CONSUMER

Maintain NEUTRAL

Soft consumer sentiment

KEY INVESTMENT HIGHLIGHTS

- **Food inflation, which encompasses fresh produce and non-alcoholic beverages, has been on a rising trend since June onwards, leading to expectancy of higher CPI**
- **Consumer sentiment to remain below the 100 level despite slight uptick seen in June 2019 in view of scepticism on the economic outlook**
- **We expect earnings pressure from F&B manufacturers who is heavily dependent on local sales**
- **Brick and mortar business remains the underdog, which lead to scaling down of future expansion plan**
- **Having a diversified income base which spread across different geographical locations will help to improve earnings quality**
- **Maintain NEUTRAL on the sector**

Private consumption to moderate to +7.3%yoy in 2HCY19. Private consumption grew +7.8%yoy during the 2QCY19, higher than +7.6%yoy recorded in the previous quarter. This was driven by a healthy distributive sales growth of +6.1%yoy attributable to the Hari Raya spending which was celebrated earlier this year, low inflation and stable labour market which facilitated the household expenditures. We view that the 25bp OPR cut on top of low inflationary pressure, and stable labour market would continue to support both distributive trade and private consumption in the 2HCY19. Nevertheless, the growth is likely to be impacted, particularly in 3QCY19, by the tax holiday period last year which ramped up household spending. As such, we forecast private consumption to moderate slightly to +7.3%yoy in the 2HCY19.

Food inflation leads to higher CPI in 2HCY19. In June 2019, the headline inflation accelerated to +1.5%yoy from tepid +0.2%yoy in May 2019. Food, inclusive of fresh produce, and non-alcoholic beverages inflation, which account for 29.5% of the Consumer Price Index (CPI) weightage, augmented to +2.3%yoy following low base effect subsequent to the removal of GST and higher demand for Hari Raya celebrations. Food inflation continues to increase at a faster pace of +2.4%yoy in July 2019. We expect the food inflation to remain elevated in the foreseeable term as: i) Malaysia remains a net importer of food, and ii) weak Ringgit will result in imported goods being more expensive. Meanwhile, we anticipate inflationary pressure steaming from fuel-related items to remain muted. In view of the above-mentioned factors, we foresee headline inflation rate to come in at +0.6%yoy this year (vs 2018: 1.0%yoy).

Consumer remains sceptical on the economic outlook. 2QCY19 Consumer Sentiment Index (CSI) increased by +7.4pts to 93.0. Nonetheless, it is still below the 100-point optimism threshold. The CSI peaked at 132.9 in 2QCY18 resulting from the change in political landscape and zero-rating of the goods and services tax (GST). Subsequent to this, the index has been on a declining trend. The fall is mainly attributable to the pessimistic view of the consumers towards the economic environment. It was marked by the volatile equity market, weak Ringgit and the strong pick up in food inflation that have led to reduction in the consumer purchasing power. To partially alleviate the concern, the Government's carry out the third Bantuan Sara Hidup (BSH) handout in August 2019. In addition, the upcoming target fuel subsidy would further bolster consumer sentiment. Despite this, we do not expect the CSI to climb above the 100.0 level in the near term.

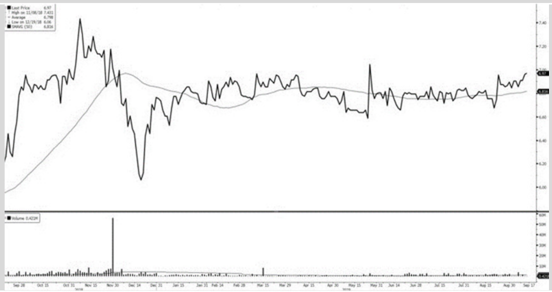
COMPANY IN FOCUS

QL Resources Bhd

Maintain NEUTRAL | Unchanged Target price: RM7.46
Price @ 13th September 2019: RM6.97

- Strong competitive advantage via vertical integration
- Horizontal diversification provides protection from investment risk
- The convenience store segment is a new growth driver for the group

Share price chart

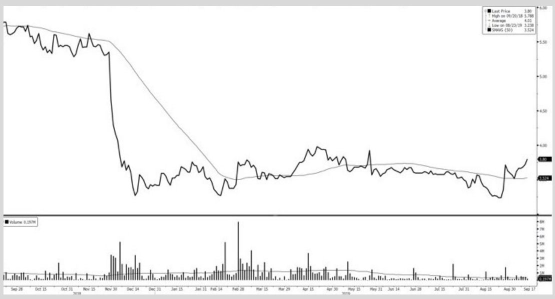


Padini Bhd

Maintain SELL | Unchanged Target price: RM2.86
Price @ 13th September 2019: RM3.80

- Higher cost of inventory sold led to a lower margin
- As competition intensifies, we view that there is little room for upward price revision
- The adoption of MFRS 16 is expected to have a negative impact on earnings

