Idea Report | Wednesday, 30 March 2022

Nestlé (Malaysia) Berhad

(4707 | NESZ MK) | Consumer Products & Services| Food & Beverages

Potential prospects from the plant-based segment but short-term concerns on high commodity prices

***Downgrade to* SELL**

(previously NEUTRAL)

***Revised* Target Price: RM116.35**

(previously RM141.50)

KEY INVESTMENT HIGHLIGHTS

- **Growing trend for plant-based products to provide an upside potential for Nestle. However, it will not be immediate**
- **Concern remains on rising raw material prices and premium pricing of the products in the segment**
- **3-year CAGR estimated at a modest 3.0%**
- **Downgrade to SELL (previously NEUTRAL) with lower TP of RM116.35 (previously RM141.50)**

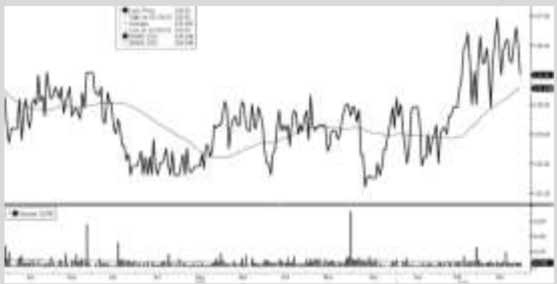
Growing trend for plant-based products. Veganism is a lifestyle that excludes all forms of animal exploitation and cruelty through food, clothing or other methods. Hence, a vegan diet is made up of only plant-based food and excludes all food from animal sources such as meat, seafood, dairy, eggs and honey. According to a report from Bloomberg Intelligence, titled Plant-Based Foods Poised for Explosive Growth, the global plant-based alternatives market could grow almost fivefold, from USD29.4b in 2020 to USD162b in 2030. The primary factor behind this strong shift away from animal sourced food is on ethical, environmental and health grounds. In a joint report called 'The Asia Food Challenge 2021' by PwC, Rabobank and Temasek, 20% of Malaysian respondents said they were likely to adopt a plant-based diet within a year, lower compared to Indonesia (43%) and Thailand (37%). This is because the plant-based food is not competitively priced and the prices are considerably higher compared to the meat products. However, with the shift in consumption patterns and growing demand for plant-based products, this price difference is expected to reduce in the next few years.

Plant-based developments in Malaysia. Plant-based meat are produced from plant-derived products to resemble the taste, texture and structure of the original meat counterparts. As such, the plant-based meat can be regarded as complex products requiring infusion of high technology, under the National Investment Aspiration. The Malaysian Investment Development Authority (MIDA) is encouraging companies to manufacture plant-based meat alternatives in Malaysia with potential to be exported worldwide to cater for the growing trend. This is in line with its commitment to support the sustainable development agenda of the nation.

Nestle plant-based initiatives. Currently, Nestle has invested RM150m to set up a plant-based meals solution manufacturing facility in Shah Alam, being the first of its kind in South East Asia, and one of the two in Asia. The Halal-certified products will cater to both the local and export markets under its Harvest Gourmet brand. The first plant-based plant in Asia was in Tianjin, China. Additionally, Nestlé is also developing a wide variety of dairy alternatives made from pea, rice, oat, soy, coconut and almonds, for both powdered and ready-to-drink beverages.

RETURN STATISTICS	
Price @ 29th March 2022 (RM)	135.00
Expected share price return (%)	-13.82
Expected dividend yield (%)	+1.83
Expected total return (%)	**-11.99**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	0.7	2.3
3 months	0.6	-1.6
12 months	-1.1	0.6

KEY STATISTICS	
FBM KLCI	1,583.42
Syariah compliant	Yes
F4BGM Index	No
ESG Grading Band (Star rating)	☆☆☆☆
Issue shares (m)	234.5
Estimated free float (%)	15.96
Market Capitalisation (RM'm)	31,657.50
52-wk price range	RM130- RM138
Beta vs FBM KLCI (x)	0.42
Monthly volatility (%)	2.88
3-mth average daily volume (m)	0.05
3-mth average daily value (RM'm)	7.35
Top Shareholders (%)	
Yee Lee Corporation	72.61
Tasik Puncak Holdings	9.36
Yee Lee Holdings	1.79

MIDF RESEARCH
research@midf.com.my

Under the Harvest Gourmet brand, there are 5 types of meat-free burgers and fillets, made from plant-based proteins derived mainly from soy and wheat. By looking at its European focused plant-based, Garden Gourmet brand which consists of 7 different plant-based products, we estimate Harvest Gourmet to introduce more products, tailored to the local tastebuds. The Group has shared the addition of a new Nuggets category under the Harvest Gourmet brand this year to increase plant-based food options. Besides Harvest Gourmet, Nestle also provides plant-based products from across its portfolio such as Milo and Nescafe products. On a global scale, Nestle SA embarked on its plant-based mission since 2017 with the acquisition of plant-based brands, Sweet Earth and Garden Gourmet, catering the growing demand in the US and Europe markets, respectively. To note, in 2021, Nestle SA recorded a +16.8%yoy growth in its plant-based segment.

