



NESTLE LANKA PLC [NEST.N0000]

MAINTAIN BUY

“PROGRESSING AMIDST COSTLY HEADWINDS”

Fair Value: 2022E - LKR 1,300 [+32%]

Total Return with DPS: 2022E - 38% [AER 50%]

NEST's earning expansion of 78.0%YoY for 4Q2021 to LKR 1.2Bn was largely supported by the improvement in revenue as a result of the strong consumer demand coupled with the upward revision in some of its product prices. However, the increase in raw material and other direct costs have squeezed the GP margins by 136bps to 30.5% in 4Q2021. Given the severity of the current economic crisis, we expect the cost escalations may persist over 2022E and 2023E, thereby intensifying the pressure on margins. Moreover, significant debt financing via related party borrowings to fulfill working capital requirements is also expected to add on to the finance cost burden. Considering the rise in operational as well as financial costs, we have lowered our earnings targets for 2022E to LKR 4.9Bn (-11% from the previous target) and 2023E to LKR 5.6Bn (-10% from the previous target). We also have lowered NEST's fair value target to LKR 1,300.0 for 2022E with a total return of 38.0%.

MAINTAIN BUY

LKR (Mn)	4Q2020	4Q2021	YoY	2020	2021	YoY
Earnings (LKR 'Mn)						
Revenue	9,940	12,504	+26%	37,866	45,420	+20%
Gross Profit	3,163	3,808	+20%	12,219	14,669	+20%
EBIT	1,020	1,487	+46%	4,497	6,263	+39%
PBT	977	1,489	+52%	4,264	6,147	+44%
Net Profit	691	1,228	+78%	2,947	5,329	+81%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	5,934	8,435	+42%	5,934	8,435	+42%
Borrowings	2,138	5,519	+158%	2,138	5,519	+158%
NAVPS	110.4	157.0		110.4	157.0	

Massive earnings growth for 4Q2021 sponsored by the improvement in top-line

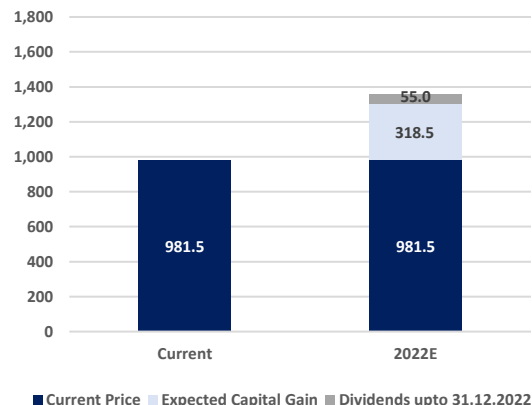
NEST recorded a massive earnings growth of 78.0%YoY for 4Q2021 to record at LKR 1.2Bn compared to 4Q2020, a quarter of which the business operations were significantly hampered by the Covid-19 pandemic. The spike in profitability was mainly driven by the growth in revenue by 26.0%YoY benefitted by the strong consumer demand coupled with the frequent price revisions stemming from the escalation of input prices. Although the household demand for NEST's budget priced packaged food products like instant noodles may increase as a result of the prevailing economic hardships over food and energy supply shortages, the overall volumes may get impacted by the possible further upward revisions in the shelf prices of the aggregate product portfolio. Therefore, our assigned revenue growth rate of 18.0%YoY and 11.0%YoY for 2022E and 2023E are weighing more towards a price driven growth over the anticipated volume growth. However, the increase in input costs have dented the GP margins by 136bps to 30.5% in 4Q2021 and we believe that the rising prices of key raw materials such as wheat, palm oil, etc. which is further aggravated by the LKR depreciation, may continue to hold pressure on GP margin, thus we expect GP margin to trap around 32.0% levels in the coming years. Therefore, considering the inevitable price adjustments in responding to the soaring input costs, we have revised our revenue targets for 2022E to LKR 53.5Bn (+14.2% from the previous target) and for 2023E to LKR 59.3Bn (+18.9% from the previous target).

Significant increase in foreign borrowings to weigh on finance cost

NEST has obtained a USD denominated 3Yr loan from a related party, Nestle Treasury Centre – Middle East and Africa Ltd, amounting to USD 26.6Mn during 4Q2021 to facilitate import payments. This has resulted in an increase in finance cost during 2021 but was negated by the increase in interest income earned via the rise in interest rates. Furthermore, NEST has obtained another 3Y loan facility of USD 45.0Mn from the same lender which will be drawn down in tranches as necessary. The significant debt additions are expected to weigh on NEST's finance cost over the coming years and may have a negative impact on the bottom line.

