



NESTLE LANKA PLC [NEST.N0000]

MAINTAIN BUY

“HIGHEST EVER QUARTERLY PERFORMANCE”

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

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

Total Return with DPS: 2022E - 30% [AER 689%]

2023E - 62% [AER 54%]

NEST delivered the highest ever quarterly results of LKR 3.1Bn (107.3%YoY) in 3Q2022, augmented by the outstanding performance of the top-line. As Sri Lanka experienced its worst hit in inflation, increase in product prices was inevitable for NEST to preserve the GP margins in the midst of subdued volumes. However, as the economy is projected to rebound from 2H2023, restored buying power is expected to recover some volumes, despite the possible increase in competition from substitutes. However, being a well-established player in the industry possessing higher economies of scale, NEST's earnings outlook signals a positive earning potential in the future. Thus, we maintain our FV target at LKR 1,200.0 for 2022E and LKR 1,400.0 for 2023E. **MAINTAIN BUY**

LKR (Mn)	3Q2021	3Q2022	YoY	9M2021	9M2022	YoY
Earnings (LKR 'Mn)						
Revenue	11,353	21,284	+87%	32,916	54,375	+65%
Gross Profit	3,739	6,886	+84%	10,861	18,619	+71%
EBIT	1,866	3,856	+107%	4,776	10,134	+112%
PBT	1,842	3,670	+99%	4,658	5,928	+27%
Net Profit	1,515	3,141	+107%	4,101	5,096	+24%
Balance Sheet (LKR 'Mn)						
Shareholder's Equity	7,089	9,602	+35%	7,089	9,602	+35%
Borrowings	925	14,246	+1440%	925	14,246	+1440%
NAVPS	132.0	178.7		132.0	178.7	

Top-line continues to shine amidst soaring food inflation

NEST posted remarkable performance on the top-line to record a growth of 87.0%YoY and 18.0%QoQ to LKR 21.3Bn fueled by the unceasing rise in food inflation during the quarter. Accordingly, food category inflation at the end of the quarter was recorded at 94.9%YoY while QoQ inflation recorded at 9.1% for the period of Jun – Sep 2022. In the midst of inflationary pressure and cost escalations, prices of products under NEST, including popular Maggi instant noodles, Nestomalt, Nescafe coffee and Maggi coconut milk powder prices were sharply increased aiding a steady growth in revenue. However, with the anticipated rebound in the economy, resumption in business activities, and eased off inflationary pressure are expected to intensify the business competition. Therefore, sustaining the same higher level of revenue growth currently enjoyed by NEST on the back of high price levels may not be viable in the medium to long term, despite the improved consumer buying power. Accordingly, in spite of higher revenue growth in 2022E, a moderated growth is forecasted for 2023E and beyond.

GP margin tripped by 302bps QoQ and 58bps YoY to 32.4%

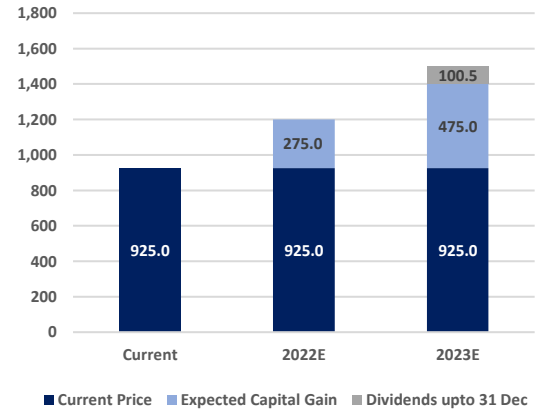
GP margin for the quarter was recorded at 32.4% compared to 32.9% recorded in 3Q2021. However, GP margin resulted in a drop of 302bps compared to the previous quarter which yielded 35.4%. Despite the decline in prices of certain commodities owing to the recessionary outlook, key raw materials of NEST such as wheat, sugar and palm oil displayed a notable volatility during the period, impacting negatively on the cost of sales. However, the ability to pass through the cost increases via frequent price revisions has enabled NEST to maintain margins at its desirable levels.

Marketing, Selling and Distribution Expenses as a % of revenue show a noteworthy decline

Marketing, Selling and Distribution Expenses (MS & D) increased by 55.9%YoY to LKR 2.0Bn owing to the surge in transportation costs, storage costs, marketing expenses, etc. However, MS & D expenses as a percentage of revenue have showcased a significant decline to 9.4% during the quarter compared to the 5-year historical average rate of 14.0% due to the price driven revenue growth amidst moderated volumes. However, marketing expenses are expected to gradually increase as the competition builds up in the coming years.

