



NESTLE LANKA PLC [NEST.N0000]

MAINTAIN BUY

“INFLATIONARY REPRICING PRAISED THE TOP-LINE”

Fair Value: 2022E - LKR 1,200.0 [+30%]

Total Return with DPS: 2022E - 30% [AER 88%]

2023E - LKR 1,400.0 [+51%]

2023E - 62% [AER 41%]

NEST posted impressive results for the quarter by recording 78.4%YoY growth in top-line while bottom-line magnified by 33.8%YoY to LKR 1.1Bn compared to LKR 0.8Bn recorded in 2Q2021. Profits were boosted by the enhancement in revenue aided by the repeated upward price revisions to the product portfolio amidst the cost escalations and inflationary pressure. GP margin notably improved by 527bps to 35.4% despite the increase in COS on a YoY basis. Recent dip in commodity prices and the looming global recessionary indications may ease pressure on maintaining the margins at current levels in 2022E. Moreover, we projected volumes to display a recovery from 2H2023E as the buying power improves upon the expected macroeconomic stability. However, anticipating a moderate growth in the long term, we marginally increase our FV target to LKR 1,200.0 for 2022E (previous – LKR 1,160.0) and LKR 1,400.0 for 2023E (previous – LKR 1,320.0). **MAINTAIN BUY**

LKR (Mn)	2Q2021	2Q2022	YoY	6M2021	6M2022	YoY
Earnings (LKR 'Mn)						
Revenue	10,109	18,040	+78%	21,563	33,091	+53%
Gross Profit	3,043	6,381	+110%	7,122	11,733	+65%
EBIT	1,189	4,845	+307%	2,910	6,278	+116%
PBT	1,000	1,337	+34%	2,816	2,258	-20%
Net Profit	844	1,130	+34%	2,586	1,955	-24%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	5,574	6,461	+16%	5,574	6,461	+16%
Borrowings	3,491	9,742	+179%	3,491	9,742	+179%
NAVPS	103.8	120.3		103.8	120.3	

Top-line soared 78.4%YoY amidst the inflationary pressure

NEST delivered outstanding top-line results for the quarter as the revenue boosted by 78.4%YoY to LKR 18.0Bn compared to LKR 10.1Bn recorded in 2Q2021. Prices of NEST's products across the entire range have witnessed more than 50.0% increase during the quarter induced by the high inflationary environment. Accordingly, food inflation during 2Q2022 was recorded at 47.0% in contrast to only 6.0% recorded in the previous comparative quarter. Despite drop in volumes, large upward revisions in product prices were more than sufficient to compensate the income from lost quantities. Moreover, as per the information from local urban retail sellers, at present the demand for NEST's products is displaying some form of stability.

GP margin improved by 527bps to 35.4%

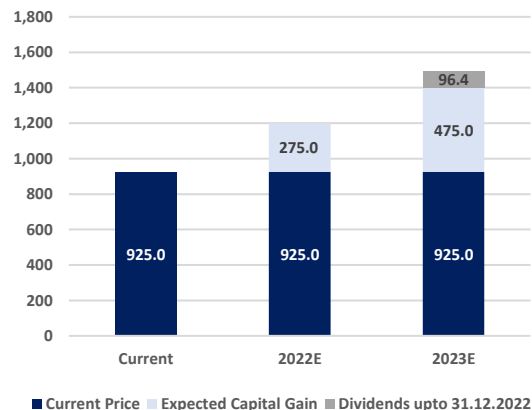
In line with the surge in revenue, GP margin also improved by 527bps for the quarter under review and reached 35.4%. Despite the increase in raw materials on a YoY basis, recent reduction in global commodity prices due to recessionary fears has positively impacted the strengthening of NEST's margins broadly at its same level on a QoQ comparison. Accordingly, prices of key raw materials such as wheat, palm oil and cocoa have dropped by nearly 12.0% - 14.0% during the quarter while other ingredients also displayed a marginal dip. We forecast NEST to maintain current margins throughout 2022E and thereafter to stabilize around 33.0%-34.0% in the medium term.