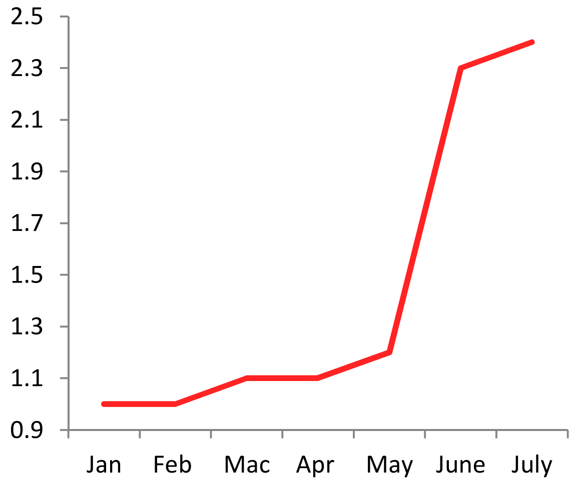
Share price chart



ANALYST (S)
NABIL Zainoodin, CFA, CA
nabil.zainoodin@midf.com.my
03 -2772 1679

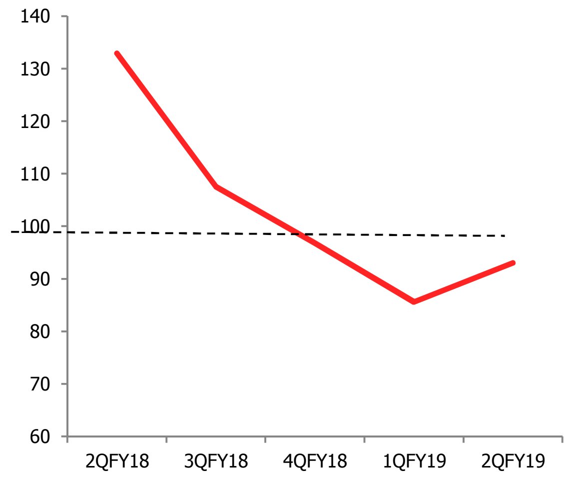
Consumer products companies' 2QCY19 financial performance was within our expectation. In the recently concluded 2QCY19 earnings season, the financial performance of top consumer products businesses namely **Nestlé (Malaysia) Berhad (Neutral; TP: RM149:50)**, **F&N Holdings Berhad (Neutral; TP: RM33.78), Leong Hup International Berhad (BUY; TP: RM0.88), and QL Resources Berhad's (Neutral; TP: RM7.46)** came in within our expectation. Of this, we gathered that large consumer products companies which derived the bulk of its earnings locally registered subdued earnings performance.

Figure 1: Food & Non-Alcoholic Beverage Price Inflation (YoY%)



Source: DOSM, MIDFR

Figure 2: MIER Consumer Sentiment Index



Source: MIER, MIDFR

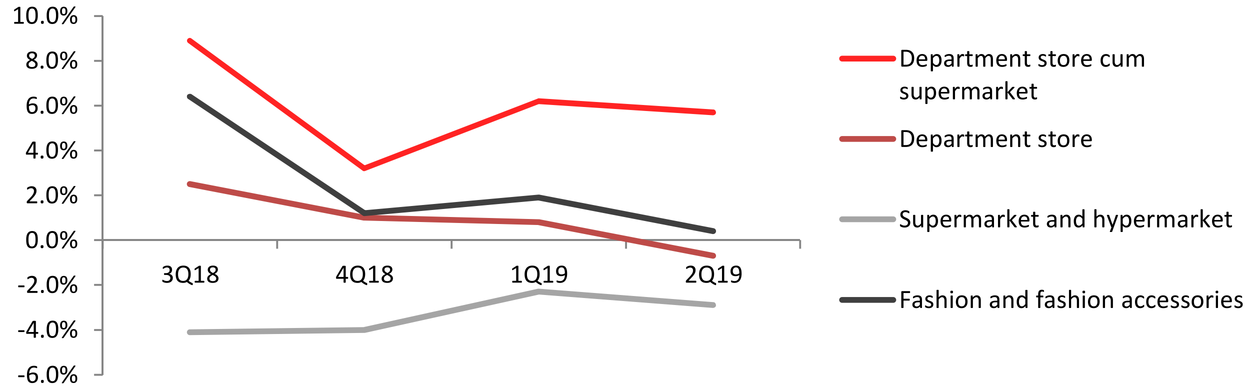
To address disappointing domestic sales... The domestic wholesales for food, beverage and tobacco grew by +6.8%yoy in 2QCY19 as reported by Department of Statistics Malaysia (DOSM). However, in comparison, revenue of F&B manufacturers under our radar underperform the industry benchmark. Nestlés's, being one of the largest F&B manufacturers which generated the bulk of its sales in Malaysia, 2QFY19 grew at a slower pace of +2.0%yoy. On the contrary, its direct competitor, **Dutch Lady Milk Industries Berhad (Non-rated)**, posted a -4.2%yoy decline in sales. Meanwhile, F&N's Malaysian operation posted a lower revenue growth of +4.7%yoy in comparison to its Thailand operation of +18.8%yoy. We gathered that the subdued sales performance was due to the availability of cheaper alternatives to their products. As such, we expect the revenue growth of these companies to remain tepid should it fail to price their products more competitively.

