



# NESTLE LANKA PLC [NEST.N0000]

## MAINTAIN BUY

### ROUGH WAVES; YET PADDLING UPSTREAM

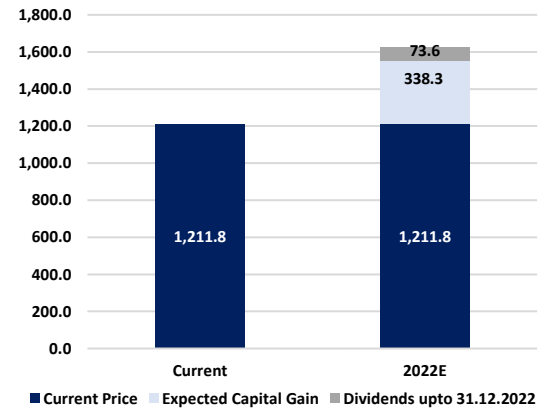
**Fair Value: 2021E - LKR 1,450 [+20%]**

Total Return with DPS: 2021E - 20% [AER 79%]

**2022E - LKR 1,550 [+28%]**

2022E - 34% [AER 25%]

NEST recorded a growth in earnings for 2Q2021 up by 41.9%YoY to score at LKR 844.3Mn compared to LKR 594.9Mn recorded in 2Q2020. The escalation in profit is mainly attributable to the surge in revenue by 22.4% to LKR 10.1Bn as opposed to LKR 8.3Bn in 2Q2020, aided by the increase in prices pertaining to some of its popular products due to the continuous pressure stemming from the increase in raw material prices amidst the stagnant growth in volumes. Accordingly, we have squeezed GP margins estimate to a range of 33%-34% (previously at 36%) for 2021E and 2022E. Thus, we are reinstating our earnings forecast while revising the profitability targets for 2021E and 2022E to LKR 4.1Bn and LKR 5.2Bn respectively. Thereby, we lower our fair value for 2021E to LKR 1,450 (previous TP – LKR 1,550) and 2022E to LKR 1,550 (previous TP – LKR 1,650). **MAINTAIN BUY**



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LKR (Mn)	2Q2020	2Q2021	YoY	6M2020	6M2021	YoY
<b>Earnings (LKR 'Mn)</b>						
Revenue	8,260	10,109	+22%	18,659	21,563	+16%
Gross Profit	2,581	3,043	+18%	5,545	7,122	+28%
EBIT	1,042	1,189	+14%	1,996	2,910	+46%
PBT	976	1,000	+2%	1,881	2,816	+50%
Net Profit	595	844	+42%	1,239	2,586	+109%
<b>Balance Sheet (LKR 'Mn)</b>						
Shareholder's Equity	5,227	5,574	+7%	5,227	5,574	+7%
Borrowings	2,924	3,491	+19%	2,924	3,491	+19%
NAVPS	97.3	103.8		97.3	103.8	

#### Earnings enhanced by 41.9%YoY

NEST has posted a growth of 41.9%YoY in earnings for 2Q2021 to record at LKR 844.3Mn, mainly driven by the growth in revenue by 22.4%YoY to LKR 10.1Bn aided by the shoot up in prices relating to some of its popular products in order to bear the relentless surge in raw material costs. Moreover, reimposition of island wide lockdowns is expected to disrupt the consumer buying patterns, and specifically the demand stemming from rural areas may momentarily shift to more essential food items in the midst of the malaise caused by the shortage in food supplies; hence the volume growth for 2021E is projected to be slightly lower than our previous forecast, yet expected to deliver a notable improvement vis-à-vis to 2020. Thereby, we revise our revenue targets for 2021E and 2022E to LKR 42.5Bn (-3% from previous target) and LKR 48.3Bn respectively. Considering both positive and negative effects on profitability, we have restated our earnings targets for 2021E and 2022E to LKR 4.1Bn and LKR 5.2Bn, respectively.