Foreign currency losses on dollar loans have dented the profits

Steep depreciation in LKR during the quarter led to a negative impact on NEST's related party loans which were denominated in USD. These loans were obtained to fund the import bills and the total of such loans obtained during the past 12 months totalled to USD 71.6Mn, including both disbursed and approved loans. The foreign currency losses on these borrowings are reflected via the elevated Net Finance Expenses to LKR 3.5Bn compared to LKR 189.7Mn in 2Q2021. Moreover, total interest-bearing borrowings as of 2Q2022 increased to LKR 9.7Bn cf. LKR 3.5Bn as of 2Q2021.

Fair Value estimated at LKR 1,200.0 for 2022E and LKR 1,400.0 for 2023E - MAINTAIN BUY

Considering the higher than expected results at the top-line as well as the bottom-line, we have scaled up the revenue target of NEST while also advancing the earnings target for 2022E to LKR 6.1Bn (+23% from previous estimate) and 2023 to LKR 7.6Bn (+31.0% from previous estimate). However, stressing the viability of sustaining higher margins, we have assigned a moderate earnings growth for the long term and thereby marginally increased the NEST's fair value target to LKR 1,200.0 for 2022E and LKR 1,400.0 for 2023E with a total return of 30.0% and 62.0%, 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 (LKR)

Product	Nov-21	Feb-22	May-22	Aug-22
Maggi Coconut Milk Powder 300g	495.0	495.0	495.0	595.0
Milo Chocolate Food Drink 180ml	70.0	70.0	100.0	120.0
Nestoma!T Packet 400g	370.0	430.0	580.0	790.0
Maggi Noodles Family Pack 335g	180.0	210.0	220.0	360.0
Nescafe Classic 100g	975.0	975.0	1,450.0	1,700.0

Source: Keells Supermarkets

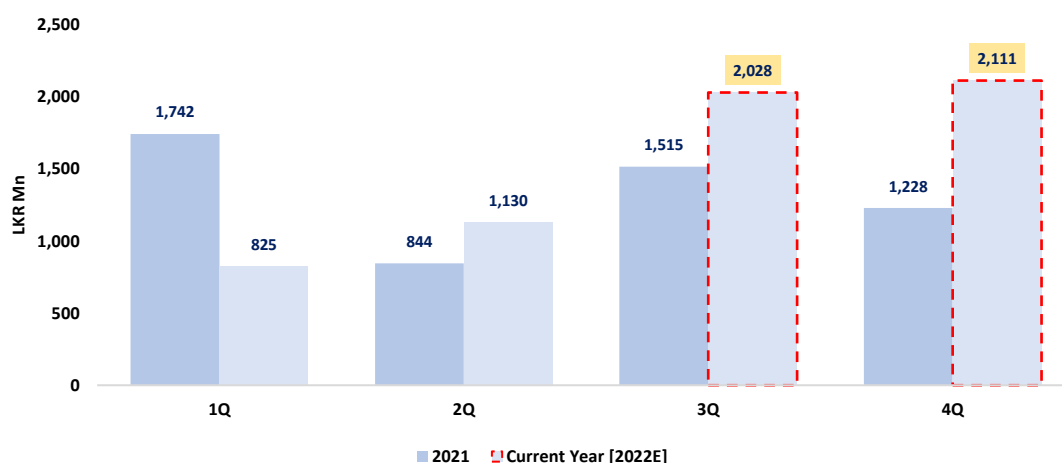
Minimum Return for BUY:

Buy Below 2022E - [AER of 23% with DPS]: LKR 1,100
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	58,574	66,735	+14%	63,010	73,369	+16%
Gross Profit	18,744	23,357	+25%	20,163	24,946	+24%
EBIT	6,229	9,613	+54%	7,307	10,801	+48%
Profit before Tax	6,503	8,019	+23%	7,560	9,938	+31%
Net Profit	4,942	6,094	+23%	5,746	7,553	+31%
Adjusted EPS	92.0	113.4		106.9	140.6	
Growth YoY	-7%	14%		16%	24%	
Balance Sheet Estimate						
Shareholders' Equity	9,090	10,242	+13%	10,635	12,614	+19%
Borrowings	7,747	12,202	+58%	9,306	9,782	+5%
Adjusted NAVPS	169.2	190.6		197.9	234.8	
Ratio Estimate						
ROE (%)	54%	60%		54%	60%	
PER (x)	10.9	8.2		9.3	6.6	
PBV (x)	5.9	4.9		5.0	3.9	

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	66,735	73,369	77,280
Operating Profit	5,147	4,089	4,497	6,263	9,613	10,801	11,003
Net Profit	3,486	2,566	2,947	5,329	6,094	7,553	8,224
EPS (LKR)	64.9	47.8	54.9	99.2	113.4	140.6	153.1
YoY % Growth	-4%	-26%	15%	81%	14%	24%	9%
Valuations							
PER (x)	14.3x	19.4x	16.9x	9.3x	8.2x	6.6x	6.0x
PBV (x)	8.8x	9.0x	8.4x	5.9x	4.9x	3.9x	3.4x
DY (%)	5.4%	5.1%	5.9%	5.9%	10.4%	12.9%	14.9%
NAVPS	104.9	102.6	110.4	157.0	190.6	234.8	268.4
DPS (LKR)	50.0	47.5	55.0	55.0	96.4	119.5	137.8
Dividend Payout	77%	99%	100%	55%	85%	85%	90%



Valuation Summary

Expected NEST price	2022E	2023E
PER based target price	1,134	1,406
DCF Valuation based target price	1,177	1,482
Average Target Price	1,156	1,444
Target price after Rounding off	1,200	1,400

Return	2022E	2023E
Target Price	1,200	1,400
Current Price	925	925
Capital Gain (LKR)	275	475
Dividend upto 31 Dec (LKR)	0	96
Capital Gain %	30%	51%
Dividend Yield %	0%	10%
Total Return %	30%	62%
Annualized Return %	88%	41%

Discounted Cash flow Valuation

DCF based Valuation	2022E	2023E
Enterprise Value	66,782	81,611
(-) Debt	(12,202)	(9,782)
(+) Cash	8,671	7,791
Total Value of Equity	63,251	79,621
No. of shares	54	54
Target Price	1,177	1,482

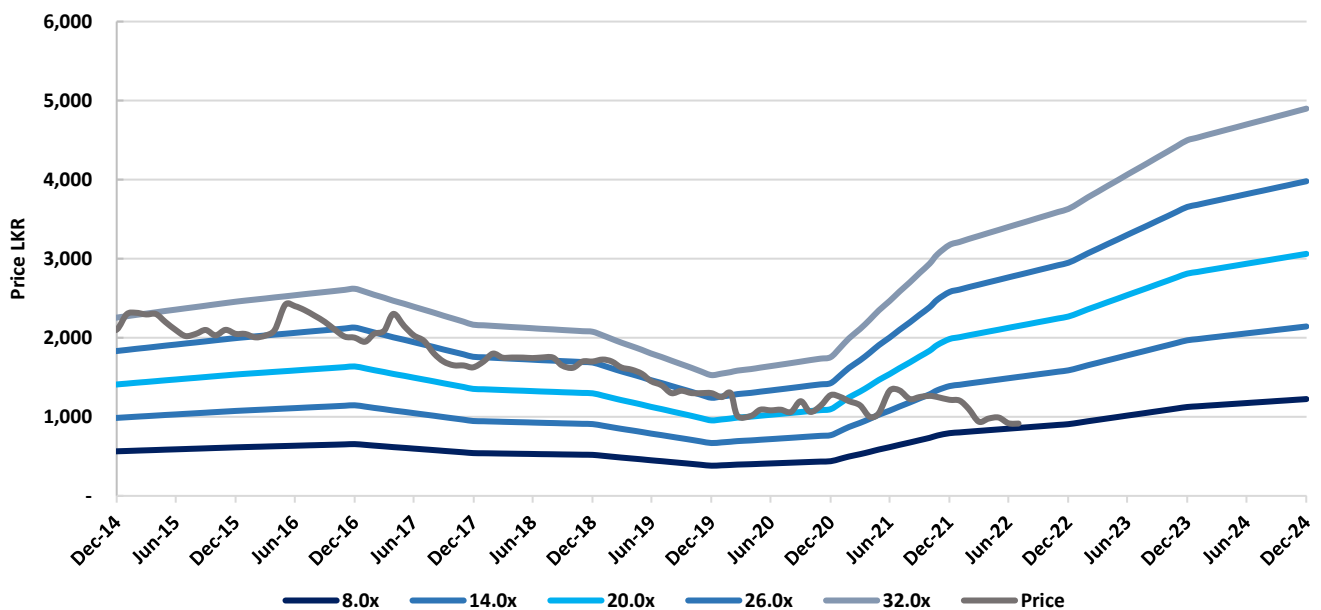
COE	2022E	2023E
R _f	15.0%	15.0%
R _m	23%	23%
Growth %	3%	3%
β	0.40	0.40
$K_e = R_f + \beta (R_m - R_f)$	18%	18%

