Corporate Update | Thursday, 23 February 2023

Nestlé (Malaysia) Berhad

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

Maintain **NEUTRAL**

Unchanged **Target Price: RM139.50**

Expanding Premium Nutrition Segment

KEY INVESTMENT HIGHLIGHTS

- **High movement in working capital**
- **Price adjustment strategy**
- **Targeted CAPEX**
- **Solid demand**
- **Proposed acquisition of Wyeth Nutrition (Malaysia) Sdn. Bhd**
- **Reiterate NEUTRAL with an unchanged TP of RM139.50**

We attended Nestle's virtual analyst briefing yesterday and remain cautious about Nestle's near-term prospects. The following were the key takeaways from the briefings:

High movement in working capital. The group reported greater movement in working capital of -RM353.8m in FY22 as compared to +RM83.9m in FY21. This was attributed to increased inventories caused by the global supply chain disruption. Recall that the main objective of the higher inventories is to ensure that there will be enough stock despite supply chain disruption. Going forward, the group anticipates lower working capital movement in FY23 due to the normalization of the supply chain and improved shipment time.

Price adjustment strategy. In FY22, the group introduced several price adjustments to pass on the increased input costs to customer. However, the group does not fully pass on higher input costs to maintain competitiveness. Moving forward, the group does not rule out the possibility of introducing price adjustments in FY23F to partially pass on the increased cost in the event of rising global commodity prices.

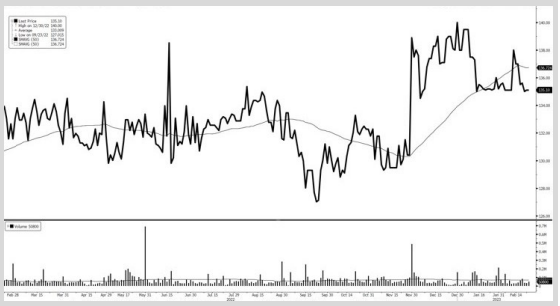
Targeted CAPEX. The group allocated a capital expenditure of RM1b for FY23-25F. This includes funding for the installation of new production capacity as well as machine upgrades to remain competitive in the market.

Solid demand. The management expects the consumer sentiment for Nestle's products to remain strong in FY23F due to its well-known household name, as well as the reopening of borders, particularly in China, which will increase demand for consumer products.

Proposed acquisition of Wyeth Nutrition (Malaysia) Sdn. Bhd ("Wyeth HK"). On a separate note, Nestle Malaysia had on 22 Feb 2023 via its wholly-owned subsidiary of Nestle Products Sdn. Bhd ("Nesmal") entered into a conditional share purchase agreement with Wyeth HK for the acquisition of for 100% equity interest in Wyeth Malaysia for cash consideration of RM165m. The agreement involves obtaining 1.97m ordinary shares of Wyeth Malaysia. Note that Wyeth Malaysia is a wholly owned subsidiary of Wyeth HK that is engaged in trading and dealing in nutritional products to satisfy the needs of infants, young children, pregnant women, lactating mothers, and the elderly. The acquisition is a related party transaction, given that Nestle SA ("SPN") is the major shareholder for Wyeth HK, Wyeth Malaysia, and Nestle Malaysia.

RETURN STATISTICS	
Price @ 22nd February 2023 (RM)	135.10
Expected share price return (%)	+3.2
Expected dividend yield (%)	+1.9
Expected total return (%)	**+5.17**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-0.1	2.4
3 months	-3.5	2.0
12 months	-1.0	6.7

KEY STATISTICS	
FBM KLCI	1,464.00
Syariah compliant	Yes
F4BGM Index	No
ESG Grading Band (Star rating)	☆☆☆☆
Issue shares (m)	234.50
Estimated free float (%)	16.47
Market Capitalisation (RM'm)	31,680.95
52-wk price range	RM127. - RM140.
Beta vs FBM KLCI (x)	0.46
3-mth average daily volume (m)	0.07
3-mth average daily value (RM'm)	9.44
Top Shareholders (%)	
Nestle SA	72.61
Employees Provident Fund Board	8.88
BlackRock Inc	1.94

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Positive about the proposed acquisition of Wyeth Malaysia. We are optimistic about the acquisition considering that it will diversify Nesmal's revenue streams, boost market share in the premium nutrition area, and expand its product portfolio. We also expect the acquisition to broaden Nesmal's clientele and boost its market share in the premium nutrition sector. Note that Wyeth Malaysia is well-known in the premium nutrition market with a 16.6% market share in the premium segment. Given that Wyeth Malaysia has a well-established history of offering scientifically formulated and nutritionally balanced products, Nesmal will be able to provide high-quality infant nutrition products that are customized to the unique needs of newborns and young children.

Strong net cash flow from operating activities. We gather that the proposed acquisition will be funded via internally generated funds entirely in cash. Given that Nestle has a proven track record of generating strong net cash from operational activities, we believe that the group will be able to fully fund the acquisition without raising borrowings.

Maintain NEUTRAL with an unchanged TP of RM139.50. Given that the proposed acquisition is still at the initial stage, we make no changes to our earnings projection for FY23-25F. Our target price of RM139.50 is based on DDM valuation with a 3.5% growth rate and a WACC of 7.0%. Moving forward, we believe that top-line growth will remain stable in the future, thanks to its staple nature and continuous product innovation. On the flip side, we are wary that Nestle's 1.3x total debt-to-equity ratio could increase its finance cost in the environment of rising interest rates. Hence, we maintain our **NEUTRAL** call. Nestle is currently trading at FY23F PER of 42.4x, compared to its 3-year mean PER of 53x, with a dividend yield of 1.9% in FY23F. **Downside risks** are: (i) a further increase in commodity prices which posted upward pressure on the margin; and (ii) higher-than-expected energy costs.

INVESTMENT STATISTICS

FYE Dec (RM'm)	2021A	2022A	2023E	2024E	2025E
Revenue	5,733.8	6,664.1	7,085.6	7,681.4	8,545.9
Cost of Sales	(3,775.6)	(4,603.3)	(4,791.6)	(5,038.7)	(5,409.6)
Gross Profit	**1,958.2**	**2,060.9**	**2,294.0**	**2,642.7**	**3,136.3**
Other Income	3.7	0.0	0.0	0.0	0.0
Selling and Distribution expenses	(906.2)	(908.3)	(985.0)	(1,153.3)	(1,385.7)
General & Administrative	(186.0)	(227.1)	(265.6)	(316.7)	(359.4)
Other operating expenses	(83.8)	(22.6)	(23.8)	(25.6)	(29.3)
EBIT	**785.9**	**902.9**	**1,019.6**	**1,147.2**	**1,361.9**
Profit before tax (PBT)	**751.6**	**859.5**	**972.9**	**1,098.1**	**1,310.5**
Income tax expense	(182.0)	(239.1)	(226.8)	(256.0)	(305.5)
PATAMI	**569.6**	**620.3**	**746.1**	**842.1**	**1,005.0**
Core PATAMI	**575.3**	**669.7**	**746.1**	**842.1**	**1,005.0**
Basic EPS (sen)	242.9	264.5	318.2	359.1	428.6
DPS (sen)	242.0	262.0	315.1	355.7	424.5
Growth & Margin (%)					
Revenue Growth (%)	5.9	16.2	6.3	8.4	11.3
Gross Profit Growth (%)	(0.4)	5.2	11.3	15.2	18.7
Core PATAMI Growth (%)	5.2	16.4	11.4	12.9	19.3
Gross Profit Margin (%)	34.2	30.9	32.4	34.4	36.7
Core PATAMI Margin (%)	10.0	10.0	10.5	11.0	11.8
Ratios & Valuation					
Effective tax rate (%)	24.2	27.8	23.3	23.3	23.3
Dividend Yield (%)	1.8	1.9	2.3	2.6	3.1
PER (x)	55.6	51.1	42.5	37.6	31.5
Total-Debt-to-Equity ratio (x)	0.6	1.3	1.3	1.4	1.5
EV/EBITDA (x)	32.6	29.3	33.8	29.9	25.0

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