FV is revised downward to LKR 1,300.0 for 2022E - MAINTAIN BUY

With the potential negative impact on earnings coupled with a massive rise in interest rates that resulted in a rise in expected risk-free rate which in turn increases the expected rate of return on equity, we have lowered NEST's fair value target to LKR 1,300.0 for 2022E with a total return of 38.0%. **MAINTAIN BUY**



FIRST CAPITAL RESEARCH

Vidushika Perera +94 11 263 9865

vidushika@firstcapital.lk

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



Source: CSE

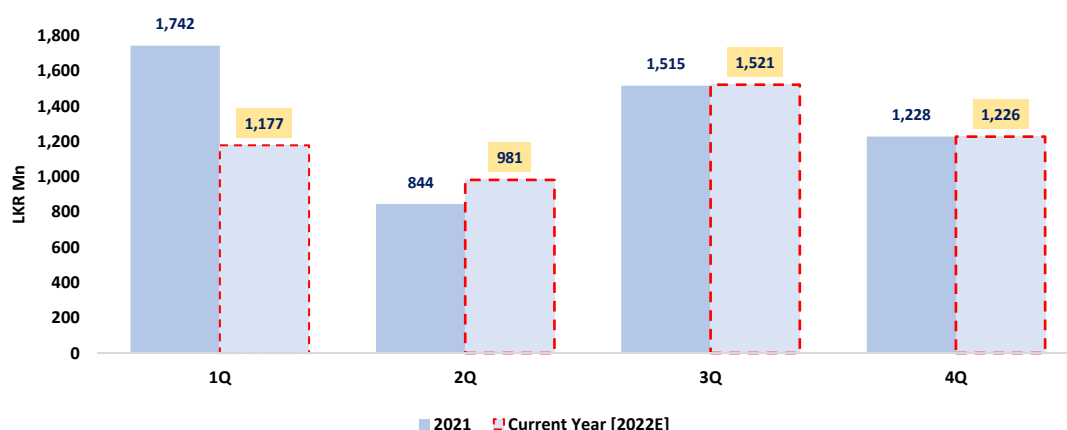
Minimum Return for BUY:

Buy Below 2022E - [AER of 20% with DPS]: LKR 1,170
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	46,821	53,483	+14%	49,911	59,322	+19%
Gross Profit	15,919	17,115	+8%	17,469	18,983	+9%
EBIT	6,686	6,410	-4%	7,504	7,271	-3%
Profit before Tax	6,709	5,983	-11%	7,539	6,794	-10%
Net Profit	5,502	4,906	-11%	6,182	5,571	-10%
Adjusted EPS	102.4	91.3		115.1	103.7	
Growth YoY	12%	-8%		12%	14%	
Balance Sheet Estimate						
Shareholders' Equity	8,726	9,053	+4%	9,681	10,454	+8%
Borrowings	816	6,689	+720%	821	7,918	+864%
Adjusted NAVPS	162.4	168.5		180.2	194.6	
Ratio Estimate						
ROE (%)	63%	54%		64%	53%	
PER (x)	12.2	10.7		10.9	9.5	
PBV (x)	7.7	5.8		6.9	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	53,483	59,322	63,981
Operating Profit	5,147	4,089	4,497	6,263	6,410	7,271	7,923
Net Profit	3,486	2,566	2,947	5,329	4,906	5,571	6,906
EPS (LKR)	64.9	47.8	54.9	99.2	91.3	103.7	128.5
YoY % Growth	-4%	-26%	15%	81%	-8%	14%	24%
Valuations							
PER (x)	15.1x	20.6x	17.9x	9.9x	10.7x	9.5x	7.6x
PBV (x)	9.4x	9.6x	8.9x	6.3x	5.8x	5.0x	4.2x
DY (%)	5.1%	4.8%	5.6%	5.6%	7.9%	9.0%	11.8%
NAVPS	104.9	102.6	110.4	157.0	168.5	194.6	235.0
DPS (LKR)	50.0	47.5	55.0	55.0	77.6	88.1	115.7
Dividend Payout	77%	99%	100%	55%	85%	85%	90%