#### Narrowing GP margins amidst cost pressure

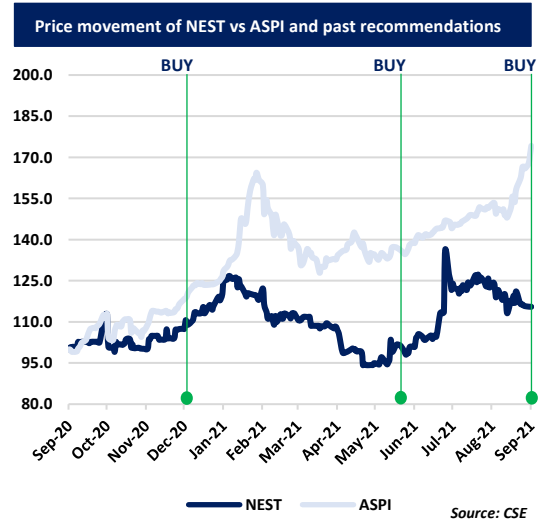
GP margins witnessed a contraction by 114bps to 30.1% during 2Q2021 against 31.2% recorded in 2Q2020 which can be considered as the worst quarter hit by the Covid-19 pandemic. Persistent rise in price of key raw materials such as wheat, sugar, coconut, etc. fueled by the supply shortages are mounting pressure on cost while hammering the margins. Therefore, we expect GP margin to step down and hover in the range of 33%-34% (previously at 36%) during 2021E and 2022E.

#### Export sales to be pampered by the dip in rupee

Despite the rise in import costs, the continuous stress on rupee is expected to boost NEST's export revenue. We have forecasted the rupee to reach c. LKR 218.0-224.0 against USD by the end of 2021E and is expected to float in the range of LKR 225.0-240.0 during 2022E.

#### FV is revised to LKR 1,450 for 2021E and to LKR 1,550 for 2022E - MAINTAIN BUY

With the upswing in raw material prices and narrowing GP margins we lowered NEST's fair value to LKR 1,450 for 2021E and to LKR 1,550 for 2022E with a total return of 20% and 34% respectively. **MAINTAIN BUY**



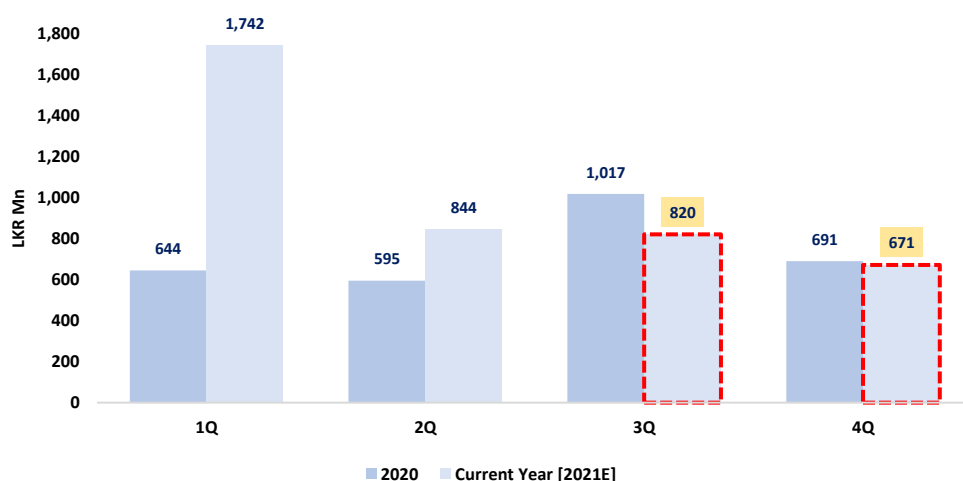
#### Minimum Return for BUY:

**Buy Below 2021E - [AER of 15% with DPS]: LKR 1,389**  
 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	2021E-O	2021E-R	% Change	2022E - O	2022E - R	% Change
<b>Earnings Estimate</b>						
Revenue	43,692	42,458	-3%	47,570	48,251	+1%
Gross Profit	15,729	14,011	-11%	16,887	16,405	-3%
EBIT	5,787	5,037	-13%	6,413	6,304	-2%
Profit before Tax	5,759	4,973	-14%	6,384	6,328	-1%
Net Profit	4,723	4,078	-14%	5,235	5,189	-1%
Adjusted EPS	87.9	75.9		97.4	96.6	
Growth YoY	60%	38%		11%	27%	
<b>Balance Sheet Estimate</b>						
Shareholders' Equity	7,701	7,057	-8%	8,450	8,290	-2%
Borrowings	741	1,404	+89%	746	732	-2%
<b>Adjusted NAVPS</b>	<b>143.3</b>	<b>131.3</b>		<b>157.3</b>	<b>154.3</b>	
<b>Ratio Estimate</b>						
<b>ROE (%)</b>	<b>61%</b>	<b>58%</b>		<b>62%</b>	<b>63%</b>	
<b>PER (x)</b>	<b>11.9</b>	<b>16.0</b>		<b>10.7</b>	<b>12.5</b>	
<b>PBV (x)</b>	<b>7.3</b>	<b>9.2</b>		<b>6.7</b>	<b>7.9</b>	

## Valuation Table

P/E 31 December	2017	2018	2019	2020	2021E	2022E	2023E
<b>Estimates (LKR 'Mn)</b>							
Revenue	37,601	37,337	36,355	37,866	42,458	48,251	51,233
Operating Profit	4,888	5,147	4,089	4,497	5,037	6,304	6,781
<b>Net Profit</b>	<b>3,636</b>	<b>3,486</b>	<b>2,566</b>	<b>2,947</b>	<b>4,078</b>	<b>5,189</b>	<b>5,589</b>
EPS (LKR)	67.7	64.9	47.8	54.9	75.9	96.6	104.0
YoY % Growth	-17%	-4%	-26%	15%	38%	27%	8%
<b>Valuations</b>							
PER (x)	17.9x	18.7x	25.4x	22.1x	16.0x	12.5x	11.6x
PBV (x)	13.6x	11.6x	11.8x	11.0x	9.2x	7.9x	7.3x
DY (%)	4.1%	4.1%	3.9%	4.5%	6.1%	7.6%	8.2%

## Valuation Summary

Expected NEST price	2021E	2022E
PER based target price	1,290	1,642
DCF Valuation based target price	1,580	1,433
Average Target Price	1,435	1,537
Target price after Rounding off	1,450	1,550

Return	2021E	2022E
Target Price	1,450	1,550
Current Price	1,212	1,212
Capital Gain (LKR)	238	338
Dividend upto 31 Dec (LKR)	0	74
Capital Gain %	20%	28%
Dividend Yield %	0%	6%
Total Return %	20%	34%
Annualized Return %	79%	25%

## Discounted Cash flow Valuation

DCF based Valuation	2021E	2022E
Enterprise Value	85,592	76,886
(-) Debt	(1,488)	(816)
(+) Cash	776	913
Total Value of Equity	84,880	76,983
No. of shares	54	54
Target Price	1,580	1,433