Key drivers for plant-based adoption in Malaysia. According to a study conducted by AT Kearney, although the plant-based market is currently dominated by the US, followed by Europe, the Asia Pacific market is expanding at a fast rate and is forecasted to hold the largest share of the global plant-based market by 2025. This is primarily due to existing familiarity with soy-based mock meats, fermented protein such as tofu, tempeh and rising environmental and health awareness, as well as technological advancements which will allow production of alternative meat. From the health perspective, we think the prevalence of lactose intolerance in Malaysia will also increase adoption of a dairy-free diet. A study conducted by lecturers from National University of Malaysia (UKM) between 2015 and 2017 involving 400 children from the urban areas in Klang Valley revealed that only 12.3% of children were lactose tolerant. As such, we think that this would bode well for the potential of the current dairy-free beverages under Nestle and also spur the innovation for more dairy-free products such as ice-cream, yogurt and other confectionaries. Additionally, while the usual imported plant-based brands target the premium grocers, we think positively of Nestle's move to supply the products through e-commerce to reach a wider group of consumers who have grown to be familiar with online shopping.

Premium pricings of items in the plant-based segment. Among Nestle's beverages, the plant-based drinks are priced at a premium compared to the non-plant-based drinks. This higher price can be attributed to the additional blending, bottling and packaging costs, in addition to the constant innovation and marketing in the segment. Despite this, we think that the cost of production will possibly reduce in the future as the segment matures and production scales up, led by improved demand. On the other hand, the price of the plant-based burger by Nestle is more competitive compared to the plant-based burgers by other brands. This is because the other plant-based burgers are being imported from overseas, whereas the Nestle burgers are manufactured locally.

Table 1: Items and Pricings of Nestle's Plant-based Products

Items	Nestle Plant-based Products	Nestle Other Products	Other Plant-based
Milo (225ml)	Milo Almond Milk: RM4.50	Milo Activ-Go: RM1.90	N/A
Milo (1L)	Milo Almond Milk: RM13.99	Milo Activ-Go: RM5.90	N/A
Milo Powder Drink	Milo Plant-based Energy (395g): RM35.00	Milo Activ-go powder (400g): RM8.50	N/A
Nescafe Latte	Nescafe Almond/Oat Latte (225ml): RM3.30	Nescafe Latte (240ml): RM2.40	N/A
Burger	Sensational Burger – 3 servings per pack (339g): RM17.50	N/A	Burger with 4 servings (around 300g) RM23.90- RM32.90

Source: Company

Rising commodity prices will affect margins and led to slower growth. As soy and wheat are the primary ingredients for the meat-free burger under Harvest Gourmet, we posit that the rising price of the raw materials, exacerbated by the Russia-Ukraine war, will affect profit margins for the Group's plant-based segment. Despite the Group's cost management initiatives, we think that if the raw material prices continue with the current momentum, there will be possible price hikes for items in the segment. Due to the price sensitive nature of the majority Malaysian consumers, we think that price hikes in the already premium plant-based products segment will result in slower growth of the segment as customers will switch to affordable options.

Chart 1: Soy price (23/03/2019 – 23/03/2022)

Source: Bloomberg

Chart 2: Wheat price (23/03/2019 – 23/03/2022)

Source: Bloomberg

Short-term pressure to margins from rise in commodity prices. Although we think that the Group would pass-through some of the cost to the end consumers, we do not think this would be substantial as the Group is committed to maintain its brand as a largely affordable food option in the country. Hence, we think the price hikes would not be significant to cover the rising cost of operations.

Plant based segment is a long-term play. As the plant-based segment for the Group is still in the nascent stage, the contribution to the Group's total earnings will remain modest for the next 3 to 5 years before becoming a more significant contributor. We estimate that the plant-based and dairy alternatives segment will gain market share, over the years and be accretive to the Group's earnings, given the Group's track record of developing products tailored to the domestic taste buds and relevant.