Valuation Summary

Expected NEST price	2022E
PER based target price	1,278
DCF Valuation based target price	1,330
Average Target Price	1,304
Target price after Rounding off	1,300

Return	2022E
Target Price	1,300
Current Price	982
Capital Gain (LKR)	319
Dividend upto 31 Dec (LKR)	55
Capital Gain %	32%
Dividend Yield %	6%
Total Return %	38%
Annualized Return %	50%

Discounted Cash flow Valuation

DCF based Valuation	2022E
Enterprise Value	70,835
(-) Debt	(6,689)
(+) Cash	7,323
Total Value of Equity	71,469
No. of shares	54
Target Price	1,330

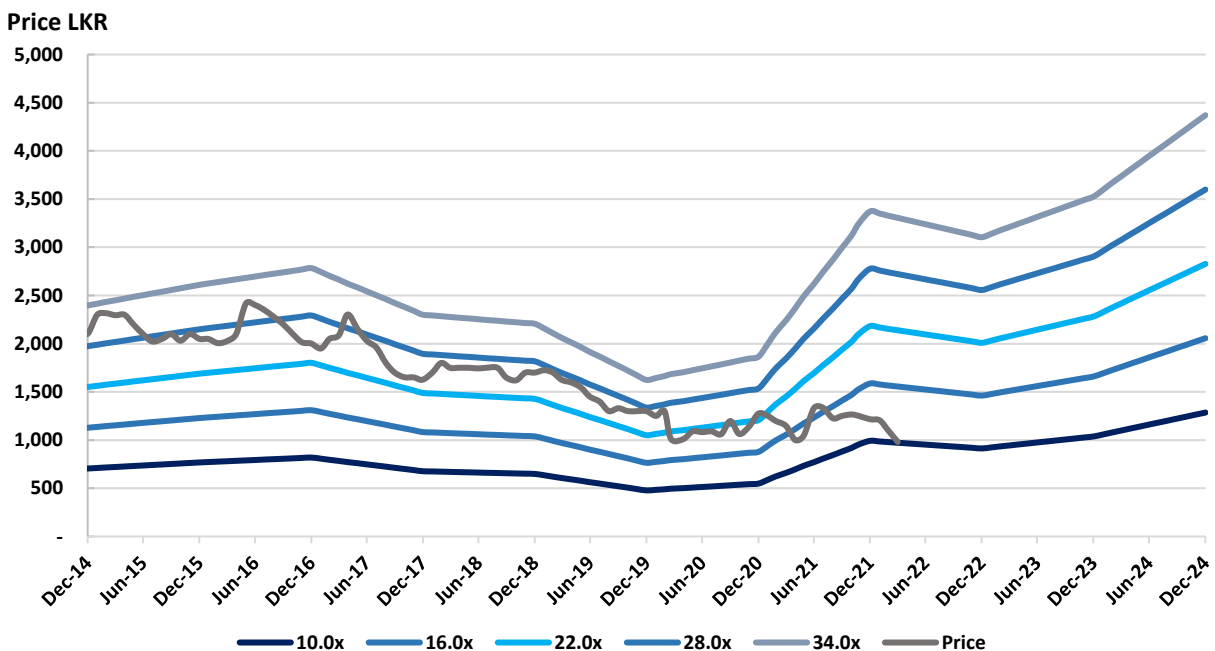
COE	2022E
R_f	12.0%
R_m	20%
Growth %	3%
β	0.50
$K_e = R_f + \beta (R_m - R_f)$	16%

PER Valuation

PER based Valuation	2022E
Earnings (LKR 'Mn)	4,906
No. of Shares ('Mn)	54
EPS	91.3
Expected Average PER	14x
Price at 14.0x Earnings	1,278

WACC	2022E
K_e	16%
K_d (Post Tax)	9%
D/E Assumption	30 / 70
Terminal Growth (%)	3%
WACC	14%

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	53,483	59,322	63,981
Cost of Sales	-23,630	-24,414	-25,647	-30,751	-36,368	-40,339	-43,507
Gross Profit	13,707	11,941	12,219	14,669	17,115	18,983	20,474
Other Operating Income / (Expense)	-135	-136	-57	-36	-36	-36	-36
Marketing, Selling and Distribution Expenses	-6,056	-5,224	-5,129	-5,816	-8,022	-8,898	-9,597
Administrative Expenses	-2,369	-2,493	-2,536	-2,554	-2,646	-2,778	-2,918
Results from Operating Activities	5,147	4,089	4,497	6,263	6,410	7,271	7,923
Net Finance Expense	-206	-319	-233	-117	-428	-477	499
Profit Before Taxation	4,941	3,770	4,264	6,147	5,983	6,794	8,421
Income Tax Expense	-1,456	-1,204	-1,317	-817	-1,077	-1,223	-1,516
Profit for the Year	3,486	2,566	2,947	5,329	4,906	5,571	6,906
EPS	64.9	47.8	54.9	99.2	91.3	103.7	128.5

