



First Capital
A Janashakthi Group Company

NESTLE LANKA PLC [NEST.N0000]

MAINTAIN BUY

“PROFITABILITY TO BE SHIELDED BY SOLID MARGINS”

Fair Value: 2022E - LKR 1,500 [+20%]

Total Return with DPS: 2022E - 27% [AER 24%]

NEST's earnings expanded by 49.0% for 3Q2021 to LKR 1.5Bn compared to LKR 1.0Bn recorded in 3Q2020. The profit surge is mainly attributable to the growth in revenue by 8.0%YoY to LKR 11.4Bn as opposed to LKR 10.5Bn in 3Q2020, aided by the gradual revival in economic activities, thereby restoring the demand for consumer goods. Moreover, GP margin has stabilised around 33.0% during 3Q2021 and we expect NEST to maintain the GP margin within a range of 33.0%-34.0% during 2021E and 2022E. Considering the higher than expected profitability for 9M2021, we are reinstating our earnings forecast for 2021E and 2022E to LKR 4.9Bn and LKR 5.5Bn respectively. However, we have lowered our fair value target for 2022E to LKR 1,500 (previous TP – LKR 1,550) predominantly due to the expected increase in risk free rate of the market. **MAINTAIN BUY**

LKR (Mn)	3Q2020	3Q2021	YoY	9M2020	9M2021	YoY
Earnings (LKR 'Mn)						
Revenue	10,497	11,353	+8%	27,927	32,916	+18%
Gross Profit	3,512	3,739	+6%	9,057	10,861	+20%
EBIT	1,481	1,866	+26%	3,477	4,776	+37%
PBT	1,406	1,842	+31%	3,287	4,658	+42%
Net Profit	1,017	1,515	+49%	2,256	4,101	+82%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	5,307	7,089	+34%	5,227	7,089	+36%
Borrowings	2,514	925	-63%	2,924	925	-68%
NAVPS	97.3	132.0		97.3	132.0	

Earnings for the quarter magnified by 49.0%YoY

NEST earnings for 3Q2021 were recorded at LKR 1.5Bn registering a substantial growth of 49.0%YoY compared to 3Q2020. The upsurge in profitability was mainly driven by the growth in revenue by 8.0%YoY underpinned by the gradual revival in economic activities, thereby restoring the demand for consumer goods. The development in technology and well established e-commerce platforms which induced online sales may have supported the increase in revenue, despite the disruptions caused by the island-wide lockdowns that prevailed for the most part of 3Q2021. Therefore, considering the removal of Covid-19 related lockdowns in Oct 2021 and the expected regularization of activities led by the successful vaccination rollout, we slightly restated our revenue targets for 2021E to LKR 43.1Bn (+2% from the previous target) and for 2022E to LKR 46.8Bn (-3% from the previous target). We have also restated our earnings targets for 2021E and 2022E to LKR 4.9Bn and LKR 5.5Bn, respectively.

Safeguarding the GP margins in the face of rising raw material costs

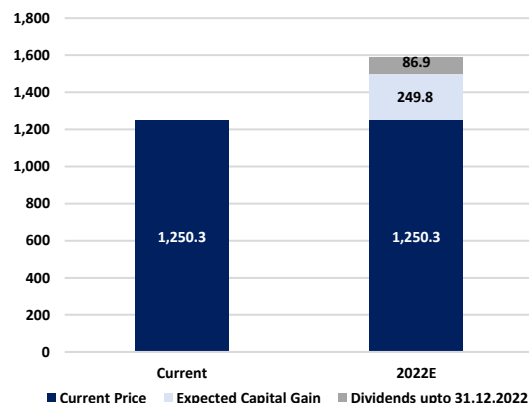
GP margins improved by 283bps to 32.9% in 3Q2021 as opposed to 30.1% in 2Q2021, despite a slight dip of 52bps witnessed on a YoY basis. Stability of the GP margin has been largely supported by the periodic product price increases along with the Government's decision to deregulate the prices of certain products including milk powder. NEST being one of the suppliers of locally manufactured milk powder is expected to benefit out of this move. However, relentless rise in prices of key raw materials such as wheat, sugar, palm oil, etc. as a result of supply side disruptions may pose a threat in achieving the desired GP margin levels. However, with the gradual ease of economic crisis, we expect GP margin to stabilise in the range of 33.0%-34.0% in 2021E and 2022E.

