

NESTLE (MALAYSIA)

(NESZ MK EQUITY, NESM.KL)

5 May 2021

Plant-based products to support long-term growth

HOLD

(Maintained)

Company report

AmInvestment Bank

www.amequities.com.my

03-2036 2290

Rationale for report: Company update

Price	RM135.80
Fair Value	RM134.00
52-week High/Low	RM147.00/RM134.00

Key Changes

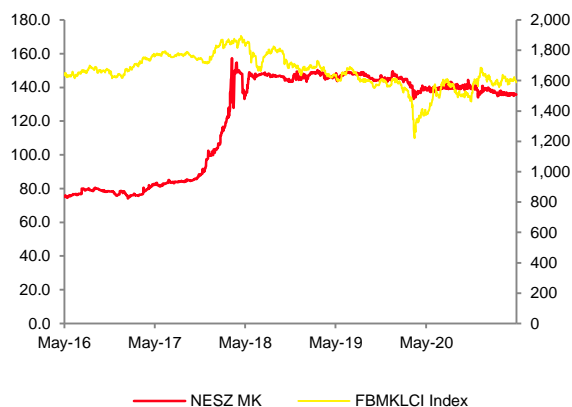
Fair value	↔
EPS	↔

YE to Dec	FY20	FY21F	FY22F	FY23F
Revenue (RM mil)	5,412.2	5,700.0	5,956.2	6,234.3
Core net profit (RM mil)	558.8	604.1	707.8	778.0
FD Core EPS (sen)	238.3	257.6	301.8	331.8
FD Core EPS growth (%)	(14.3)	8.1	17.2	9.9
Consensus Net Profit (RM mil)		616.1	671.4	724.6
DPS (sen)	232.0	247.3	295.8	325.1
PE (x)	57.0	52.7	45.0	40.9
EV/EBITDA (x)	34.5	31.8	28.1	25.9
Div yield (%)	1.7	1.8	2.2	2.4
ROE (%)	90.5	106.1	120.3	129.0
Net Gearing (%)	62.5	54.7	50.0	43.5

Stock and Financial Data

Shares Outstanding (million)	234.5
Market Cap (RM mil)	31,845.1
Book Value (RM/share)	2.38
P/BV (x)	57.2
ROE (%)	90.5
Net Gearing (%)	62.5
Major Shareholders	Nestle SA (72.6%) EPF (8.4%) Blackrock Group (1.7%)
Free Float	35.4
Avg Daily Value (RM mil)	11.3

Price performance	3mth	6mth	12mth
Absolute (%)	(1.6)	(2.8)	(2.7)
Relative (%)	(1.8)	(10.4)	(15.7)



Investment Highlights

- We maintain our HOLD call on Nestle (Malaysia) with an unchanged fair value (FV) of RM134.00/share. We use a DCF valuation with a terminal growth rate of 2.5%. There is no ESG-related price adjustment for our rating of 3 stars.
- We note the lack of short-term rerating catalysts. Nonetheless, Nestle's new plant-based meals solution (PBMS) segment and its capacity expansion of its Batu Tiga factory should support long-term growth.
- We are positive on Nestle's efforts to streamline its factory operations and reduce costs. However, Covid-19 testing efforts, unfavourable commodity market movements and freight costs are likely to offset margin improvements, at least in the near term.
- Here are some highlights of the results briefing:

Earnings and earnings pressure.

- We are optimistic that Nestle will see a recovery in its Out of Home (OOH) food segment in 2HFY21, contingent on the success of seasonal festivals and pent-up demand being a strong driver of HoReCa recovery. We believe that the Malaysian government will issue more targeted, district-focused pandemic restrictions in its effort to preserve economic activities.
- However, we believe that Nestle's "other" category will continue to underperform, due to weak demand for its catering services this year.
- Covid-19 prevention and testing measures will be a drag on earnings for now, although they have been effective in preventing severe production disruptions. About RM22mil of Covid-19-related expenses were incurred in 1QFY21, the bulk used for the 8,000–12,000 antigen tests performed each week.
- The group intends to maintain its competitive price point. It does not intend to pass on higher COGS and operational expenses to its customers. Nestle has been hedging some of its raw materials to offset price volatility. The group has incurred higher storage costs in stocking up on these materials beforehand.

Capex

- **Nestle intends to invest RM300mil on capex, the bulk of which will be used for the capacity expansion of its Batu Tiga factory.** Demand for *Maggi* products such as instant noodles has already begun to overtake supply, bolstered by strong export sales. In 1QFY21, export turnover made up 19% of total revenue and rose by 1.2% YoY.
- **We view Nestle's efforts in digitalizing its processes positively, not merely as a means to improve margins but also to reduce reliance on workforce.** Less manpower reliance is critical in minimizing the effects of Covid-19 outbreaks within the factory and lowering the number of Covid-19 testing. Additionally, Malaysia is currently experiencing a significant outflow of foreign workers, which is likely to result in manpower shortages within the year.

New products

- **We are optimistic of the ability of Nestle's PBMS segment to tap into the middle-class market.** Nestle intends to make this segment affordable, enough to appeal to the local middle class, as imported variations tend to be far too expensive. This is an initiative supported by the Malaysian government, with Nestle having claimed tax incentives for the group's new PBMS factory.
- **We believe that the group's strong brand presence compensates for restrictions on in-store tasting.** It is worth noting that a number of the group's new launches (e.g. *Kit Kat Gold* and *Oreo* ice creams) have been successful. We believe that the group's ability to leverage its household brand names gives it a competitive edge over the rest.
- **The group is currently utilizing e-commerce platforms as a gauge of customer preferences.** E-commerce channels such as Lazada and Shopee currently contribute to 4% of sales. Nestle uses these channels as testing tools to see which products appeal most to customers before producing them on a large scale.

EXHIBIT 1: PB BAND CHART

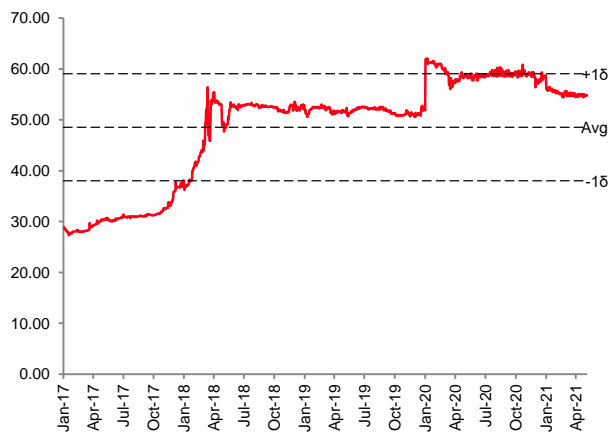


EXHIBIT 2: PE BAND CHART

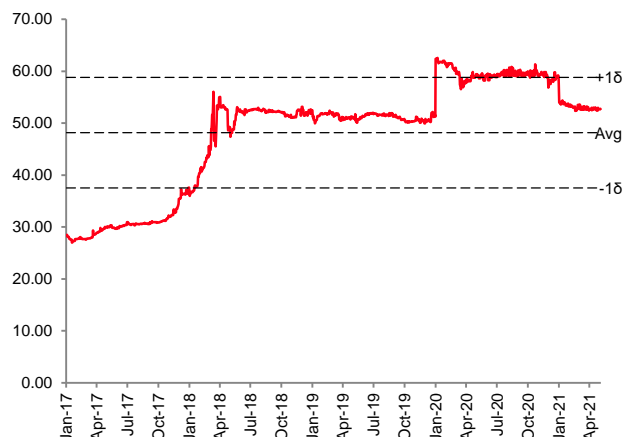


EXHIBIT 3: ESG VALUATION

Overall	★	★	★		
Biological preservation	★	★			
Water + energy conservation	★	★	★		
Pollution + waste regulation	★	★	★	★	
Sustainable sourcing	★	★	★		
Occupational safety + health	★	★	★		
Workplace diversity	★	★	★		
Employee training + wellbeing	★	★	★	★	
Volunteering + charitable giving	★	★	★	★	
Corruption-free pledge	★	★	★		
Accessibility & transparency	★	★	★		

We accord a discount/premium of **-6%**, **-3%**, **0%**, **+3%** and **+6%** on fundamental fair value based on the overall ESG rating as appraised by us, from 1-star to 5-stars

EXHIBIT 4: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Revenue	5,518.1	5,412.2	5,700.0	5,956.2	6,234.3
EBITDA	1,079.5	932.5	1,011.2	1,145.6	1,241.7
Depreciation/Amortisation	(167.5)	(176.5)	(183.5)	(189.9)	(196.3)
Operating income (EBIT)	912.0	756.0	827.7	955.7	1,045.4
Other income & associates	0.7	0.7	-	-	-
Net interest	(37.0)	(31.9)	(35.9)	(34.1)	(32.3)
Exceptional items	21.0	(6.1)	-	-	-
Pretax profit	875.7	724.8	791.8	921.6	1,013.1
Taxation	(202.8)	(172.1)	(187.6)	(213.8)	(235.0)
Minorities/pref dividends	-	-	-	-	-
Net profit	672.9	552.7	604.1	707.8	778.0
Core net profit	652.0	558.8	604.1	707.8	778.0
Balance Sheet (RMmil, YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Fixed assets	1,277.9	1,423.8	1,483.8	1,543.8	1,603.8
Intangible assets	65.8	64.5	64.5	64.5	64.5
Other long-term assets	309.9	293.1	300.0	299.0	297.9
Total non-current assets	1,653.5	1,781.5	1,848.3	1,907.3	1,966.3
Cash & equivalent	10.4	9.4	14.6	20.1	37.2
Stock	551.8	597.3	566.5	588.2	621.4
Trade debtors	508.1	472.7	578.0	596.7	611.8
Other current assets	2.7	0.5	0.5	0.5	0.5
Total current assets	1,073.0	1,079.9	1,159.6	1,205.6	1,271.0
Trade creditors	1,321.4	1,480.8	1,533.0	1,552.8	1,625.7
Short-term borrowings	257.4	257.7	242.7	227.7	212.7
Other current liabilities	75.9	78.3	179.4	260.7	297.5
Total current liabilities	1,654.8	1,816.8	1,955.1	2,041.1	2,135.9
Long-term borrowings	-	100.0	90.0	90.0	90.0
Other long-term liabilities	406.9	387.4	392.4	397.4	402.4
Total long-term liabilities	406.9	487.4	482.4	487.4	492.4
Shareholders' funds	664.9	557.1	581.3	595.5	611.0
Minority interests	-	-	-	-	-
BV/share (RM)	2.84	2.38	2.48	2.54	2.61
Cash Flow (RMmil, YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Pretax profit	875.7	724.8	791.8	921.6	1,013.1
Depreciation/Amortisation	167.5	176.5	183.5	189.9	196.3
Net change in working capital	(150.5)	133.0	(29.2)	(19.7)	25.7
Others	(166.4)	(125.0)	(95.2)	(123.1)	(146.2)
Cash flow from operations	726.3	909.3	850.9	968.6	1,088.8
Capital expenditure	(183.3)	(294.6)	(164.9)	(177.7)	(184.3)
Net investments & sale of fixed assets	-	-	-	-	-
Others	105.5	4.5	-	-	-
Cash flow from investing	(77.8)	(290.1)	(164.9)	(177.7)	(184.3)
Debt raised/(repaid)	73.8	77.0	(58.7)	(53.7)	(58.7)
Equity raised/(repaid)	-	-	-	-	-
Dividends paid	(656.6)	(657.0)	(579.9)	(693.6)	(762.5)
Others	(40.7)	(35.5)	(39.5)	(38.1)	(36.3)
Cash flow from financing	(623.5)	(615.5)	(678.1)	(785.4)	(857.5)
Net cash flow	25.0	3.7	7.9	5.5	47.1
Net cash/(debt) b/f	(52.0)	(27.0)	(22.9)	(15.4)	(9.9)
Net cash/(debt) c/f	(27.0)	(23.3)	(15.0)	(9.9)	37.2
Key Ratios (YE 31 Dec)	FY19	FY20	FY21F	FY22F	FY23F
Revenue growth (%)	-	(1.9)	5.3	4.5	4.7
EBITDA growth (%)	-	(13.6)	8.4	13.3	8.4
Pretax margin (%)	15.9	13.4	13.9	15.5	16.2
Net profit margin (%)	12.2	10.2	10.6	11.9	12.5
Interest cover (x)	24.6	23.7	23.0	28.0	32.3
Effective tax rate (%)	23.2	23.7	23.7	23.2	23.2
Dividend payout (%)	97.6	118.9	96.0	98.0	98.0
Debtors turnover (days)	37	33	34	36	35
Stock turnover (days)	36	39	37	35	35
Creditors turnover (days)	94	94	96	95	93

Source: Company, AmlInvestment Bank Bhd estimates

DISCLOSURE AND DISCLAIMER

This report is prepared for information purposes only and it is issued by AmInvestment Bank Berhad (“AmInvestment”) without regard to your individual financial circumstances and objectives. Nothing in this report shall constitute an offer to sell, warranty, representation, recommendation, legal, accounting or tax advice, solicitation or expression of views to influence any one to buy or sell any real estate, securities, stocks, foreign exchange, futures or investment products. AmInvestment recommends that you evaluate a particular investment or strategy based on your individual circumstances and objectives and/or seek financial, legal or other advice on the appropriateness of the particular investment or strategy.

The information in this report was obtained or derived from sources that AmInvestment believes are reliable and correct at the time of issue. While all reasonable care has been taken to ensure that the stated facts are accurate and views are fair and reasonable, AmInvestment has not independently verified the information and does not warrant or represent that they are accurate, adequate, complete or up-to-date and they should not be relied upon as such. All information included in this report constitute AmInvestment’s views as of this date and are subject to change without notice. Notwithstanding that, AmInvestment has no obligation to update its opinion or information in this report. Facts and views presented in this report may not reflect the views of or information known to other business units of AmInvestment’s affiliates and/or related corporations (collectively, “AmBank Group”).

This report is prepared for the clients of AmBank Group and it cannot be altered, copied, reproduced, distributed or republished for any purpose without AmInvestment’s prior written consent. AmInvestment, AmBank Group and its respective directors, officers, employees and agents (“Relevant Person”) accept no liability whatsoever for any direct, indirect or consequential losses, loss of profits and/or damages arising from the use or reliance of this report and/or further communications given in relation to this report. Any such responsibility is hereby expressly disclaimed.

AmInvestment is not acting as your advisor and does not owe you any fiduciary duties in connection with this report. The Relevant Person may provide services to any company and affiliates of such companies in or related to the securities or products and/or may trade or otherwise effect transactions for their own account or the accounts of their customers which may give rise to real or potential conflicts of interest.

This report is not directed to or intended for distribution or publication outside Malaysia. If you are outside Malaysia, you should have regard to the laws of the jurisdiction in which you are located.

If any provision of this disclosure and disclaimer is held to be invalid in whole or in part, such provision will be deemed not to form part of this disclosure and disclaimer. The validity and enforceability of the remainder of this disclosure and disclaimer will not be affected.