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

Considering the higher than expected earnings for the quarter, and the promising earnings outlook in the overall Food and Beverage industry upon the rebound in economy, we have increased the earnings target for 2022E to LKR 7.7Bn (+27.0% from the previous) and 2023E to LKR 8.1Bn (+7.0% from previous). However, given the high degree of market volatility amidst the economic uncertainties, we have maintained NEST's fair value at 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	Feb-22	Mar-22	Aug-22	Oct-22
Maggi Coconut Milk Powder 300g	495.0	495.0	595.0	795.0
Milo Chocolate Food Drink 180ml	70.0	100.0	120.0	130.0
Nestomalt Packet 400g	430.0	580.0	790.0	850.0
Maggi Noodles Family Pack 335g	210.0	220.0	360.0	420.0
Nescafe Classic 100g	975.0	1,450.0	1,700.0	2,000.0

Source: Keells Supermarkets

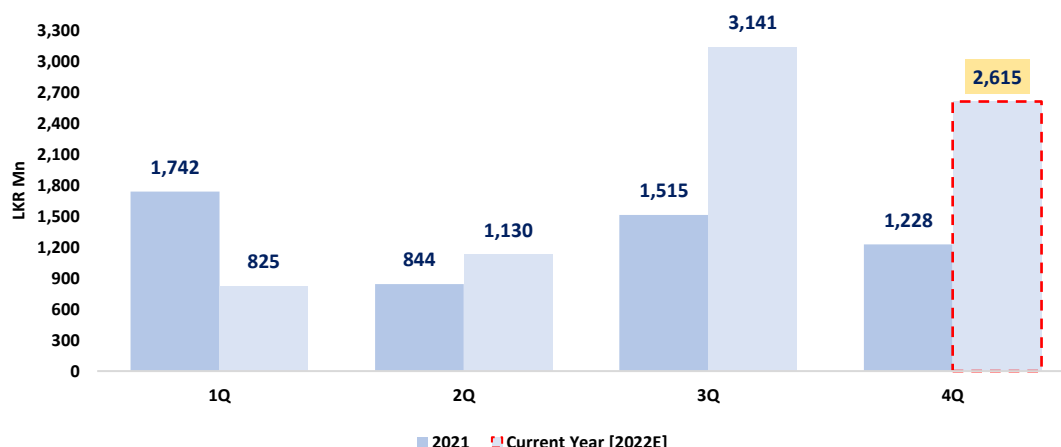
Minimum Return for BUY:

Buy Below 2022E - [AER of 23% with DPS]: LKR 1,168
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	66,735	76,112	+14%	73,369	81,518	+11%
Gross Profit	23,357	26,259	+12%	24,946	26,901	+8%
EBIT	9,613	13,438	+40%	10,801	12,431	+15%
Profit before Tax	8,019	9,404	+17%	9,938	11,567	+16%
Net Profit	6,094	7,711	+27%	7,553	8,097	+7%
Adjusted EPS	113.4	143.5		140.6	150.7	
Growth YoY	14%	45%		24%	5%	
Balance Sheet Estimate						
Shareholders' Equity	10,242	11,858	+16%	12,614	14,558	+15%
Borrowings	12,202	12,202	0%	9,782	9,782	0%
Adjusted NAVPS	190.6	220.7		234.8	271.0	
Ratio Estimate						
ROE (%)	60%	65%		60%	56%	
PER (x)	8.2	6.4		6.6	6.1	
PBV (x)	4.9	4.2		3.9	3.4	

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	76,112	81,518	87,072
Operating Profit	5,147	4,089	4,497	6,263	13,438	12,431	12,477
Net Profit	3,486	2,566	2,947	5,329	7,711	8,097	8,607
EPS (LKR)	64.9	47.8	54.9	99.2	143.5	150.7	160.2
YoY % Growth	-4%	-26%	15%	81%	45%	5%	6%
Valuations							
PER (x)	14.3x	19.4x	16.9x	9.3x	6.4x	6.1x	5.8x
PBV (x)	8.8x	9.0x	8.4x	5.9x	4.2x	3.4x	2.8x
DY (%)	5.4%	5.1%	5.9%	5.9%	10.9%	11.4%	15.6%
NAVPS	104.9	102.6	110.4	157.0	220.7	271.0	325.7
DPS (LKR)	50.0	47.5	55.0	55.0	100.5	105.5	144.2
Dividend Payout	77%	99%	100%	55%	70%	70%	90%



Valuation Summary

Expected NEST price	2022E	2023E
PER based target price	1,292	1,356
DCF Valuation based target price	1,154	1,502
Average Target Price	1,223	1,429
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	100
Capital Gain %	30%	51%
Dividend Yield %	0%	11%
Total Return %	30%	62%
Annualized Return %	689%	54%

Discounted Cash flow Valuation

DCF based Valuation	2022E	2023E
Enterprise Value	65,427	81,539
(-) Debt	(12,202)	(9,782)
(+) Cash	8,771	8,965
Total Value of Equity	61,996	80,722
No. of shares	54	54
Target Price	1,154	1,502