Drop in Marketing, Selling and Distribution Expenses

Marketing, Selling and Distribution declined by 6.2%YoY in 3Q2021 and displayed a gradual reduction during 2021 due to the prolonged lockdowns and travel restrictions that were in effect to curb Covid-19 pandemic.

FV is revised to LKR 1,500 for 2022E - MAINTAIN BUY

With the gradual rise in risk free rate and thereby the increase in expected rate of return, we lowered NEST's fair value to LKR 1,500 for 2022E with a total return of 27%. **MAINTAIN BUY**

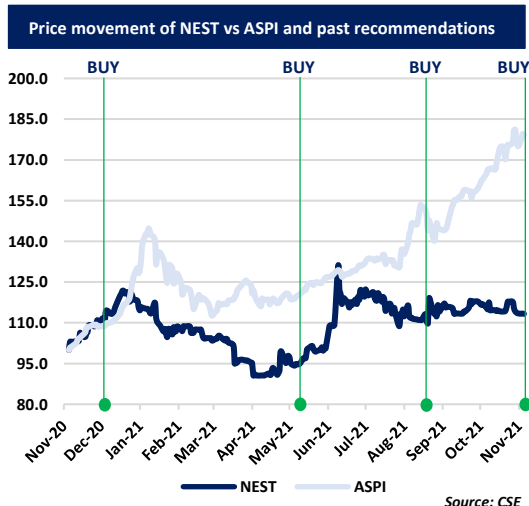


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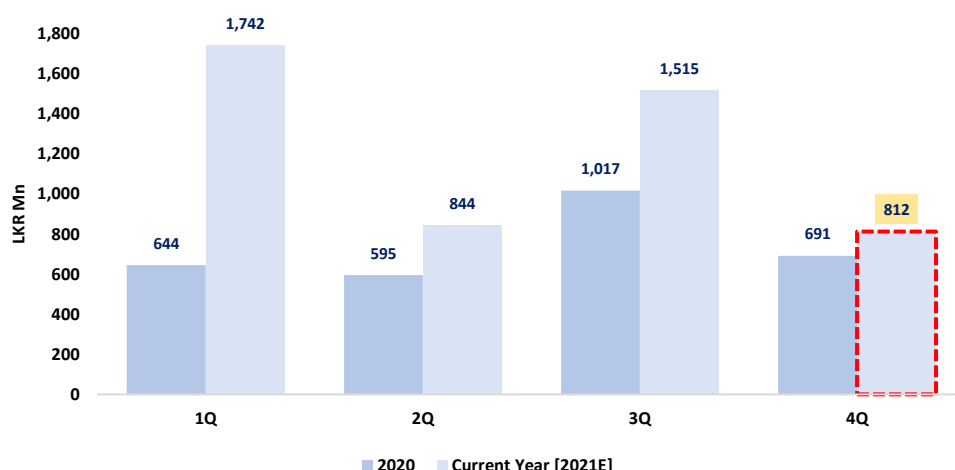
Minimum Return for BUY:

Buy Below 2022E - [AER of 18% with DPS]: LKR 1,322
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
Earnings Estimate						
Revenue	42,458	43,102	+2%	48,251	46,821	-3%
Gross Profit	14,011	14,224	+2%	16,405	15,919	-3%
EBIT	5,037	6,056	+20%	6,304	6,686	+6%
Profit before Tax	4,973	5,992	+20%	6,328	6,709	+6%
Net Profit	4,078	4,913	+20%	5,189	5,502	+6%
Adjusted EPS	75.9	91.5		96.6	102.4	
Growth YoY	38%	67%		27%	12%	
Balance Sheet Estimate						
Shareholders' Equity	7,057	7,892	+12%	8,290	8,726	+5%
Borrowings	1,404	1,404	0%	732	732	0%
Adjusted NAVPS	131.3	146.9		154.3	162.4	
Ratio Estimate						
ROE (%)	58%	62%		63%	63%	
PER (x)	16.0	13.7		12.5	12.2	
PBV (x)	9.2	8.5		7.9	7.7	