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	7,706	7,704	7,640
Capital Work-in-Progress	673	377	524	716	566	716	866
Total Non-Current Assets	10,237	9,756	9,270	8,888	8,594	8,742	8,828
Inventories	2,988	3,486	4,948	6,155	7,220	8,008	8,957
Trade and Other Receivables	3,362	2,687	2,046	2,188	3,744	4,153	4,479
Cash and Cash Equivalents	218	508	2,508	7,012	7,323	9,457	5,622
Total Current Assets	7,422	7,115	9,942	16,228	19,160	22,491	19,931
Total Assets	17,659	16,871	19,212	25,116	27,754	31,234	28,759
Equity							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	5,098	4,972	5,397	7,897	8,516	9,917	12,087
Total Equity	5,635	5,510	5,934	8,435	9,053	10,454	12,625
Liabilities							
Non-Current Financial Liabilities							
Total Non-Current Liabilities	3,689	3,772	2,084	7,361	8,531	4,341	4,341
Current Financial Liabilities							
Trade and Other Payables	4,635	4,951	6,225	6,418	7,274	8,068	8,701
Income Tax Payable	681	653	935	728	722	778	918
Current Financial Liabilities	1,524	988	2,054	101	101	5,519	101
Total Current Liabilities	8,335	7,589	11,194	9,320	10,170	16,438	11,793
Total Liabilities	12,024	11,361	13,278	16,681	18,701	20,779	16,134
Total Equity and Liabilities	17,659	16,871	19,212	25,116	27,754	31,234	28,759
NAVPS	104.9	102.6	110.4	157.0	168.5	194.6	235.0



First Capital

First Capital Holdings PLC

No.2, Deal Place,
Colombo 3

Tel: +94 11 2145 000
Fax: +94 11 2145 050

RESEARCH

Dimantha Mathew	+94 11 2639 853	Vidushika Perera	+94 11 2639 865
Hiruni Perera	+94 11 2639 864	Tharusha Ashokgar	+94 11 2639 866

GOVERNMENT SECURITIES SALES

Anjelo Simmons	+94 77 3031 636	Neminda Jayawardena	+94 76 6644 080
Anushka Dissanayake	+94 77 2220 021	Arun Kandasamy	+94 75 4861 506
Anushi Ranawaka	+94 77 3876 819		

CORPORATE DEBT SALES

Tharusha Ekanayake	+ 94 77 7 809 154
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EQUITY SALES

CEO	Jaliya Wijeratne	+94 70 2910 042	Negombo	
			Priyanka Anuruddha	+94 70 2910 035
Colombo			Priyantha Wijesiri	+94 70 2910 036
Rasika Indra Kumara	+94 77 7072 698			
Isuru Jayawardena	+94 76 7084 953			
Nishantha Mudalige	+94 70 2910 041			
Ifadh Marikar	+94 77 9625 679			
Anushka Buddhika	+94 71 4310 600			
Thushara Pathiraja	+94 70 2910 037			
Chandika Jayawardana	+94 77 3940 070			

UNIT TRUST SALES

Kavin Karunamoorthy	+94 77 0328 060	Imali Abeygunawardena	+94 77 1764 799
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BRANCHES

Kandy	Kurunegala	Matara	Negombo
CSE Branch Office, No. 88, Dalada Veediya, Kandy 20000.	No.174/B2, Negombo Road, Kurunegala. Kurunegala 60000.	CSE Branch Office, 1 st Floor, E.H.Cooray Tower, No.24, Anagarika Dharmapala Mawatha, Matara 81000.	Colombo Stock Exchange Negombo Branch Office, No. 72 A, 2/1, Old Chilaw Road, Negombo 11500.
Manager: Salinda Samarakoon	Manager:	Manager: Rohana Jayakody	Manager:
Tel: +94 81 2236 010	Tel: +94 37 2222 930	Tel: +94 41 2222 988	Tel: +94 31 4937 072

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