Earnings for FY22E and FY23F trimmed by -16.0% and -25.4%. We revised our earnings estimates downwards to account for the rising cost of raw materials which we think this would continue to affect profit margins, moving forward.

Downgrade to SELL with a lower TP of RM116.35 (previously RM141.50). We estimate the Group to record moderate earnings for FY21F-FY23F, with an estimated 3-year CAGR of 3.0%. The Group is currently trading around 53.0x 12-month forward PE, which is considerably higher than its 5-year mean PE of 42.0x. This is despite earnings for the recent 4QFY21 results showing a considerable decline and coming below consensus. We think that the Group is currently overvalued at the current trading levels, with a moderate dividend yield of 1.8%. As such, we think that the PE will return to its median range due to lack of strong imminent catalysts to support the current valuations. Our TP is based on DDM-derived valuation with a growth rate of 2.6% and cost of equity of 4.7%. All-in, we downgrade our recommendation for the stock to **SELL.**

INVESTMENT STATISTICS

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	2019A	2020A	2021A	2022E	2023F
Revenue	5,518.1	5,412.2	5,733.8	5,989.8	6,289.3
Cost of sales	(3,444.6)	(3,446.7)	(3,755.6)	(3,713.7)	(4,402.5)
Gross profit	2,073.5	1,965.5	1,958.2	2,276.1	1,886.8
PBT	875.7	724.8	751.8	778.7	754.7
PAT	**672.9**	**552.7**	**569.8**	**584.0**	**596.2**
Normalised PAT	672.9	608.5	569.8	584.0	596.2
EPS (sen)	287.0	235.7	243.0	249.0	254.3
Normalised EPS (sen)	287.0	259.5	243.0	249.0	254.3
Net Dividend (sen)	280.0	232.0	242.0	247.0	252.0
Gross profit margin (%)	37.6	36.3	34.2	38.0	30.0
PBT margin (%)	15.9	13.4	13.1	13.0	12.0
Normalised PAT margin (%)	12.2	10.2	9.9	9.8	9.5
Normalised EPS growth (%)	3.8	(9.6)	(6.4)	2.5	2.1
Dividend yield (%)	2.1	1.7	1.8	1.8	1.9
PER (x)	47.5	52.6	56.1	54.2	53.1

Source: Company, MIDFR

PEER COMPARISON TABLE

Company	Recommendation	Share Price* (RM) at 29/3/21	Target Price (RM)	Mkt Cap (RM 'b)	PER(X)	Dividend Yield (%)	ESG Grading Band
Nestle	SELL	135.00	RM117.51	31.7	53.2	1.8	☆☆☆☆
F&N	BUY	20.86	RM30.03	7.7	18.3	2.9	☆☆☆☆
Spritzer	BUY	1.94	RM2.63	0.4	12.8	2.3	N/A

*Price as at 29/3/2022

Source: Company, MIDFR

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (197501002077(23878 – X)).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (197501002077 (23878 – X)) for distribution to and use by its clients to the extent permitted by applicable law or regulation.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that MIDF Investment believes are reliable at the time of publication. All information, opinions and estimates contained in this report are subject to change at any time without notice. Any update to this report will be solely at the discretion of MIDF Investment.

MIDF Investment makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such. MIDF Investment and its affiliates and related companies and each of their respective directors, officers, employees, connected parties, associates and agents (collectively, "Representatives") shall not be liable for any direct, indirect or consequential loess, loss of profits and/or damages arising from the use or reliance by anyone upon this report and/or further communications given in relation to this report.

This report is not, and should not at any time be construed as, an offer, invitation or solicitation to buy or sell any securities, investments or financial instruments. The price or value of such securities, investments or financial instruments may rise or fall. Further, the analyses contained herein are based on numerous assumptions. This report does not take into account the specific investment objectives, the financial situation, risk profile and the particular needs of any person who may receive or read this report. You should therefore independently evaluate the information contained in this report and seek financial, legal and other advice regarding the appropriateness of any transaction in securities, investments or financial instruments mentioned or the strategies discussed or recommended in this report.

The Representatives may have interest in any of the securities, investments or financial instruments and may provide services or products to any company and affiliates of such companies mentioned herein and may benefit from the information herein.

This document may not be reproduced, copied, distributed or republished in whole or in part in any form or for any purpose without MIDF Investment's prior written consent. This report is not directed or intended for distribution to or use by any person or entity where such distribution or use would be contrary to any applicable law or regulation in any jurisdiction concerning the person or entity.

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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology