Briefing Note | Friday, 28 October 2022

Nestlé (Malaysia) Berhad

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

Maintain **NEUTRAL**

Demand remains intact

Unchanged **Target Price: RM137.80**

KEY INVESTMENT HIGHLIGHTS

- **Green initiatives continue**
- **High movement in working capital**
- **RM40.1m of provision and write off inventories in 3QFY22**
- **Solid demand despite multiple price adjustment**
- **Manageable impact from strengthening USD**
- **Maintain NEUTRAL with an unchanged TP of RM137.80**

We attended Nestle's 3QFY22 result briefing and we remain positive on its topline growth for FY22. Key takeaways from briefing are as below:

Green initiatives continue. Nestle Malaysia adopted 100% of rPET for the bottled Nescafe Iced series. This is consistent with the group's sustainability objectives to launch out and scale up recycled polyethylene terephthalate (rPET) across all product lines. The group also introduced paper cluster packaging, which is compatible with its sustainability goal of using paper-based solutions to reduce the use of plastic.

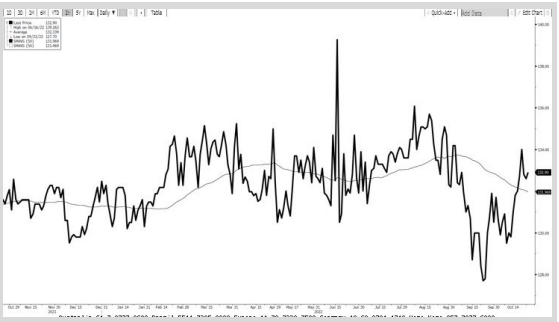
High movement in working capital. The group's working capital movement expanded in 9MFY22, mainly due to increased inventories. Recall that the purpose of the higher inventories is to ensure that there will be enough stock despite supply chain disruption. It also serves as a partial hedge against rising commodity prices. In view of the recent reduction in global supply chain disruption, management anticipates lower inventories ahead which could improve working capital. The management also expects commodity prices to stabilize in the next three to six months, which might result in further working capital reductions.

RM40.1m of provision and write off inventories in 3QFY22. This is equivalent to 35.6% of 3QFY22 PAT. The provision was introduced to guard against the risk of obsolete raw material and packaging because of the product reformulations. The group intends to propose multiple product reformulations to lower the sugar content in view of Malaysia's imposition of a sugar tax.

Solid demand despite multiple price adjustment. The company has been able to pass on some of the increased costs to customers since December 2021 by making several price changes. We saw that the topline has steadily increased since 1QFY22. This shows that despite multiple price adjustments to pass on costs, sales volume and consumer momentum are still high.

RETURN STATISTICS	
Price @ 27th October 2022 (RM)	132.80
Expected share price return (%)	+3.8
Expected dividend yield (%)	+2.2
Expected total return (%)	**+6.0**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	2.5	-0.6
3 months	2.1	0.2
12 months	-0.4	8.4

KEY STATISTICS	
FBM KLCI	1,453.60
Syariah compliant	Yes
F4BGM Index	No
ESG Grading Band (Star rating)	☆☆☆☆
Issue shares (m)	234.50
Estimated free float (%)	16.34
Market Capitalisation (RM'm)	31,165.05
52-wk price range	RM127 - RM140
Beta vs FBM KLCI (x)	0.45
3-mth average daily volume (m)	0.07
3-mth average daily value (RM'm)	9.08
Top Shareholders (%)	
Nestle SA	72.61
Employees Provident Fund Board	8.99
BlackRock Inc	2.06

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Manageable impact from strengthening USD. The bottom line will be significantly impacted by the stronger USD. Since most raw materials are purchased in USD, hence the group is subject to foreign exchange risk. The impact is however manageable as the group has a foreign exchange contract to hedge against the volatility. To hedge foreign exchange risk, the Group generally uses forward foreign exchange contracts with maturities of 3-5months. Additionally, exports serve as a natural hedge to minimize the impact of weak local currencies.