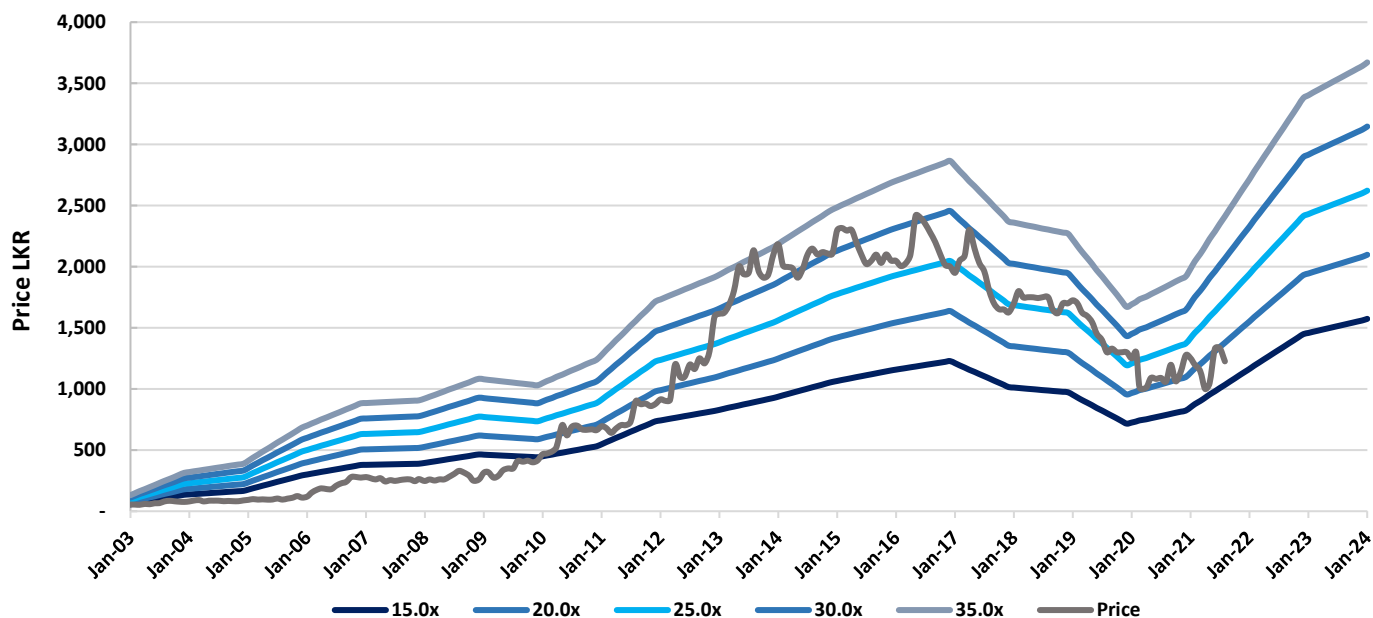
COE	2021E	2022E
$R_f$	7.0%	9.0%
$R_m$	15%	17%
Growth %	3%	3%
$\beta$	0.50	0.50
$K_e = R_f + \beta (R_m - R_f)$	11%	13%

## PER Valuation

PER based Valuation	2021E	2022E
Earnings (LKR 'Mn)	4,078	5,189
No. of Shares ('Mn)	54	54
EPS	75.9	96.6
Expected Average PER	17x	17x
Price at 17.0x Earnings	1,290	1,642

WACC	2021E	2022E
$K_e$	11%	13%
$K_d$	9%	9%
D/E Assumption	30 / 70	30 / 70
Terminal Growth (%)	3%	3%
WACC	10%	11%

## PER Chart



**Appendix I: Statement of Income and Expenses**

Income Statement (LKR Mn)	2017	2018	2019	2020	2021E	2022E	2023E
<b>Y/E 31st December</b>							
Revenue	37,601	37,337	36,355	37,866	42,458	48,251	51,233
Cost of Sales	-24,525	-23,630	-24,414	-25,647	-28,447	-31,846	-33,301
<b>Gross Profit</b>	<b>13,076</b>	<b>13,707</b>	<b>11,941</b>	<b>12,219</b>	<b>14,011</b>	<b>16,405</b>	<b>17,931</b>
Other Operating Income / (Expense)	-45	-135	-136	-57	-57	-57	-57
Marketing, Selling and Distribution Expenses	-5,828	-6,056	-5,224	-5,129	-6,241	-7,238	-8,146
Administrative Expenses	-2,315	-2,369	-2,493	-2,536	-2,676	-2,807	-2,948
<b>Results from Operating Activities</b>	<b>4,888</b>	<b>5,147</b>	<b>4,089</b>	<b>4,497</b>	<b>5,037</b>	<b>6,304</b>	<b>6,781</b>
Finance Income	30	46	37	39	129	105	117
Finance Expenses	-183	-252	-356	-272	-193	-82	-82
Net Finance Expense	-153	-206	-319	-233	-64	24	35
<b>Profit Before Taxation</b>	<b>4,735</b>	<b>4,941</b>	<b>3,770</b>	<b>4,264</b>	<b>4,973</b>	<b>6,328</b>	<b>6,816</b>
Income Tax Expense	-1,099	-1,456	-1,204	-1,317	-895	-1,139	-1,227
<b>Profit for the Year</b>	<b>3,636</b>	<b>3,486</b>	<b>2,566</b>	<b>2,947</b>	<b>4,078</b>	<b>5,189</b>	<b>5,589</b>
EPS	67.7	64.9	47.8	54.9	75.9	96.6	104.0

**Appendix II: Statement of Financial Position**

Balance Sheet (LKR Mn)	2017	2018	2019	2020	2021E	2022E	2023E
<b>As at 31st December</b>							
<b>ASSETS</b>							
<b>Non-Current Assets</b>							
Property, Plant and Equipment	5,366	9,210	9,012	8,397	8,284	7,926	7,917
	<b>8,170</b>	<b>10,237</b>	<b>9,756</b>	<b>9,270</b>	<b>9,307</b>	<b>8,799</b>	<b>8,940</b>
<b>Current Assets</b>							
Inventories	2,870	2,988	3,486	4,948	5,732	6,514	6,916
Trade and Other Receivables	3,647	3,362	2,687	2,046	2,547	3,378	3,842
Cash and Cash Equivalents	129	218	508	2,508	776	913	894
	<b>7,406</b>	<b>7,422</b>	<b>7,115</b>	<b>9,942</b>	<b>9,496</b>	<b>11,245</b>	<b>12,093</b>
<b>Total Assets</b>	<b>15,577</b>	<b>17,659</b>	<b>16,871</b>	<b>19,212</b>	<b>18,803</b>	<b>20,044</b>	<b>21,034</b>
<b>EQUITY AND LIABILITIES</b>							
<b>Equity</b>							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	4,264	5,098	4,972	5,397	6,519	7,753	8,412
	<b>4,801</b>	<b>5,635</b>	<b>5,510</b>	<b>5,934</b>	<b>7,057</b>	<b>8,290</b>	<b>8,950</b>
<b>Non-Current Liabilities</b>							
Non Current Financial Liabilities	12	2,008	1,984	84	84	84	84
	<b>1,496</b>	<b>3,689</b>	<b>3,772</b>	<b>2,084</b>	<b>2,084</b>	<b>2,084</b>	<b>2,084</b>
<b>Current Liabilities</b>							
Trade and Other Payables	4,770	4,635	4,951	6,225	5,547	6,210	6,494
Bank Overdrafts	2,592	1,524	988	2,054	1,404	732	737
<b>Total Current Liabilities</b>	<b>9,280</b>	<b>8,335</b>	<b>7,589</b>	<b>11,194</b>	<b>9,663</b>	<b>9,670</b>	<b>10,000</b>
<b>Total Liabilities</b>	<b>10,776</b>	<b>12,024</b>	<b>11,361</b>	<b>13,278</b>	<b>11,747</b>	<b>11,754</b>	<b>12,084</b>
<b>Total Equity and Liabilities</b>	<b>15,577</b>	<b>17,659</b>	<b>16,871</b>	<b>19,212</b>	<b>18,803</b>	<b>20,044</b>	<b>21,034</b>
NAVPS	89.4	104.9	102.6	110.4	131.3	154.3	166.6



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