKR 825.1Mn as opposed to LKR 1,741.7Mn recorded in 1Q2021 despite recording a revenue growth of 31.4%YoY to LKR 15.1Bn. Revenue was largely boosted by the substantial upward revision in product prices owing to the unceasing commodity cost inflation amidst the subdued domestic demand. Accordingly, substantial price hikes were seen in NEST's key products such as Maggi Noodles, Coffee, Nestomalt and other dairy products to offset the margin pressures. Gross profit margin for the quarter was sustained at the same level of 36.0% compared to 1Q2021 as the Cost of Sales (COS) upheaved by the same magnitude of revenue to record at LKR 9.7Bn (+31.5%YoY). Increase in prices of key raw materials such as wheat and palm oil caused by the global supply scarcities together with the rise in import bills as a result of the steep depreciation of LKR stirred up the COS. However, NEST's export income which accounts for about 17.0% of the total revenue is expected to be blessed by the rupee devaluation. Considering the persistence cost pressure on product pricing, we have increased our revenue target to LKR 58.6Bn (+10.0% from the previous forecast) for 2022E and LKR 63.0Bn (+6.0% from the previous forecast) for 2023E while retaining our GP Margin forecast at c. 32.0%.

LKR depreciation disfavoured the servicing of foreign borrowings and exchange gains

NEST's net finance expense recorded a massive increase of 635.1%YoY to LKR 511.4Mn in contrast to a net finance income of LKR 95.6Mn in 1Q2021. Dollar denominated foreign borrowings that are tied to LIBOR comprise for most of the total borrowings of NEST and those are highly exposed to exchange rate fluctuations. Therefore, LKR plunging by c. 49.0% during 1Q2022 is appeared to have negatively reacted on the finance expenses. Additionally, upward revision in global policy rates may also have impacted on the finance expenses during 1Q2022. Moreover, other operating expenses, which carries a significant portion of forex gains, have also magnified by 990.7%YoY to LKR 1.6Bn due to the LKR depreciation while negatively impacting the bottom line.

TP is revised downward to LKR 1,160.0 for 2022E - MAINTAIN BUY

With the looming economic uncertainties which largely affects the corporate earnings and the massive upsurge in interest rates that resulted a rise in expected risk-free rate which in turn increases the expected rate of return on equity investments, thereby resulting an upward adjustment in the weighted average cost of capital (WACC), we have lowered NEST's fair value target to LKR 1,160.0 for 2022E and LKR 1,320.0 for 2023E with a total return of 24.0% and 52.0%, respectively. **MAINTAIN BUY**



FIRST CAPITAL RESEARCH

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Price movement of NEST vs ASPI (Indexed and Rebased to 100)



Price Movement in NEST's Key Products

Product	Aug-21	Nov-21	Feb-22	May-22
Maggi Coconut Milk Powder 300g	495.0	495.0	495.0	495.0
Milo Chocolate Food Drink 180ml	70.0	70.0	70.0	100.0
Nestomalt Packet 400g	370.0	370.0	430.0	580.0
Maggi Noodles Family Pack 335g	180.0	180.0	210.0	220.0
Nescafe Classic 100g	925.0	975.0	975.0	1,450.0

Source: Keells Supermarkets

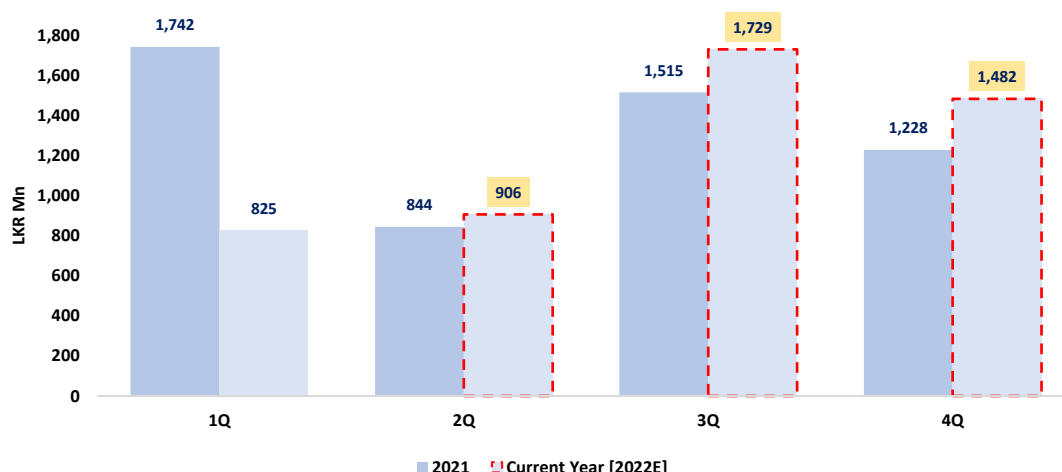
Minimum Return for BUY:

Buy Below 2022E - [AER of 23% with DPS]: LKR 1,092
NEST categorized as 'Grade B' counter

Disclosure on Shareholding:

First Capital Group or the covering analyst did not hold 1% or more of the total outstanding share capital of NEST during the five trading days prior to the issuance of this document.

