

Nestlé (Malaysia) Bhd

Below Expectations; A Costly Quarter

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1H19 CNP of RM372.4m (-6%) came in below expectations due to costlier raw materials and higher operating expenses. Meanwhile, it declared dividend of 70.0 sen, deemed to be within expectations. Moving forward, sturdy top-line growth could be undermined by the impact of volatile forex fluctuations against commodity prices. Downgrade to UP with lower TP of RM128.00 (from previously RM137.00) following earnings revision of -8.5%/-6.5% for FY19E/FY20E.

Missed expectations. 1H19 core net profit of RM372.4m (arrived at after stripping off one-off disposal gain of RM19.7m) came in below expectations at 51% each of our and consensus forecasts. Note that 1H historically formed up to c.60% of full-year's earnings due to festive-led buying. We believe the deviation is largely due to higher-than-expected raw material cost and higher operating expenses (likely from aggressive marketing to fuel new launches). A declared dividend of 70.0 sen is deemed to be within expectations.

Dragged by higher costs. 1H19 CNP plunged 6% YoY to RM372.4m. We believe the decline largely stemmed from: (i) inflated raw material costs in tandem with unfavourable forex fluctuations, which depressed gross margins by 0.8ppt to 37.7%, (ii) diminishing core EBIT margin of 18.3% (-9.0 ppts), likely due to higher marketing spends, and (iii) higher ETR of 23.4% (+1.4 ppts) following the expiration of tax incentives. For 2Q19, CNP declined by 18% YoY to RM137.2m similarly due to the aforementioned reasons.

QoQ, 2Q19 CNP dropped 42% to RM137.2m, similarly due to: (i) higher commodity prices which saw gross margin sequentially contracted 3.0 ppts to 36.2%, and (ii) higher operating costs for its new product launches. As usual, 2Q19 sales declined by 8% owing to slower demand during the fasting season and stronger 1Q demand helmed by CNY festivities.

No escape from global headwinds. In terms of sales, we are still confident that the group could register solid top-line growth, backed by its market-leader position with backing from its product innovations. Additionally, the ongoing consolidation of its Milo plant in Chembong could boost its longer-term outlook from better economies of scales and production capabilities. However, recent global developments have caused a sense of uncertainty on macroeconomic factors, most evidently on forex where rising USD rates are putting pressure on commodity prices. We estimate that 50% of the group's raw materials are imported, while c.20% of sales is exported. We anticipate this cost pressure on commodity to linger at least for the medium term.

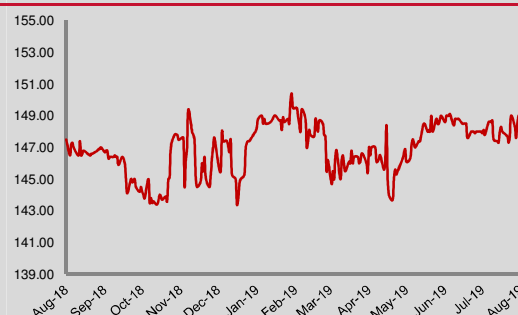
Downgrade to UNDERPERFORM with a lower TP of RM128.00 (from RM137.00). This is following a -8.5%/-6.5% downwards adjustment to our FY19E/20E earnings forecasts post-results, after accounting for more conservative gross margin assumptions and higher opex. Our call is based on an unchanged 42.0x FY20E PER, closely in line with the stock's +0.5.0SD over its 3-year mean. The persistently steep valuation is largely attributed to the defensive quality of its business model and positioning as one of the very few large cap F&B stocks, as well as being a FBMKLCI index member, warranting above-mean valuations for now. Nonetheless, we believe the aforementioned merits have been largely priced in, given the projected downside to our TP and its uninspiring dividend yield of c.2.0%.

Risks to our call include: (i) stronger-than-expected sales, (ii) more favourable commodity prices, and (iii) lower-than-expected operating costs.

UNDERPERFORM ↓

Price : **RM148.60**
Target Price : **RM128.00** ↓

Share Price Performance



KLCI	1,590.84
YTD KLCI chg	-5.9%
YTD stock price chg	0.8%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	NESZ MK Equity
Market Cap (RM m)	34,846.7
Shares Outstanding	234.5
52-week range (H)	150.60
52-week range (L)	142.80
3-mth avg daily vol	95,340
Free Float	18%
Beta	0.6

Major Shareholders

Nestlé SA	72.6%
Employees Provident Fund	7.3%
Skim Amanah Saham Bumiputera	2.0%

Summary Earnings Table

FY Dec (RM'm)	2018A	2019E	2020E
Turnover	5,519.0	5,658.8	5,872.4
EBIT	914.6	938.7	974.2
PBT	875.9	916.9	952.9
Net Profit (NP)	658.9	687.7	714.6
Core NP	649.5	670.1	714.6
Consensus (NP)	-	723.9	767.1
Earnings Revision	-	-8.5%	-6.5%
Core EPS (sen)	277.0	285.7	304.8
Core EPS growth (%)	1.1%	3.2%	6.7%
NDPS (sen)	280.0	290.0	300.0
BVPS (RM)	2.8	2.8	2.9
Core PER	53.7	51.9	48.4
Price/Bv (x)	53.3	52.5	51.2
Net Gearing (x)	0.3	0.1	0.1
Net Div. Yield (%)	1.9%	2.0%	2.0%

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Results Highlights

	2Q	1Q	QoQ	2Q	YoY	6M	6M	YoY
FYE Dec (RM'm)	FY19	FY19	Chg	FY18	Chg	FY19	FY18	Chg
Turnover	1,335.7	1,452.7	-8.1%	1,309.1	2.0%	2,788.4	2,738.7	1.8%
Gross Profit	482.9	569.1	-15.2%	495.8	-2.6%	1,052.0	1,055.2	-0.3%
Core EBIT*	187.8	321.8	-41.6%	223.6	-16.0%	509.6	527.0	-3.3%
EBIT	207.5	321.8	-35.5%	223.6	-7.2%	529.3	527.0	0.4%
PBT/(LBT)	199.1	312.8	-36.3%	214.4	-7.1%	511.9	509.2	0.5%
Taxation	(42.2)	(77.6)	45.6%	(48.2)	12.5%	(119.8)	(111.9)	-7.1%
Net Profit	156.9	235.2	-33.3%	166.2	-5.6%	392.1	397.4	-1.3%
Core Net Profit*	137.2	235.2	-41.7%	166.2	-17.5%	372.4	397.4	-6.3%
EPS (sen)	58.5	100.3	-41.7%	70.9	-17.5%	158.8	169.5	-6.3%
DPS (sen)	70.0	-	N.A.	70.0	0.0%	70.0	70.0	0.0%
Gross Margin	36.2%	39.2%		37.9%		37.7%	38.5%	
Core EBIT margin	14.1%	22.2%		17.1%		18.3%	19.2%	
PBT margin	14.9%	21.5%		16.4%		18.4%	18.6%	
NP margin	11.7%	16.2%		12.7%		14.1%	14.5%	
Effective tax rate	21.2%	24.8%		22.5%		23.4%	22.0%	

Note:

* Core net profits for 2Q19 is adjusted for a RM19.7m gain from the disposal of the group's Chilled Dairy business

Source: Company, Kenanga Research

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Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	Revenue Growth		Core Earnings Growth		PER (x) - Core Earnings			PBV (x)		ROE (%)		Net Div Yld (%)	Target Price (RM)	Rating
					1-Yr. Fwd.	2-Yr. Fwd.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.			
F&B AND RETAIL																		
7-ELEVEN MALAYSIA HOLDINGS BHD	1.48	1,733.8	N	12/2019	12.4%	4.9%	13.6%	5.5%	35.6	31.3	29.7	24.6	23.9	77.5%	2.7%	1.35	UP	
AEON CO (M) BHD	1.65	2,316.6	Y	12/2019	5.5%	5.4%	-18.2%	9.6%	18.6	22.7	20.7	1.1	1.1	5.0%	2.4%	1.70	MP	
AMWAY MALAYSIA HOLDINGS BHD	6.08	999.5	Y	12/2019	2.2%	2.0%	5.5%	6.3%	18.3	17.4	16.4	4.3	4.0	23.8%	4.5%	5.90	MP	
DUTCH LADY MILK INDUSTRIES BHD	63.90	4,089.6	Y	12/2019	-3.0%	2.0%	-17.4%	10.0%	33.0	39.9	36.3	38.8	38.2	97.9%	2.5%	54.60	UP	
FRASER & NEAVE HOLDINGS BHD	35.78	13,123.3	Y	09/2019	5.9%	7.0%	9.4%	2.9%	33.1	30.2	29.4	5.7	5.2	18.0%	1.8%	36.60	MP	
HAI-O ENTERPRISE BHD	2.23	647.5	N	04/2020	1.7%	2.3%	0.1%	1.8%	13.7	13.7	13.4	2.0	2.1	15.1%	5.8%	1.95	UP	
MYNEWS HOLDINGS BHD	1.40	955.0	N	10/2019	27.3%	14.2%	21.0%	20.7%	36.0	29.8	24.7	3.1	3.0	10.2%	0.7%	1.55	OP	
NESTLE (MALAYSIA) BHD	148.60	34,846.7	Y	12/2019	2.5%	3.8%	3.5%	7.2%	53.7	51.9	48.4	53.3	52.5	104.6%	2.0%	128.00	UP	
PADINI HOLDINGS BHD	3.38	2,223.7	Y	06/2020	6.2%	-1.6%	21.8%	12.7%	14.2	11.7	10.3	3.4	2.9	26.8%	3.4%	3.75	OP	
PARKSON HOLDINGS BHD	0.22	234.8	Y	06/2019	1.2%	0.2%	-50.4%	718.1%	N.A.	N.A.	28.4	0.1	0.1	-1.7%	0.0%	0.24	UP	
POWER ROOT BHD	1.96	776.3	Y	03/2020	12.3%	9.7%	26.6%	16.0%	23.4	19.1	17.0	3.5	3.3	18.1%	4.6%	2.30	OP	
QL RESOURCES BHD	6.92	11,227.3	Y	03/2020	10.9%	4.5%	13.0%	4.2%	51.8	45.8	44.0	5.6	5.2	12.1%	0.8%	6.05	UP	
SPRITZER BHD	2.30	482.9	Y	12/2019	5.1%	1.2%	14.6%	13.0%	19.9	17.4	15.4	1.2	1.2	7.0%	1.7%	2.40	MP	
Simple Average					6.9%	4.3%	3.3%	63.7%	29.3	27.6	25.7	11.3	11.0	31.9%	2.5%			
SIN																		
BRITISH AMERICAN TOBACCO (M) BHD	20.06	5,727.7	N	12/2019	-12.8%	0.6%	-22.3%	0.7%	12.2	13.8	13.6	13.6	13.0	84.5%	6.0%	24.40	UP	
CARLSBERG BREWERY MALAYSIA BHD	25.92	7,973.5	N	12/2019	11.4%	4.6%	6.9%	4.8%	29.1	27.2	26.0	46.9	51.2	186.7%	3.9%	25.95	OP	
HEINEKEN MALAYSIA BHD	24.76	7,479.9	N	12/2019	6.1%	5.0%	2.8%	5.1%	26.5	25.7	24.5	20.2	20.0	77.9%	3.8%	23.25	MP	
Simple Average					1.6%	3.4%	-4.2%	3.5%	22.6	22.3	21.3	26.9	28.1	116.4%	4.6%			
CONSENSUS ESTIMATES																		
BERJAYA FOOD BHD	1.55	555.9	N	06/2019	9.8%	8.4%	14.3%	9.1%	21.1	18.5	16.9	1.5	1.5	7.5%	3.0%	1.94	BUY	
BONIA CORPORATION BHD	0.26	205.2	Y	06/2019	3.4%	3.1%	-29.7%	18.2%	10.4	14.8	12.5	0.6	0.6	3.2%	2.7%	0.30	SELL	
COCOALAND BHD	1.87	427.9	Y	12/2019	5.7%	7.1%	2.9%	7.0%	13.8	13.4	12.6	1.7	1.7	13.1%	4.1%	2.29	NEUTRAL	
KAWAN FOOD BHD	1.21	435.0	Y	12/2019	10.5%	14.5%	-41.0%	61.1%	19.1	32.3	20.0	1.4	1.3	4.1%	2.1%	1.14	SELL	
MAGNI-TECH INDUSTRIES BHD	5.19	844.2	Y	04/2020	18.8%	4.5%	13.0%	5.2%	8.2	7.3	6.9	1.6	N..A.	20.3%	N..A.	6.60	BUY	

Source: Bloomberg, Kenanga Research

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Stock Ratings are defined as follows:**Stock Recommendations**

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*****Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.**

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