Valuation Table

P/E 31 December	2017	2018	2019	2020	2021E	2022E	2023E
Estimates (LKR 'Mn)							
Revenue	37,601	37,337	36,355	37,866	43,102	46,821	49,911
Operating Profit	4,888	5,147	4,089	4,497	6,056	6,686	7,504
Net Profit	3,636	3,486	2,566	2,947	4,913	5,502	6,182
EPS (LKR)	67.7	64.9	47.8	54.9	91.5	102.4	115.1
YoY % Growth	-17%	-4%	-26%	15%	67%	12%	12%
Valuations							
PER (x)	18.5x	19.3x	26.2x	22.8x	13.7x	12.2x	10.9x
PBV (x)	14.0x	11.9x	12.2x	11.3x	8.5x	7.7x	6.9x
DY (%)	4.0%	4.0%	3.8%	4.4%	6.9%	7.8%	8.7%
NAVPS	89.4	104.9	102.6	110.4	146.9	162.4	180.2
DPS (LKR)	50.0	50.0	47.5	55.0	86.9	97.3	109.3
Dividend Payout	74%	77%	99%	100%	95%	95%	95%



Valuation Summary

Expected NEST price	2022E
PER based target price	1,536
DCF Valuation based target price	1,467
Average Target Price	1,501
Target price after Rounding off	1,500

Return	2022E
Target Price	1,500
Current Price	1,250
Capital Gain (LKR)	250
Dividend upto 31 Dec (LKR)	87
Capital Gain %	20%
Dividend Yield %	7%
Total Return %	27%
Annualized Return %	24%

Discounted Cash flow Valuation

DCF based Valuation	2022E
Enterprise Value	78,436
(-) Debt	(816)
(+) Cash	1,186
Total Value of Equity	78,806
No. of shares	54
Target Price	1,467

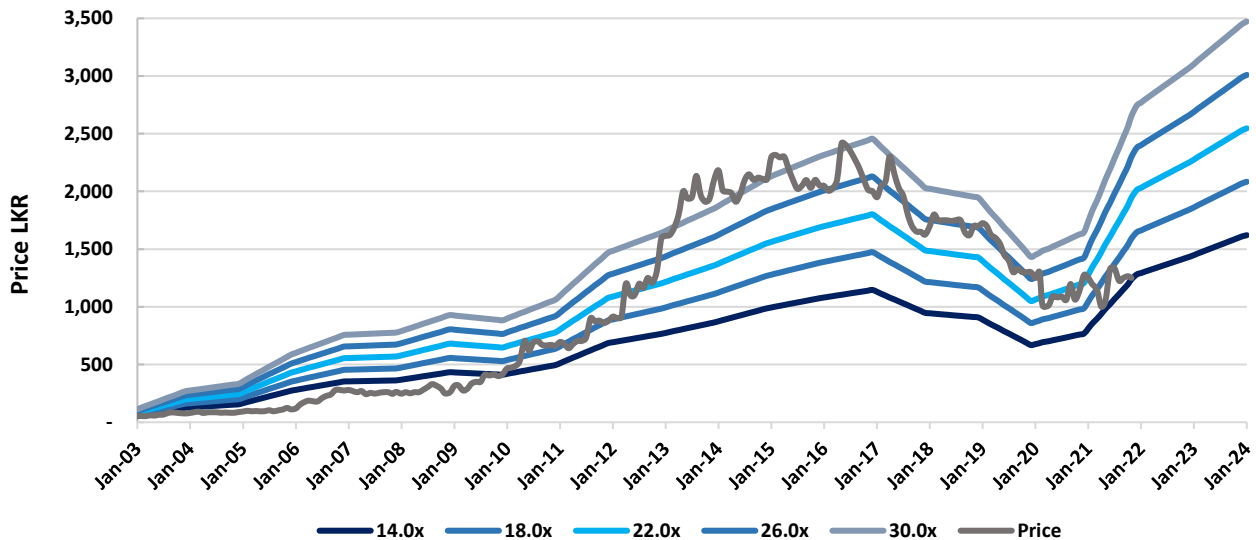
COE	2022E
R_f	10.0%
R_m	18%
Growth %	3%
β	0.50
$K_e = R_f + \beta (R_m - R_f)$	14%