Quarterly Earnings



Estimate Revision

In LKR Mn	2022E-O	2022E-R	% Change	2023E - O	2023E - R	% Change
Earnings Estimate						
Revenue	53,483	58,574	+10%	59,322	63,010	+6%
Gross Profit	17,115	18,744	+10%	18,983	20,163	+6%
EBIT	6,410	6,229	-3%	7,271	7,307	+0%
Profit before Tax	5,983	6,503	+9%	6,794	7,560	+11%
Net Profit	4,906	4,942	+1%	5,571	5,746	+3%
Adjusted EPS	91.3	92.0		103.7	106.9	
Growth YoY	-8%	-7%		14%	16%	
Balance Sheet Estimate						
Shareholders' Equity	9,053	9,090	+0%	10,454	10,635	+2%
Borrowings	6,689	7,747	+16%	7,918	9,306	+18%
Adjusted NAVPS	168.5	169.2		194.6	197.9	
Ratio Estimate						
ROE (%)	54%	54%		53%	54%	
PER (x)	10.7	10.9		9.5	9.3	
PBV (x)	5.8	5.9		5.0	5.0	

Valuation Table

P/E 31 December	2018	2019	2020	2021	2022E	2023E	2024E
Estimates (LKR 'Mn)							
Revenue	37,337	36,355	37,866	45,420	58,574	63,010	67,942
Operating Profit	5,147	4,089	4,497	6,263	6,229	7,307	8,653
Net Profit	3,486	2,566	2,947	5,329	4,942	5,746	6,724
EPS (LKR)	64.9	47.8	54.9	99.2	92.0	106.9	125.2
YoY % Growth	-4%	-26%	15%	81%	-7%	16%	17%
Valuations							
PER (x)	15.4x	20.9x	18.2x	10.1x	10.9x	9.3x	8.0x
PBV (x)	9.5x	9.7x	9.0x	6.4x	5.9x	5.0x	4.3x
DY (%)	5.0%	4.8%	5.5%	5.5%	7.8%	9.1%	11.3%
NAVPS	104.9	102.6	110.4	157.0	169.2	197.9	232.2
DPS (LKR)	50.0	47.5	55.0	55.0	78.2	90.9	112.6
Dividend Payout	77%	99%	100%	55%	85%	85%	90%



Valuation Summary

Expected NEST price	2022E	2023E
PER based target price	1,196	1,390
DCF Valuation based target price	1,130	1,251
Average Target Price	1,163	1,321
Target price after Rounding off	1,160	1,320

Return	2022E	2023E
Target Price	1,160	1,320
Current Price	999	999
Capital Gain (LKR)	161	321
Dividend upto 31 Dec (LKR)	78	169
Capital Gain %	16%	32%
Dividend Yield %	8%	17%
Total Return %	24%	49%
Annualized Return %	43%	28%

Discounted Cash flow Valuation

DCF based Valuation	2022E	2023E
Enterprise Value	58,925	63,992
(-) Debt	(7,747)	(9,306)
(+) Cash	9,555	12,529
Total Value of Equity	60,733	67,215
No. of shares	54	54
Target Price	1,130	1,251

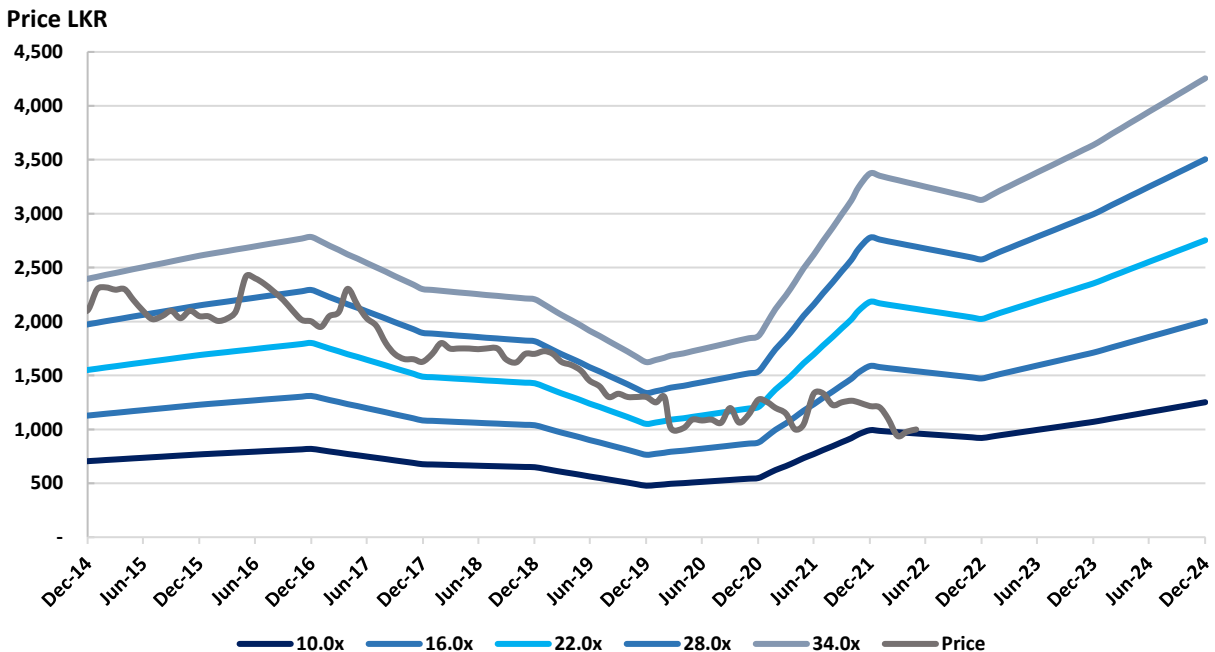
COE	2022E	2023E
R _f	15.0%	15.0%
R _m	23%	23%
Growth %	3%	3%
β	0.30	0.30
K _e = R _f + β (R _m - R _f)	17%	17%