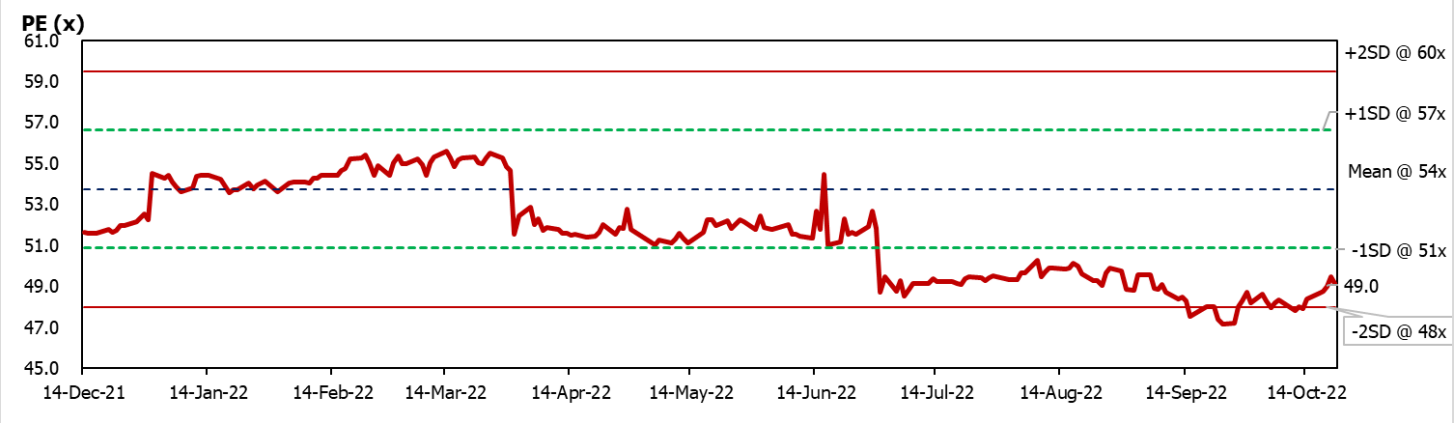
Maintain NEUTRAL with an unchanged TP of RM137.80. We make no changes to our estimation post analyst briefing. Our TP is based on a DDM-based valuation with a sustainable growth rate of 2.5% and a revised weighted average cost of capital (WACC) of 5.8%. We expect the group to continue experiencing cost pressure in the near term, due to the high commodity prices and energy costs. Nevertheless, we think that the top-line growth would remain solid ahead, supported by its staple nature coupled with its continuous product innovation to meet different consumer preferences. **Downside risks** are: (i) a further increase in commodity prices which posted upward pressure on the margin; and (ii) higher-than-expected energy cost.

INVESTMENT STATISTICS

FYE Dec (RM'm)	2020A	2021A	2022E	2023E	2024E
Revenue	5,412.2	5,733.8	6,641.1	6,860.5	7,087.4
Cost of Sales	(3,446.7)	(3,775.6)	(4,550.1)	(4,606.4)	(4,616.0)
Gross Profit	1,965.5	1,958.2	2,091.0	2,254.1	2,471.4
EBIT	752.1	785.9	906.3	1,026.1	1,130.8
Net finance (expenses)/income:	(31.9)	(35.0)	(43.4)	(55.8)	(69.8)
Profit before Associates & JV	**720.2**	**750.9**	**862.9**	**970.3**	**1,061.0**
Profit before tax (PBT)	720.9	751.6	862.9	970.3	1,061.0
Income tax expense	(172.1)	(182.0)	(239.9)	(232.9)	(254.6)
Profit After tax (PAT)	**548.8**	**569.6**	**623.0**	**737.4**	**806.4**
PATANCI	548.8	569.6	623.0	737.4	806.4
Core PATANCI	**546.9**	**575.3**	**695.0**	**737.4**	**806.4**
Basic EPS (sen)	234.0	242.9	265.7	314.5	343.9
Core EPS (sen)	233.2	245.3	296.4	314.5	343.9
DPS (sen)	232.0	242.0	293.4	311.3	340.4
Growth & Margin					
Revenue Growth (%)	(1.9)	5.9	15.8	3.3	3.3
Gross Profit Growth (%)	(5.2)	(0.4)	6.8	7.8	9.6
Core PATANCI Growth (%)	(17.7)	5.2	20.8	6.1	9.3
Gross Profit Margin (%)	36.3	34.2	31.5	32.9	34.9
PBT Margin (%)	13.3	13.1	13.0	14.1	15.0
Core PATANCI Margin (%)	10.1	10.0	10.5	10.7	11.4
Ratios & Valuation					
Effective tax rate (%)	23.9	24.2	27.8	24.0	24.0
Dividend Yield (%)	1.7	1.8	2.2	2.3	2.6
PER (x)	56.8	54.8	50.1	42.3	38.7
Cash/share (sen)	4.0	2.9	4.8	5.0	5.1
Net Debt to Equity	62.5	58.1	69.5	84.1	101.6
Price to Book Value (P/B)	56.0	53.5	52.8	52.2	51.5
EV/EBIT (x)	41.9	40.1	34.9	30.9	28.1

Source: Company, MIDFR

NESTLÉ (MALAYSIA) BERHAD: 2-Year Forward PE



Source: Bloomberg, 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