PER Valuation

PER based Valuation	2022E	2023E
Earnings (LKR 'Mn)	6,094	7,553
No. of Shares ('Mn)	54	54
EPS	113.4	140.6
Expected Average PER	10x	10x
Target Price	1,134	1,406

WACC	2022E	2023E
K _e	18%	18%
K _d (Post Tax)	14%	11%
D/E Assumption	30 / 70	30 / 70
Terminal Growth (%)	3%	3%
WACC	17%	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	66,735	73,369	77,280
Cost of Sales	-23,630	-24,414	-25,647	-30,751	-43,378	-48,424	-52,164
Gross Profit	13,707	11,941	12,219	14,669	23,357	24,946	25,116
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	-9,677	-10,272	-10,046
Administrative Expenses	-2,369	-2,493	-2,536	-2,554	-3,048	-3,312	-3,478
Results from Operating Activities	5,147	4,089	4,497	6,263	9,613	10,801	11,003
Net Finance Expense	-206	-319	-233	-117	-1,594	-863	-182
Profit Before Taxation	4,941	3,770	4,264	6,147	8,019	9,938	10,821
Income Tax Expense	-1,456	-1,204	-1,317	-817	-1,925	-2,385	-2,597
Profit for the Year	3,486	2,566	2,947	5,329	6,094	7,553	8,224
EPS	64.9	47.8	54.9	99.2	113.4	140.6	153.1

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	14,682	15,408	15,456
Trade and Other Receivables	3,362	2,687	2,046	2,188	4,671	5,136	5,410
Cash and Cash Equivalents	218	508	2,508	7,012	8,671	7,791	7,549
Total Current Assets	7,422	7,115	9,942	16,228	28,897	29,208	29,288
Total Assets	17,659	16,871	19,212	25,116	37,507	37,982	38,164
Equity							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	5,098	4,972	5,397	7,897	9,705	12,077	13,881
Total Equity	5,635	5,510	5,934	8,435	10,242	12,614	14,418
Liabilities							
Non-Current Financial Liabilities							
Total Non-Current Liabilities	3,689	3,772	2,084	7,361	14,043	11,623	9,203
Current Financial Liabilities							
Trade and Other Payables	4,635	4,951	6,225	6,418	8,676	8,716	9,129
Income Tax Payable	681	653	935	728	1,061	1,378	1,590
Current Financial Liabilities	1,524	988	2,054	101	101	101	101
Total Current Liabilities	8,335	7,589	11,194	9,320	13,222	13,745	14,542
Total Liabilities	12,024	11,361	13,278	16,681	27,265	25,368	23,745
Total Equity and Liabilities	17,659	16,871	19,212	25,116	37,507	37,982	38,164
NAVPS	104.9	102.6	110.4	157.0	190.6	234.8	268.4



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