PER Valuation

PER based Valuation	2022E
Earnings (LKR 'Mn)	5,502
No. of Shares ('Mn)	54
EPS	102.4
Expected Average PER	15x
Price at 15.0x Earnings	1,536

WACC	2022E
K_e	14%
K_d	9%
D/E Assumption	30 / 70
Terminal Growth (%)	3%
WACC	12%

PER Chart



Appendix I: Statement of Income and Expenses

Income Statement (LKR Mn)	2017	2018	2019	2020	2021E	2022E	2023E
Y/E 31st December							
Revenue	37,601	37,337	36,355	37,866	43,102	46,821	49,911
Cost of Sales	-24,525	-23,630	-24,414	-25,647	-28,878	-30,902	-32,442
Gross Profit	13,076	13,707	11,941	12,219	14,224	15,919	17,469
Other Operating Income / (Expense)	-45	-135	-136	-57	-57	-57	-57
Marketing, Selling and Distribution Expenses	-5,828	-6,056	-5,224	-5,129	-5,603	-6,555	-6,988
Administrative Expenses	-2,315	-2,369	-2,493	-2,536	-2,507	-2,622	-2,921
Results from Operating Activities	4,888	5,147	4,089	4,497	6,056	6,686	7,504
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
Profit Before Taxation	4,735	4,941	3,770	4,264	5,992	6,709	7,539
Income Tax Expense	-1,099	-1,456	-1,204	-1,317	-1,079	-1,208	-1,357
Profit for the Year	3,636	3,486	2,566	2,947	4,913	5,502	6,182
EPS	67.7	64.9	47.8	54.9	91.5	102.4	115.1

Appendix II: Statement of Financial Position

Balance Sheet (LKR Mn)	2017	2018	2019	2020	2021E	2022E	2023E
As at 31st December							
ASSETS							
Non-Current Assets							
Property, Plant and Equipment	5,366	9,210	9,012	8,397	8,445	8,255	8,246
	8,170	10,237	9,756	9,270	9,467	9,127	9,269
Current Assets							
Inventories	2,870	2,988	3,486	4,948	5,819	6,321	6,738
Trade and Other Receivables	3,647	3,362	2,687	2,046	2,586	3,277	3,743
Cash and Cash Equivalents	129	218	508	2,508	1,484	1,186	1,482
	7,406	7,422	7,115	9,942	10,329	11,225	12,404
Total Assets	15,577	17,659	16,871	19,212	19,797	20,352	21,673
EQUITY AND LIABILITIES							
Equity							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	4,264	5,098	4,972	5,397	7,355	8,189	9,144
	4,801	5,635	5,510	5,934	7,892	8,726	9,681
Non-Current Liabilities							
Non-Current Financial Liabilities	12	2,008	1,984	84	84	84	84
	1,496	3,689	3,772	2,084	2,084	2,084	2,084
Current Liabilities							
Trade and Other Payables	4,770	4,635	4,951	6,225	5,631	6,026	6,326
Bank Overdrafts	2,592	1,524	988	2,054	1,404	732	737
Total Current Liabilities	9,280	8,335	7,589	11,194	9,820	9,543	9,908
Total Liabilities	10,776	12,024	11,361	13,278	11,904	11,626	11,991
Total Equity and Liabilities	15,577	17,659	16,871	19,212	19,797	20,352	21,673
NAVPS	89.4	104.9	102.6	110.4	146.9	162.4	180.2



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