...top F&B players are adopting a more aggressive pricing strategy. In response to the relatively sluggish local sales, more efforts are placed by F&B companies to price their product more competitive to cater to the masses. For instance, Nestlé has committed to maintain the product prices of six items that are most consume by the B40 category. These includes Maggi Chili Sauce (340g), Nescafe Classic (50g), Nestum Original (250g), Milo (200g), Koko Crunch (80g) and Everyday Milk (300g). Dutch Lady has also undergone repricing strategies to stave off the intense competition in the dairy segment. We view that their effort to defend the market share would inevitable result in thinning profit margin.

Diversification strategy leads to more resilient earnings. We observed that the significant drop in broiler's selling prices in 2QCY19 had negatively affected the financial performance of poultry players such as Leong Hup and QL Resources. Thankfully, the impact to the latter was less severe given its diversified operations which spread across various geographical locations. The downturn suffered by its poultry and palm oil operation was counterbalanced by its export oriented marine product manufacturing and premium convenience store operation. Furthermore, the geographical diversification strategy makes its operation more resilient to any particular country-specific risk. As mentioned earlier, F&N's overall earnings was also lifted by the performance of its Thailand's operation. Thus, we can safely conclude that having the right mix of earnings base which spread over different geographical locations could help to manage specific investment risk in the current global economic climate.

Inconsistent performance of brick and mortar retail businesses. The Retail Group Malaysia (RGM) reported that brick and mortar retail companies have recorded a +4.5%yoy growth in 2QCY19 sales. As we delved into the sub-segment level, we observed that there is disparity in sales performance. For instance, the department store-cum-supermarket achieved a commendable growth of +5.7%yoy. On the contrary, standalone departmental store operators' sales contracted by -0.7%yoy. While the supermarket and hypermarket sub-segment's registered a -2.9%yoy reduction in sales in view of stores closure. Interestingly, the pharmacy and personal care segment continues to be the best performing sub-segment with sales growth of +14.2%yoy. Premised on this, we believe that **Aeon Co. (M) Berhad (Neutral, TP: RM1.60)**, which has business presence across all the retail sub-segment, would be in a better position to weather the challenging brick and mortar retail business.

Figure 3: Retail Growth by Sub-Segments (Quarterly)



Source: RGM, MIDFR

Retailers are scaling down expansion plan. We anticipate an increasingly challenging outlook for the consumer discretionary segment particularly in the fashion industry. The pessimistic view of the economic outlook has consumer to become more cautious on spending discretionary items as compared to basic necessities. In this regard, the Fashion and Fashion accessories sub-segment reported a slowdown of -0.4%yoy in 2QCY19. Moreover, the heightening competition among brick and mortars retailers and shift in preference to the online shopping platform have led to overall decline in retail prices. In view of this, **Padini Holdings Berhad (Sell, TP: RM2.86)** has scaled down their future stores expansion plan. We understand that, at this juncture, Padini has no concrete plan to open new outlet in FY20. This will lead to moderate sales-growth in the immediate term.

Maintain Neutral. We believe that the private consumption growth to remain above seven percent, driven by a supportive monetary and fiscal policy changes which include OPR cut and steady retail fuel prices. Nevertheless, not all sub-segments are expected to perform equally well. We expect companies which provide basic necessities products would expect to fare better in comparison with those providing discretionary items such as fashion products. In addition, having a diverse products portfolio across different geographical location would further reinforce the earnings quality. That being said, the well-being of F&B manufacturers would primarily depend on their abilities to offer value-for-money products to the general masses. As such, we infer that financial performance of consumer companies are heavily reliant on the consumer's willingness to spend. Due to the absence of significant positive catalyst, we are reiterating our **NEUTRAL** stance on the sector.

PEER COMPARISON TABLE

Stock	FYE	Recommendation	Price @ 13-Sep-19	TP (RM)	EPS (sen)		PER (x)		Net DPS (sen)		Net Divd Yield (%)	
					FY19E	FY20F	FY19E	FY20F	FY19E	FY20F	FY19E	FY20F
Nestlé	Dec	NEUTRAL	146.70	149.50	297.6	312.3	49.3	47.0	300.0	315.0	2.0	2.1
F&N	Sep	NEUTRAL	35.50	33.78	121.3	129.9	29.3	27.3	72.5	77.5	2.0	2.2
QL Resources*	Mar	NEUTRAL	6.97	7.46	15.5	18.2	45.0	38.3	5.5	6.5	0.8	0.9
Leong Hup	Dec	BUY	0.81	0.88	5.3	5.6	15.2	14.4	1.9	2.0	2.4	2.5
Spritzer	Dec	NEUTRAL	2.28	2.42	12.6	13.8	18.1	16.5	3.8	4.1	1.7	1.8
Aeon Co	Dec	NEUTRAL	1.51	1.60	8.2	8.0	18.4	18.9	4.0	4.0	2.6	2.6
Padini*	Jun	SELL	3.80	2.86	22.9	21.2	16.6	17.9	10.0	10.0	2.6	2.6
Panasonic	Mar	NEUTRAL	37.98	37.20	224.0	265.7	17.0	14.3	240.0	260.0	6.3	6.8

** FYE – FY20 and FY21*
Source: Company MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.