

29 July 2022

Nestlé (Malaysia) Bhd

Not Spared Pitfalls of Inflation

By Ahmad Ramzani Ramli | ahmadramzani@kenanga.com.my

NESTLE's 1HFY22E earning came in broadly in-line with our forecast but exceeded consensus estimates. While we expect topline to be robust, courtesy of the economy being in the endemic phase, we remain cautious as input prices are likely to stay elevated, suppressing margins. Earnings estimates are unchanged but we lowered our TP to RM119.75 (DCF-derived based on a WACC of 4.9% and TG of 2%) to reflect a higher risk-free rate on a rising interest rate environment. Downgrade to **UNDERPERFORM** from **MARKET PERFORM**.

Met our forecast, beat the market. 1HFY22 PATAMI of RM375m met our expectation at 53% of our full-year forecast but beat market expectations at 62% of consensus full-year estimate. An interim DPS of 70.0 sen (implying a 44% payout) declared is broadly within expectation as NESTLE usually pays a bumper dividend in the 2H of the financial year.

1HFY22, topline grew 18% to RM3.3b as economies reopened. Domestic and export sales grew 14% and 36%, respectively, with domestic sales boosted by strong F&B and retail performances. F&B business grew 17% to RM2.8b, cementing its position as the largest topline contributor at 83%. GP margin saw a 2ppt erosion to 33% (vs. our assumptions of 34%) on account of the still elevated commodity prices and supply disruptions. However, EBITDA margin improved slightly by 1% on account of reduced Covid-19 related expenses. Nestle also introduced several new products that we believe had helped to improve margins. PATAMI ended 19% higher to RM375m as the impact of Cukai Makmur was milder than expected, at 29% vs. our estimate of 34%.

QoQ performance showed deterioration in both the topline and margins. 2QFY22 topline fell 3% sequentially to RM1.6b which we reckon was due to consumers tightening their belts as inflation ate into their disposable incomes. Likewise, 2QFY22 margins fell by 2-3ppt sequentially which we believe was due to NESTLE choosing to absorb part of the higher input costs.

Cautious outlook ahead. We are cautious on NESTLE's outlook. We see downside risks to its topline growth and margins as consumers down trade, i.e. opting for cheaper brands or alternatives, while cost pressures remain with extended supply chain disruptions as well as a seemingly prolonged Russian-Ukraine war. Dairy prices, in particular, are expected to continue on an uptrend into 2023 as supply is only expected to catch up with demand by end-2023, according to expert opinion. Apart from concerns over the loss of market shares, we believe NESTLE has moral as well as ESG obligations not to excessively raise prices of its staple food products that make up the daily diet of the population.

Post results, we maintained our earnings estimates.

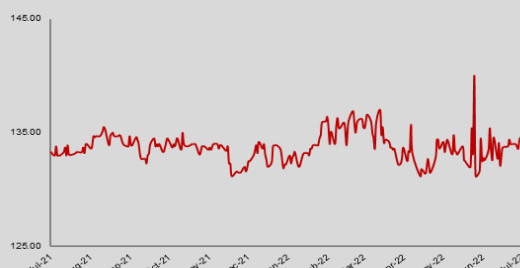
We revise down our valuation applying a DCF-derived TP of RM119.75 (RM136.50 previously) based on a WACC of 4.9% and TG of 2%. There is no adjustment to TP based on ESG of which it is given a 3-star rating as appraised by us. Downgrade to **UNDERPERFORM**.

Risks to our call include: (i) Normalization of food commodity prices, (ii) Stronger ringgit resulting in lower cost of imported raw materials.