PER Valuation

PER based Valuation	2022E	2023E
Earnings (LKR 'Mn)	4,942	5,746
No. of Shares ('Mn)	54	54
EPS	92.0	106.9
Expected Average PER	13x	13x
Price at 13.0x Earnings	1,196	1,390

WACC	2022E	2023E
Ke	17%	17%
Kd (Post Tax)	11%	11%
D/E Assumption	30 / 70	30 / 70
Terminal Growth (%)	3%	3%
WACC	16%	16%

PER Chart



Appendix I: Statement of Income and Expenses

Income Statement (LKR Mn)	2018	2019	2020	2021	2022E	2023E	2024E
Y/E 31st December							
Revenue	37,337	36,355	37,866	45,420	58,574	63,010	67,942
Cost of Sales	-23,630	-24,414	-25,647	-30,751	-39,830	-42,847	-45,521
Gross Profit	13,707	11,941	12,219	14,669	18,744	20,163	22,421
Other Operating Income / (Expense)	-135	-136	-57	-36	-1,020	-561	-589
Marketing, Selling and Distribution Expenses	-6,056	-5,224	-5,129	-5,816	-8,786	-9,452	-10,191
Administrative Expenses	-2,369	-2,493	-2,536	-2,554	-2,709	-2,844	-2,988
Results from Operating Activities	5,147	4,089	4,497	6,263	6,229	7,307	8,653
Net Finance Expense	-206	-319	-233	-117	274	253	195
Profit Before Taxation	4,941	3,770	4,264	6,147	6,503	7,560	8,847
Income Tax Expense	-1,456	-1,204	-1,317	-817	-1,561	-1,814	-2,123
Profit for the Year	3,486	2,566	2,947	5,329	4,942	5,746	6,724
EPS	64.9	47.8	54.9	99.2	92.0	106.9	125.2

Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2018	2019	2020	2021	2022E	2023E	2024E
As at 31st December							
ASSETS							
Non-Current Assets							
Property, Plant and Equipment	9,210	9,012	8,397	7,850	7,722	7,736	7,688
Capital Work-in-Progress	673	377	524	716	566	716	866
Total Non-Current Assets	10,237	9,756	9,270	8,888	8,610	8,774	8,875
Inventories	2,988	3,486	4,948	6,155	7,907	8,506	9,512
Trade and Other Receivables	3,362	2,687	2,046	2,188	4,100	4,411	4,756
Cash and Cash Equivalents	218	508	2,508	7,012	9,555	12,529	10,039
Total Current Assets	7,422	7,115	9,942	16,228	22,435	26,319	25,180
Total Assets	17,659	16,871	19,212	25,116	31,045	35,093	34,055
Equity							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	5,098	4,972	5,397	7,897	8,553	10,097	11,937
Total Equity	5,635	5,510	5,934	8,435	9,090	10,635	12,475
Liabilities							
Non-Current Financial Liabilities							
Total Non-Current Liabilities	3,689	3,772	2,084	7,361	9,588	5,729	7,367
Current Financial Liabilities							
Trade and Other Payables	4,635	4,951	6,225	6,418	7,966	8,569	9,104
Income Tax Payable	681	653	935	728	916	1,092	1,286
Current Financial Liabilities	1,524	988	2,054	101	101	5,519	101
Total Current Liabilities	8,335	7,589	11,194	9,320	12,367	18,730	14,214
Total Liabilities	12,024	11,361	13,278	16,681	21,955	24,459	21,581
Total Equity and Liabilities	17,659	16,871	19,212	25,116	31,045	35,093	34,055
NAVPS	104.9	102.6	110.4	157.0	169.2	197.9	232.2



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