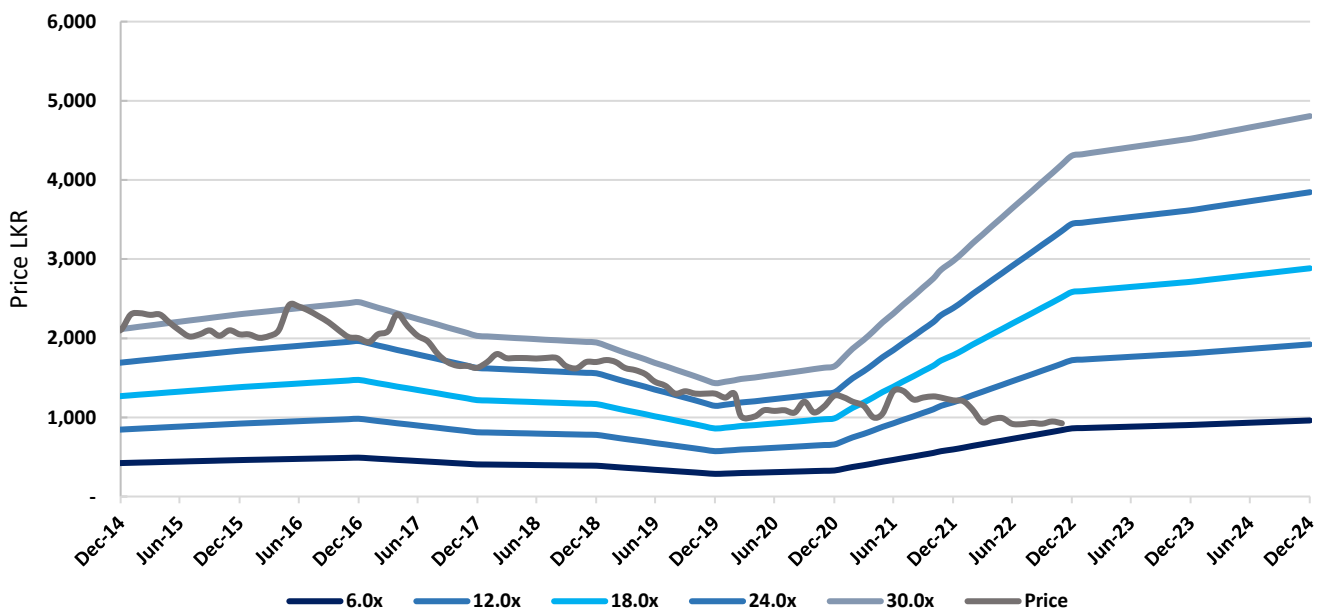
COE	2022E	2023E
R _f	15.0%	15.0%
R _m	23%	23%
Growth %	3%	3%
β	0.40	0.40
K _e = R _f + β (R _m - R _f)	18%	18%

PER Valuation

PER based Valuation	2022E	2023E
Earnings (LKR 'Mn)	7,711	8,097
No. of Shares ('Mn)	54	54
EPS	143.5	150.7
Expected Average PER	9x	9x
Target Price	1,292	1,356

WACC	2022E	2023E
K _e	18%	18%
K _d (Post Tax)	16%	11%
D/E Assumption	30 / 70	30 / 70
Terminal Growth (%)	3%	3%
WACC	18%	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	76,112	81,518	87,072
Cost of Sales	-23,630	-24,414	-25,647	-30,751	-49,853	-54,617	-59,209
Gross Profit	13,707	11,941	12,219	14,669	26,259	26,901	27,863
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	-8,753	-10,597	-11,319
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	13,438	12,431	12,477
Net Finance Expense	-206	-319	-233	-117	-4,034	-863	-182
Profit Before Taxation	4,941	3,770	4,264	6,147	9,404	11,567	12,295
Income Tax Expense	-1,456	-1,204	-1,317	-817	-1,693	-3,470	-3,689
Profit for the Year	3,486	2,566	2,947	5,329	7,711	8,097	8,607
EPS	64.9	47.8	54.9	99.2	143.5	150.7	160.2

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	16,745	17,119	17,414
Trade and Other Receivables	3,362	2,687	2,046	2,188	5,328	5,706	6,095
Cash and Cash Equivalents	218	508	2,508	7,012	8,771	8,965	9,812
Total Current Assets	7,422	7,115	9,942	16,228	31,716	32,663	34,195
Total Assets	17,659	16,871	19,212	25,116	40,326	41,437	43,070
Equity							
Stated Capital	537	537	537	537	537	537	537
Retained Earnings	5,098	4,972	5,397	7,897	11,321	14,021	16,959
Total Equity	5,635	5,510	5,934	8,435	11,858	14,558	17,497
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	9,971	9,831	10,362
Income Tax Payable	681	653	935	728	968	1,775	2,186
Current Financial Liabilities	1,524	988	2,054	101	101	101	101
Total Current Liabilities	8,335	7,589	11,194	9,320	14,425	15,257	16,371
Total Liabilities	12,024	11,361	13,278	16,681	28,468	26,880	25,574
Total Equity and Liabilities	17,659	16,871	19,212	25,116	40,326	41,437	43,070
NAVPS	104.9	102.6	110.4	157.0	220.7	271.0	325.7



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