Company Update | Monday, 01 August 2022

Nestlé (Malaysia) Berhad

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

Maintain **NEUTRAL**

Unchanged **Target Price: RM141.50**

Cautious outlook

KEY INVESTMENT HIGHLIGHTS

- **High inventories**
- **Slightly higher capex**
- **Expect stable sales growth in 2HFY22**
- **Macro headwinds remains**
- **Reiterate NEUTRAL with an unchanged TP of RM141.50**

We attended the Nestle's 2QFY22 virtual briefing last Friday and remained cautiously optimistic for its FY22 earnings growth. Key highlights are as follows:

High inventories. In 1HFY22, Nestle posted reduced net cash from operating activities on the back of greater movement in working capital, which was primarily caused by a surge in inventories (+60.8%yoy) to RM1.02b of inventories. The higher stockpile is part of the company's strategy to; i) provide a cushion against the potential supply chain disruption, which enabling sufficient inventory to meet demand, and ii) act as a natural hedge against a potential raw material hike in 2HFY22.

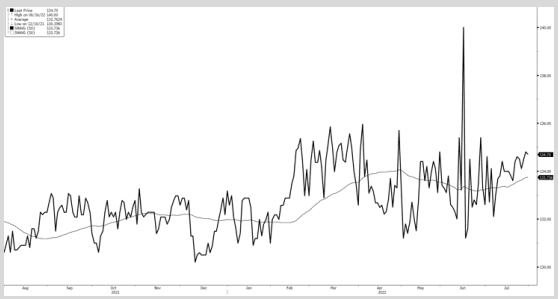
Slightly higher capex. Capital expenditure rose +1.32%yoy to RM86m in line with its strategy of product innovation and portfolio expansion. We opine that the slightly higher CAPEX would enable Nestle to concentrate on launching a stream of new products and open new avenues to ensure future growth. Recall that the group joined the plant-based market via its HARVEST GOURMET brand to meet the growing for plant-based foods in both Malaysian and international markets.

Macro headwinds remains. The group believes that the multiple headwinds will persist in 2HFY22. The still-high commodities & materials prices, currency fluctuations, supply disruption, and the increase in the minimum wage will have a significant influence on product costs, which might lead to a decline in profit margins. The group hedged against US Dollar to lessen the effects of a weakening RM because the raw materials were bought in US dollars. The final effort to mitigate the impact of margin erosion, according to management, will be an increase in selling price.

Expect stable sales growth in 2H22. The group are cautiously optimistic of a steady sales growth in the remaining 2HFY22 on the back of; i) gradual recovery in sales volume, especially for export sales as most of its exported countries have reopened its border; (ii) stable consumer demand and spending on its products; and (iii) continued product innovation and portfolio innovation to grow sales.

RETURN STATISTICS	
Price @ 29th July 2022 (RM)	134.70
Expected share price return (%)	+5.02
Expected dividend yield (%)	+2.18
Expected total return (%)	**+7.20**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	1.6	-1.3
3 months	1.6	8.5
12 months	1.3	1.4

KEY STATISTICS	
FBM KLCI	1,492.23
Syariah compliant	Yes
F4BGM Index	No
ESG Grading Band (Star rating)	☆☆☆☆
Issue shares (m)	234.50
Estimated free float (%)	16.10
Market Capitalisation (RM'm)	31587.15
52-wk price range	RM130 – RM140
Beta vs FBM KLCI (x)	0.45
Monthly velocity (%)	0.39
Monthly volatility (%)	2.75
3-mth average daily volume (m)	0.08
3-mth average daily value (RM'm)	10.52
Top Shareholders (%)	
Nestle SA	72.61
Employees Provident Fund Board	9.23
BlackRock Inc	1.89

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Outlook. We expect the group to continue experiencing margin compression moving forward due to its inability to fully pass on the higher input costs to the consumer amid the inelastic demand for its product. Nevertheless, Nestle's long-term prospects are positive, supported by its strong balance sheet and high inventories, which could provide a cushion towards any downside risk.

Maintain NEUTRAL with an unchanged TP of RM141.50. Post analyst briefing, we kept our earnings forecast as we had previously factored in the higher input costs when making our forecast. Our TP is based on DDM-based valuation with a sustainable growth rate of 2.5% and weighted average cost of capital (WACC) of 5.2%. Downside risks are: (i) a significant depreciation of RM against the US Dollar; and (ii) a further increase in commodity prices which posted upward pressure on the margin.

INVESTMENT STATISTICS

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY2020	FY2021	FY2022E	FY2023F	FY2024F
Revenue	5,421.2	5,733.8	5,792.9	6,024.6	6,265.6
Cost of sales	(3,446.7)	(3,775.6)	(3,823.3)	(3,988.3)	(4,166.6)
Gross profit	1,965.5	1,958.2	1,969.6	2,036.3	2,099.0
PBT	724.8	741.8	918.2	945.9	1,033.8
PAT	**552.7**	**569.8**	**695.3**	**737.8**	**806.4**
Normalised Net Profit	**544.9**	**569.4**	695.3	737.8	806.4
EPS (sen)	232.4	242.8	296.5	314.6	343.9
Normalised EPS (sen)	232.4	242.8	296.5	314.6	343.9
Net Dividend (sen)	232.0	242.0	294.0	312.0	341.0
Gross profit margin (%)	36.3	34.2	34.0	33.8	33.5
PBT margin (%)	13.4	12.9	15.9	15.7	16.5
Normalised PAT margin (%)	10.2	9.9	12.0	12.2	12.9
Normalised EPS growth (%)	(19.0)	4.5	22.1	6.1	9.3
Dividend yield (%)	1.7	1.8	2.2	2.3	2.5
PER (x)	58.0	55.5	45.4	42.8	39.2

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.
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