UNDERPERFORM

Price : RM133.40
Target Price : RM119.75

Share Price Performance



KLCI	1,486.25
YTD KLCI chg	-5.2%
YTD stock price chg	0.4%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	NESZ MK Equity
Market Cap (RM m)	31,610.6
Shares Outstanding	234.5
52-week range (H)	140.00
52-week range (L)	130.50
3-mth avg daily vol	79,444
Free Float	16%
Beta	0.4

Major Shareholders

Nestlé SA	72.6%
Employees Provident Fund	9.2%
Blackrock	1.9%

Summary Earnings Table

FY Dec (RM m)	2021A	2022E	2023E
Turnover	5,734	6,171	6,470
EBIT	786	1,025	871
PBT	752	989	842
Net Profit (NP)	570	703	638
PATAMI	570	703	638
Consensus (NP)		605	680
Earnings Revision	N.m	0%	0%
Core EPS (sen)	243.0	299.6	272.1
Core EPS growth (%)	3.1%	23.3%	-9.2%
NDPS (sen)	242.0	290.0	255.0
BVPS (RM)	2.5	2.6	2.8
Core PER (x)	55.5	45.0	49.5
Price/BV (x)	54.2	52.2	49.0
Net Gearing (x)	0.6	0.5	0.3
Net Div. Yield (%)	1.8%	2.2%	1.9%

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Results Highlights

FYE Dec (RM m)	2Q22	1Q22	QoQ Chg	2Q21	YoY Chg	6M22	6M21	YoY Chg
Turnover	1,639.0	1,693.8	-3.2%	1,379.8	18.8%	3,332.7	2,828.6	17.8%
Gross Profit	517.8	575.8	-10.1%	480.5	7.8%	1,093.5	999.3	9.4%
EBITDA	297.8	346.0	-13.9%	232.1	28.3%	643.8	507.6	26.8%
EBIT	247.8	297.8	-16.8%	185.3	33.8%	545.6	413.3	32.0%
PBT/(LBT)	237.9	288.7	-17.6%	177.0	34.4%	526.6	397.4	32.5%
Taxation	(68.3)	(83.5)	-18.2%	(42.5)	60.7%	(151.8)	(87.7)	73.0%
Net Profit	169.6	205.2	-17.3%	134.5	26.1%	374.8	309.7	21.0%
PATAMI	169.6	205.2	-17.3%	132.2	28.4%	374.8	315.5	18.8%
Core EPS (sen)	72.3	87.5	-17.3%	56.4	28.4%	159.8	134.6	18.8%
DPS (sen)	70.0	0.0	N.m	70.0	0.0%	70.0	70.0	0.0%
Gross Margin	31.6%	34.0%		34.8%		32.8%	35.3%	
EBITDA Margins	18.2%	20.4%		16.8%		19.3%	17.9%	
EBIT Margin	15.1%	17.6%		13.4%		16.4%	14.6%	
Pre-Tax Margin	14.5%	17.0%		12.8%		15.8%	14.0%	
Net Profit Margin	10.4%	12.1%		9.7%		11.2%	10.9%	
PATAMI Margin	10.4%	12.1%		9.6%		11.2%	11.2%	
Tax Rate	-28.7%	-28.9%		-24.0%		-28.8%	-22.1%	

Source: Company, Kenanga Research

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Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)		Net Div Yld (%) 1-Yr. Fwd.	Target Price (RM)	Rating	
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.					
F&B AND RETAIL																			
7-ELEVEN MALAYSIA HOLDINGS BHD	1.56	1,757.1	N	12/2022	10.2%	-2.6%	79.2%	-5.8%	39.7	22.1	23.5	14.2	12.7	60.6%	3.2%	1.70	OP		
AEON CO. (M) BHD	1.42	1,993.7	Y	12/2022	20.2%	4.4%	32.5%	8.8%	23.4	17.6	16.2	1.2	1.1	6.5%	2.9%	1.85	OP		
AMWAY (MALAYSIA) HOLDINGS BHD	5.15	846.6	Y	12/2022	-10.0%	-5.0%	62.6%	-4.8%	22.9	14.1	14.8	3.8	3.6	26.1%	5.2%	5.30	MP		
DUTCH LADY MILK INDUSTRIES BHD	33.00	2,112.0	Y	12/2022	1.0%	1.0%	-67.3%	5.2%	8.5	26.0	24.7	5.5	4.9	19.9%	1.5%	35.60	MP		
FRASER & NEAVE HOLDINGS BHD	21.36	7,834.4	Y	09/2022	4.8%	6.4%	-16.5%	3.5%	19.8	23.7	22.9	2.8	2.6	11.4%	2.3%	26.30	OP		
MR D.I.Y.	2.21	20,832.8	Y	12/2022	27.6%	16.1%	39.3%	23.5%	48.2	34.6	28.1	18.1	15.6	48.4%	2.1%	2.65	OP		
MYNEWS HOLDINGS BHD	0.365	249.0	N	10/2022	36.7%	12.1%	-22.7%	-147.1%	N.A.	N.A.	15.9	1.7	1.6	-22.1%	0.0%	0.500	UP		
NESTLE (MALAYSIA) BHD	134.80	31,610.6	Y	12/2022	7.6%	4.8%	23.3%	-9.2%	55.5	45.0	49.5	54.2	52.2	118.3%	2.2%	119.75	UP		
PADINI HOLDINGS BHD	3.25	2,138.2	Y	06/2022	23.3%	32.2%	123.6%	-4.1%	39.6	17.7	18.5	2.7	2.6	14.8%	3.7%	3.80	OP		
POWER ROOT BHD	1.80	749.2	Y	03/2023	8.2%	7.9%	7.3%	-6.8%	28.8	26.8	28.8	2.6	2.4	13.4%	5.0%	1.70	OP		
QL RESOURCES BHD	5.30	12,898.4	Y	03/2023	17.5%	11.1%	15.9%	34.3%	59.4	51.2	38.1	4.4	4.2	8.9%	1.1%	5.35	MP		
Simple Average					13.4%	8.0%	25.2%	-9.3%	34.6	27.9	25.6	10.1	9.4	27.8%	2.7%				
SIN																			
BRITISH AMERICAN TOBACCO (M) BHD	10.80	3,083.7	N	12/2022	-2.7%	-1.0%	-10.2%	5.6%	10.8	12.1	11.4	8.1	7.8	65.7%	7.9%	11.20	MP		
CARLSBERG BREWERY MALAYSIA BHD	22.66	6,928.2	N	12/2022	31.3%	6.0%	38.0%	15.1%	33.6	24.4	21.2	32.4	32.4	130.8%	4.1%	28.05	OP		
HEINEKEN MALAYSIA BHD	22.60	6,827.4	N	12/2022	30.8%	11.1%	32.8%	16.9%	27.8	20.9	17.9	17.3	17.3	82.5%	4.8%	27.40	OP		
Simple Average					19.8%	5.4%	20.2%	12.5%	24.1	19.1	16.8	19.2	19.2	93.0%	5.6%				

Source: Bloomberg, Kenanga Research

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Stock ESG Ratings:

	Criterion	Rating			
GENERAL	Earnings Sustainability & Quality	★	★	★	★
	Corporate Social Responsibility	★	★	★	★
	Management/Workforce Diversity	★	★	★	
	Accessibility & Transparency	★	★	☆	
	Corruption-Free Pledge	★	★	★	
	Carbon-Neutral Initiatives	★	★	★	
	OVERALL	★	★	★	
SPECIFIC	Employee Training	★	★	★	
	Energy Efficiency	★	★		
	Food Safety & Quality	★	★	★	★
	GMO	★	★	★	★
	Nutrition, Health & Wellness	★	★	★	☆
	Occupational Health & Safety	★	★	★	☆
	Renewable Energy	★	★	★	★
	Sustainable Supply Chain	★	★	★	★
	Waste Disposal/Pollution Control	★	★	★	★
	Water Efficiency	★	★	☆	

☆ denotes half-star
 ★ -10% discount to TP
 ★★ -5% discount to TP
 ★★★ TP unchanged
 ★★★★ +5% premium to TP

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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Published and printed by:

KENANGA INVESTMENT BANK BERHAD (15678-H)

Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

