Consumer

On Defensive Stance

NEUTRAL
↔

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Maintain NEUTRAL on consumer sector. We are cautiously optimistic that consumer sentiment, and by extension, our F&B and Retail players, will be resilient against economic challenges stemming from a stable job outlook, potential further rate cut by BNM and in anticipation of supportive government policies from the upcoming budget 2020. Nonetheless, the lacklustre Ringgit outlook, which could spell further pressure on discretionary spending, remains a concern. For 4Q19, we continue to like PWROOT (OP; TP: RM2.30) as it continues to deliver strong growth numbers, reaping the benefits of its on-going rationalisation efforts and CARLSBG (OP; TP: RM27.15) for its rosy growth trajectory of its premium beer portfolio which fetches 7% FY20E CAGR, ahead of HEIM's 5%. Both our top picks carry stable dividend yield of c.4%, which offer some measure of defence amidst the current market volatility.

Bread and Butter. Moving forward, we expect our F&B and Retail counters to be cushioned by the resilient consumer sentiment, premised on; (i) sticky demand for our consumer staples, evidenced by minimal negative impact to sales amid passive government policies (i.e. SST and sugar tax), (ii) stable job conditions, (iii) potential lower interest rate environment with our inhouse forecast putting a 75% probability of another rate cut by 25 bps to 2.75% in November, and (iv) expectations for a consumer friendly Budget 2020. Despite that, we also note that the weak Ringgit is a headwind on discretionary spending.

Visit Malaysia 2020 goodies. 2020 could be a better year for F&B players and Retailers with the launch of Visit Malaysia 2020. The Tourism, Arts and Culture Ministry is working towards achieving the target of 30m tourist arrivals that will generate around RM100b in income under the Visit Malaysia 2020 campaign. Note that, Malaysia already registered 13.4m visitor arrivals in 1HCY19 (+4.9% YoY). The top 10 source markets for arrivals were Singapore (5.4m), Indonesia (1.9m), China (1.6m), Thailand (1m), Brunei (0.6m), India (0.4m), South Korea (0.3m), the Philippines (0.2m), Vietnam (0.2m) and Japan (0.2m).Government has allocated RM1b through the Tourism Infrastructure Fund, which is available up to 31st Dec, 2020 or until depleted. The fund is available to all tourism infrastructure projects such as projects that contribute to the development of the tourism industry and not just limited to hotel, convention centre, facilities related to education, medical or agro-tourism. Retailers could tap into the fund to build around their existing infrastructure to cater for tourism activities, which may increase footfalls into their stores/malls.

Opportunity to Buy into 3Q Retailers weakness to position for a better 4Q and Visit Malaysia 2020. Retailers usually fare the worst in 3Q19 due to the absence of festivities that typically spur consumer spending. We believe that investors could use this opportunity to buy into 3Q weakness while expecting better growth in 4Q19 from year-end and Christmas festive season sales, as well as upcoming Visit Malaysia 2020 *(refer to AEON and PADINI's Quarterly net profit vs. share price table).* This is in line with the RGM's targeted sales growth for 3QCY19 at 3.2%, which is the lower than the whole year targeted sales growth of 4.4%, as well as lower than 4QCY19 targeted sales growth of 5.8%. On-going PH government measures to lessen the financial burden of B40 group such as the BSH, minimum wages and targeted fuel subsidies are expected to continue supporting consumer spending on basic necessity items, which in turn will benefit affordable apparel retailers (PADINI) and supermarket/department stores operator (AEON). We also expect more goodies in the upcoming budget 2020 for the B40 group.

For our 4Q19 top pick, we continue to like **PWROOT (OP; TP: RM2.30)** for its anticipated delivery of strong growth numbers, driven by: (i) continuous cost improvements, (ii) better hedged commodity positions and, (iii) new SKUS coupled with (iv) more efficiently appointed distributors providing exciting growth prospects. For a bigger market cap defensive play, we favour **CARLSBG (OP; TP: RM27.15)** for its premiumisation growth story which yields a 5-year earnings CAGR of 7% in FY20E against HEIM's 5% of the same. This is on top of a possible shift in market share towards CARLSBG. Both of our top picks offer stable dividends (c.4% yield), thus providing some defence against the current market turmoil.

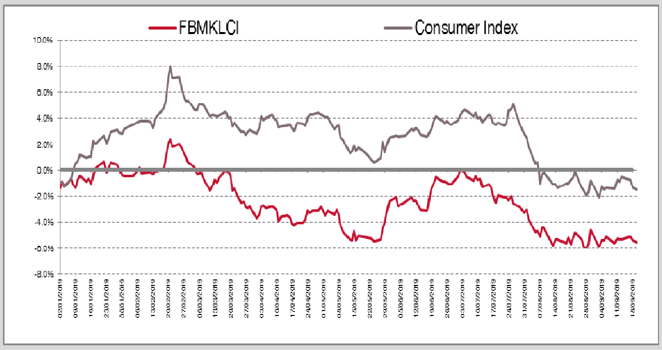
Maintain NEUTRAL on consumer sector. Top-line expectations may be held back by a lacklustre domestic currency. However, this could play well with net exporters where markets are independent of our local developments. Nonetheless, recovery in margins for food manufacturers could come in the way of better commodity trends. While Retailers with high import content may see a dampening impact from sales taxes, as well as from weaker forex exposure against CY18, gradual sales price re-structuring exercise could potentially offset the higher tax component in their respective pricing models. With our view that investors should take opportunity to buy into 3Q Retailers weakness to position for a better 4Q and Visit Malaysia 2020, we **upgrade AEON to OP from MP** and **SEM to MP from UP**, with unchanged TP of RM1.70 (based on unchanged 21x FY20E EPS, at -1.0SD of its 5-year historical mean PER) and unchanged TP of RM1.35 (based on unchanged 27x FY20E EPS, in line with regional peers' average PER), respectively. We also believe that PADINI could see further upside with the exciting event next year, as such, we **upgrade PADINI TP to RM4.35** from RM3.75 on higher PER of 15x (at +1SD of 5-year forward historical mean PER) from 13x (mean) of FY20E EPS.

Sin Sector Upgraded to OVERWEIGHT. Post 2Q19 results release, both HEIM and CARLSBG posted commendeable double-digit YoY earnings growth which we view as a further affirmation on the breweries' defensive earnings nature despite current market uncertainty and the unsettling illicit hinderances. As we take this opportunity to relook at our applied valuation ranges for the stocks, we applied higher PERs to CARLBG at 27.0x (from 26.0x, staying with its +2SD over its 3-year mean) and HEIM at 24.0x (from 23.0x, staying with its +1SD over its 3-year mean). With this, we present CARLSBG (OP) at RM27.15 (from RM25.95) and HEIM (MP) at RM24.25 (from RM23.25). We continue to value CARLSBG at a premium against HEIM as we prefer the former for its: (i) rosy growth trajectory for its premium beer portfolio, (ii) possible shift in market share towards CARLSBG based on our back of the envelope calculations, and (iii) stronger 5-year earnings CAGR of 7% in FY20E against HEIM's 5%. Meanwhile, we **upgraded BAT to a OP call** following its sharp share price correction in lieu of another dissapointing set of 2Q19 results but **cut its TP to RM21.80** (from previously RM23.10). This is arising from lower applied valutions (i.e. 17x PER from 18x PER) as the group's outlook remains bleak from (i) the obstinate affordability issue and illicit tobacco trades (c.60% of market share), and (ii) an alarming shift in demand towards e-cigarettes and vapes which are likely to spell further pressure on the already shrinking industry volume. In spite of this, we believe that the selling could have been overdone as the group: (i) remains the market leader within the legal scene, (ii) still holds high brand equity (Dunhill), and (iii) potential medium term recovery with its heat-not-burn offerings (Glo) hitting the market in 4Q19. Additionally, valuations could have bottomed at this level with decent dividend yields of c.6% to boot.

QoQ improvement in Consumer Sentiment Index. The Malaysian Institute of Economic Research's (MIER) posted 93.0 points (+8.6ppt QoQ, -30ppt YoY) for its 2Q19 Consumer Sentiment Index (CSI). We believe the QoQ rebound is largely driven by normalising consumer confidence on the back of: (i) festive purchases in conjunction with the Eid celebration, (ii) stable labour markets, and (iii) resilient consumers demand, as evidenced by the minimal to nil negative spillover from the implementaion of SST and sugar tax. Moving forward, we cautiously anticipate consumer sentiment to remain resilient, though a slight normalisation would not come as a surprise as the prolonged weakness in our domestic currency and the geopolitical tensions may dampen confidence.

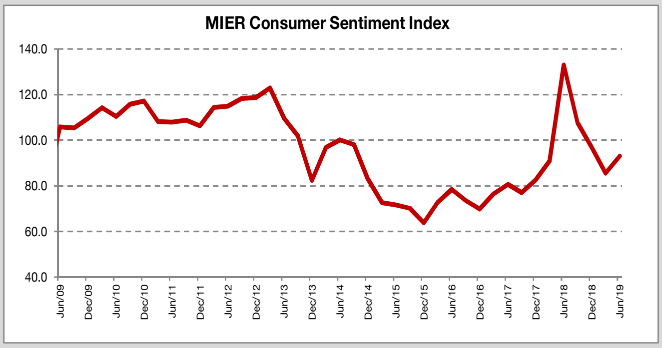
KLCSU outperformed KLCI by 4%. Albeit being in the negative region, the KL Consumer Index (KLCSU) has managed to sustain a solid gap above the FBMKLCI beachmark. As the overall market sentiment remains tepid against the backdrop of the on-going global headwinds, the market has experienced another period of consolidation after the plunge in August'19 following the intensifying trade tensions. As of our cut-off date, the KLSCU ended with a -1.5% YTD loss which was still ahead of the FBMKLCI's decline of 5.5%. Among the members of the KLCSU that are within our F&B coverage, CARLSBG, PPB and HEIM were the key leaders, likely due to investors' inclination towards safer F&B counters which have registered satisfactory YTD results. Expectations for the same may follow through into subsequent quarters. On the flipside, BAT persists to be the biggest laggard as stubborn illicit trade continues to undermine its earnings. Nevertheless, under the current market volatility, we believe that consumer stocks will continue to be favoured for its resiliency in comparison to other sectors.

FBM KLCI VS KL Consumer Index (YTD-20 Sep)



Source: Bloomberg, Kenanga Research

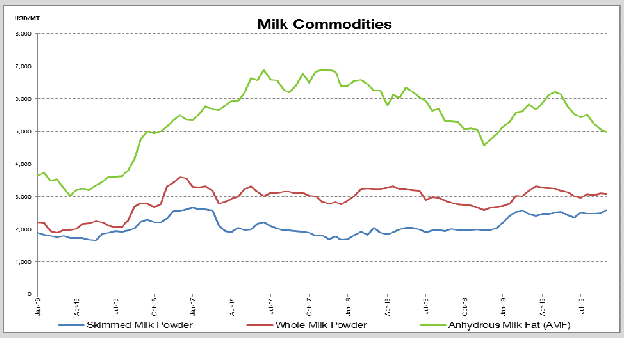
MIER Consumer Sentiment Index



Source: MIER, Kenanga Research

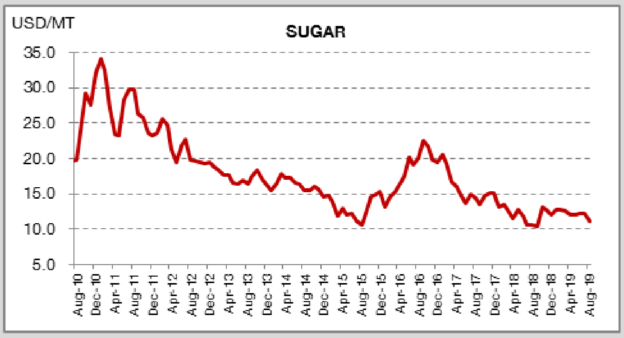
Softer commodity prices, but higher YoY forex. Recent monthly readings have shown a softening trend in major commodities prices, with the exception of dairies. Coffee continues to see a fall in prices in an oversupply state as bumper crops and weaker domestic currencies from key producers (i.e. Brazil) continues to spur supply. Indian government's pro-export policies continue to take a toll on global sugar prices. Nonetheless, local F&B manufacturers could benefit from the declining sugar prices should government persists with its open policy to permit more sugar imports. On a flipside, milk powder prices continue to be on the rising, fuelled by dwindling milk production. That said, while the on-going dairy price trends may be buoyed by DLADY's global procurement network, the rising USD rates may spell further pressure to cost management in the near-future.

Milk Powder Prices



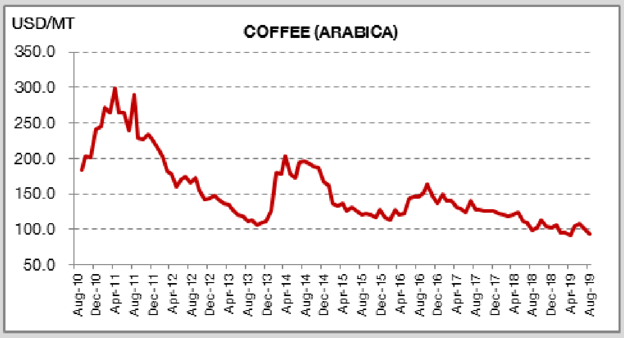
Source: Global Dairy Trade, Kenanga Research

Sugar Prices



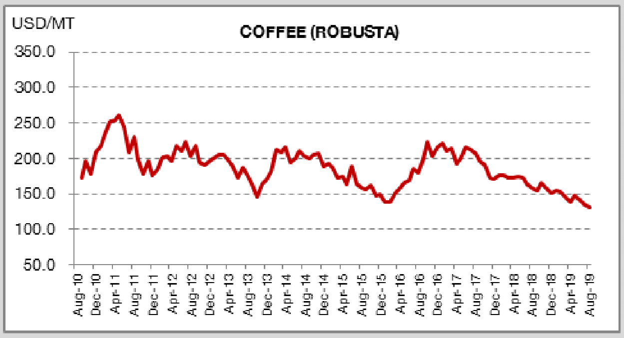
Source: Bloomberg, Kenanga Research

Coffee (Arabica) Prices



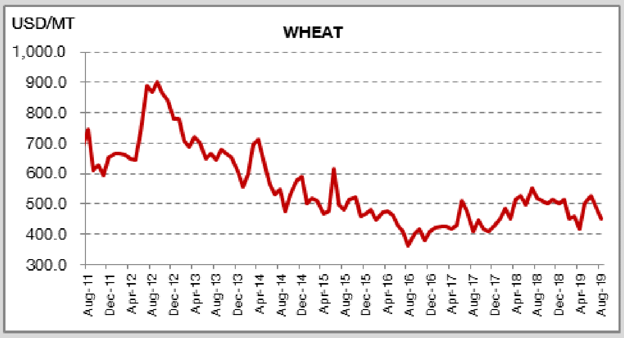
Source: Bloomberg, Kenanga Research

Coffee (Robusta) Prices



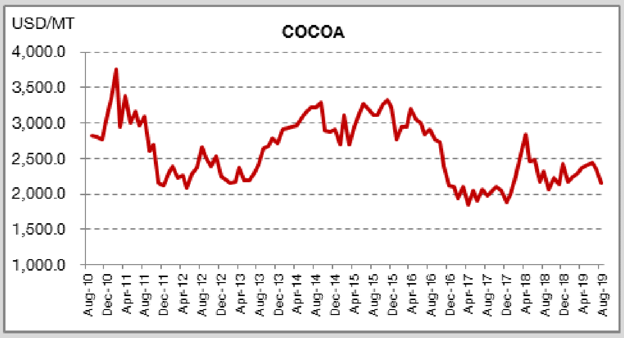
Source: Bloomberg, Kenanga Research

Wheat Prices



Source: Bloomberg, Kenanga Research

Cocoa Prices



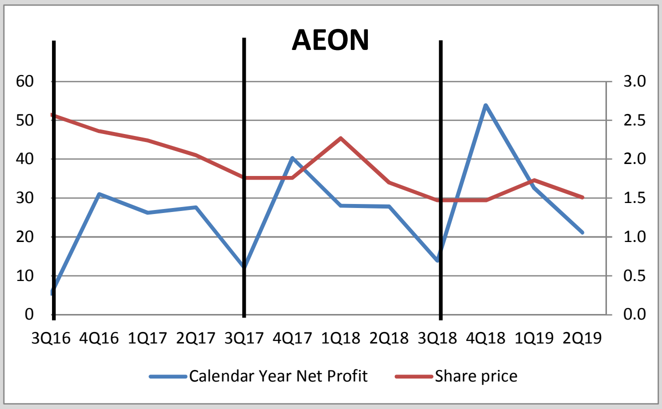
Source: Bloomberg, Kenanga Research

2QCY19 results mostly met expectations. Within our 16 stocks coverage, 11 stocks came in within (AMWAY, CARLSBG, F&N, HEIM, MYNEWS, QL, SEM, PADINI, PARKSON, PWROOT, SPRITZER) while 5 stocks came below (BAT, DLADY, NESTLE, HAIO, AEON).

Overall stronger performance seen for retailers as 2Q is generally one of the stronger quarter of the year, buoyed by the Hari Raya Aidilfitri sales, other than year-end sales in 4Q. However, AEON and HAIO fared the worst this quarter as both benefitted from Chinese New Year sales more than Hari Raya Aidilfitri. Furthermore, HAIO still experiencing dismal MLM distributors force. This is in line with Retail Group Malaysia (RGM)'s reported 2QCY19 retail sales growth of 4.5% which is higher than 1QCY19 retail sales growth at 3.8%. Based on RGM's reported numbers, the retail mix was leaning towards high value-added retail goods (such as luxury items, sporting goods, electrical goods, gadgets and furniture) compared to our stocks offerings of which skewed towards value-for-money goods and basic necessities. The Department Store sub-sector did not see improvement in its sale performance during the 2Q19 which increased by only -0.7% compared to 0.8% in 1QCY19 as both quarter was boosted by festive season sales. Whereas, the Fashion and Fashion Accessories sub-sector continued to record slower growth rate (-0.7%) which is good for PADINI which cater more to lower-end of fashion spectrum compared to Fashion and Fashion Accessories sub-sector which mostly covered by high-end fashion stores. The strongest growth were from Pharmacy and Personal Care sub-sector (+14.2%) and the Other Specialty Stores sub-sector (including retailers selling photographic equipment with photo processing services, optical, sporting goods, fitness equipment, second-hand goods, toys, baking ingredients as well as TV shopping) which managed to sustain its growth at 7.8%.

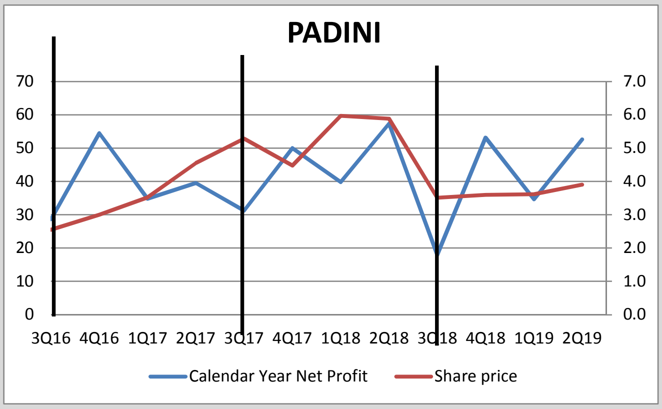
Overall anticipated results from F&B and Sin players, on the back of normalising consumer sentiment. Nonetheless, current global headwinds most evidently on forex with rising USD rates putting pressure on raw material importers has depressed margins for some of our players. That said, NESTLE and DLADY's earnings misses are largely dragged by the foresaid reason, while DLADY's top line were further dented by its low pricing strategy which was aimed at capturing volume growth. Besides that, coming in below expectations again, BAT continues to struggle in a hostile operating environment, which is flooded with illicit products (i.e. illicit cigarettes – c.60% of market share; e-cigarettes and vapes- c.10% of market share)

AEON Quarterly Profit Vs Share Price



Source: Bloomberg, Company, Kenanga Research

Padini Quarterly Profit Vs Share Price



Source: Bloomberg, Company, Kenanga Research

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Peer Comparison

Name	Price @ 20/9/2019 (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	1.45	1,698.7	N	12/2019	12.4%	4.9%	13.6%	5.5%	34.9	30.7	29.1	24.1	23.4	77.5%	3.3%	1.35	MP
AEON CO (M) BHD	1.51	2,063.9	Y	12/2019	5.5%	5.4%	-18.2%	9.6%	17.0	20.8	19.0	1.0	1.0	5.0%	2.6%	1.70	OP
AMWAY MALAYSIA HOLDINGS BHD	5.92	969.9	Y	12/2019	2.2%	2.0%	5.5%	6.3%	17.9	16.9	15.9	4.1	3.9	23.8%	4.6%	5.90	MP
DUTCH LADY MILK INDUSTRIES BHD	57.84	3,838.7	Y	12/2019	-3.0%	2.0%	-17.4%	10.0%	29.8	36.1	32.9	35.1	34.6	97.9%	2.8%	54.60	UP
FRASER & NEAVE HOLDINGS BHD	35.42	12,749.2	Y	09/2019	5.9%	7.0%	9.4%	2.9%	32.7	29.9	29.1	5.6	5.2	18.0%	1.9%	36.60	MP
HAI-O ENTERPRISE BHD	2.52	670.7	N	04/2020	1.7%	2.3%	0.1%	1.8%	15.4	15.4	15.2	2.3	2.4	15.1%	5.2%	1.95	UP
MYNEWS HOLDINGS BHD	1.39	914.1	N	10/2019	27.3%	14.2%	21.0%	20.7%	35.8	29.6	24.5	3.1	3.0	10.2%	0.7%	1.55	OP
NESTLE (MALAYSIA) BHD	145.20	34,002.5	Y	12/2019	2.5%	3.8%	3.5%	7.2%	52.4	50.7	47.3	52.0	51.3	104.6%	2.0%	128.00	UP
PADINI HOLDINGS BHD	3.80	2,513.2	Y	06/2020	6.2%	-1.6%	21.8%	12.7%	16.0	13.1	11.6	3.8	3.3	26.8%	3.0%	4.35	OP
PARKSON HOLDINGS BHD	0.210	229.4	Y	06/2020	0.4%	0.5%	749.5%	16.0%	N.A.	27.0	23.3	0.1	0.1	0.3%	0.0%	0.270	OP
POWER ROOT BHD	2.05	830.0	Y	03/2020	12.3%	9.7%	26.6%	16.0%	24.5	20.0	17.8	3.7	3.4	18.1%	4.4%	2.30	OP
QL RESOURCES BHD	7.05	11,681.6	Y	03/2020	10.9%	4.5%	13.0%	4.2%	52.8	46.7	44.8	5.7	5.3	12.1%	0.8%	6.30	UP
SPRITZER BHD	2.29	466.1	Y	12/2019	5.1%	1.2%	14.6%	13.0%	19.8	17.3	15.3	1.2	1.2	7.0%	1.7%	2.40	MP
Simple Average					**6.9%**	**4.3%**	**64.9%**	**9.7%**	**29.1**	**27.2**	**25.0**	**10.9**	**10.6**	**32.0%**	**2.5%**		
SIN																	
BRITISH AMERICAN TOBACCO (M) BHD	19.68	5,436.5	N	12/2019	-12.8%	0.6%	-22.3%	0.7%	12.0	13.6	13.3	13.3	12.8	84.5%	6.1%	23.10	OP
CARLSBERG BREWERY MALAYSIA BHD	25.50	8,016.6	N	12/2019	11.4%	4.6%	6.9%	4.8%	28.6	26.8	25.5	46.1	50.4	186.7%	3.9%	27.15	OP
HEINEKEN MALAYSIA BHD	24.08	7,214.1	N	12/2019	6.1%	5.0%	2.8%	5.1%	25.7	25.0	23.8	19.6	19.4	77.9%	3.9%	24.25	MP
Simple Average					**1.6%**	**3.4%**	**-4.2%**	**3.5%**	**22.1**	**21.8**	**20.9**	**26.3**	**27.5**	**116.4%**	**4.7%**		
CONSENSUS ESTIMATES																	
BERJAYA FOOD BHD	1.47	502.1	N	06/2019	9.8%	8.4%	15.9%	7.8%	19.1	16.5	15.3	1.3	1.3	7.5%	3.1%	1.94	BUY
BONIA CORPORATION BHD	0.27	201.3	Y	06/2020	2.4%	2.0%	-4.0%	4.0%	11.2	11.6	11.2	0.5	0.5	3.7%	3.0%	0.28	NEUTRAL
COCOALAND BHD	1.95	439.3	Y	12/2019	4.8%	6.6%	6.2%	9.8%	14.2	13.4	12.2	1.7	1.8	13.4%	3.9%	2.36	NEUTRAL
KAWAN FOOD BHD	1.26	463.8	Y	12/2019	10.5%	14.5%	-47.4%	75.0%	20.3	38.6	22.1	1.5	1.4	3.6%	2.0%	1.42	SELL
MAGNI-TECH INDUSTRIES BHD	6.40	1,042.6	Y	04/2020	18.8%	4.5%	13.0%	5.2%	10.2	9.0	8.5	1.9	N/A	20.3%	N/A	6.60	BUY

Source: Bloomberg, Kenanga Research

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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