

PP14767/09/2012(030761)

Market Access

Nestle Malaysia Berhad

“Still Hoping”

We foresee Nestle Malaysia Berhad (Nestle) may continue to face with a tough and challenging operating environment due to the anticipation of lower consumer spending no thanks to higher costs of living and GST cautiousness which may weigh on their performance in 2H15. The stiff competition in the market will also result in price war among consumer players which likely to distress Nestle’s sales performance. Hence, the stock is a SELL with target price of RM61.50.

- 1H15 performance.** Nestle recorded a net profit of RM312 million in 1H15 compared to RM302 million in 1H14 or growing by 3.2% y-o-y. Higher earnings were aided by fruitful efforts in costs saving as well lower material prices e.g. milk, coffee and CPO in this quarter that assisted PAT margin to be higher by 100bps y-o-y to 13% in 1H15 (1H14’s PAT margin: 12%). In sum, Nestle has showed steady performance in 1H15 despite persistently weak consumer sentiment in view of the implementation of GST in 2Q15 (April 2015).
- Sri Muda plant on going.** Nestle’s new plant, located in Shah Alam, has commenced operation in mid-3Q15 and is set to boost its ready-to-drink (RTD) segment. The plant, which specializes in RTD has rolled out its first product, Milo Nutri G, a new blend of Milo serves in a pack resin bottle. The new product has received overwhelming response and Nestle is confident that there will be no cannibalization of the existing product as the targeted customers for this latest product are different. We expect the new plant will drive domestic and export sales with more innovative RTD products in the pipeline.
- Low raw material price.** Currently, commodity prices for Nestle had showed declining trend as at YTD August 2015, continuing the similar trend in 1H15. As observed as at August, CPO price remained weak at

Wednesday, September 30, 2015

SELL (TP: RM61.50)

Current Price (RM)	RM72.02
New Fair Value (RM)	RM61.50
Previous Fair Value (RM)	RM59.30
Previous Recommend.	Sell
Upside To Fair Value	-15%
Dividend Yield (FY16F)	3.4%

Stock Code	
Bloomberg	NESZ MK

Stock & Market Data	
Listing	MAIN MARKET
Sector	Consumer
Shariah Compliance	Yes
Issued Shares (mn)	234.5
Market Cap (RM mn)	16,884.0
YTD Chg In Share Price	5.11%
Beta (x)	0.42
52-week Hi/Lo (RM)	75.50 65.90
6M Average Volume (shrs)	17,593mn
Estimated Free Float	0.1%

Major Shareholders	
Nestle SA	72.61%
Landsbanki	9.75%
Securities UK LTD	
EPF	9.27%

RM1,928/MT (-9% m-o-m, -0.5% y-o-y) while wheat price fell to USD482/bu (-3% m-o-m, -12% y-o-y), sugar price declined to USD10.69/lb (-4% m-o-m, -31% y-o-y), arabica coffee went down to USD120.5/lb (-4% m-o-m, 38% y-o-y), robusta coffee slipped to USD1,581/MT (-11% m-o-m, -22% y-o-y). In addition, price for milk and cocoa bean also showed similar negative trend as at August 2015 after slid to EUR1675/MT (-23% y-o-y) and USD3,161/MT (-4% m-o-m, -3% y-o-y) respectively.

The weaker commodity prices will give positive impact to the group's bottom-line thanks to favourable raw material cost. As witnessed, Nestle recorded improvement in gross profit margin in 1H15 which rose to 39% compared to 35% in 1H14 (+400bps) coinciding with lower average commodity prices in 1H15 including CPO that dropped 17% y-o-y, wheat that tanked 18% y-o-y, sugar that tumbled 23% y-o-y, followed by Arabica that decreased by 20% y-o-y, robusta that sank 12% y-o-y, milk that slid 34% y-o-y and cocoa bean that fallen by 2% y-o-y.

- **Innovation and renovation.** Nestle has been known as a company that remains active in making innovation to provide some value add on its products. Product innovation has played a vital role in attracting Nestle's consumers especially with its interesting new product launches. To recap, Nestle has introduced approximately 6 new products as to date in 2015. Nonetheless, this is lower against FY14 (10 new products) and FY13 (9 new products). Nestle's new product launches in 2015 are comprise of Mat Kool Butterfly, Milo Nutri G, Swiss-inspired La Cremeria sticks range, Ice Cream Durian Flavor, Nescafe Blend & Brew (zero sugar) and Nescafe Mountain Wash.
- We expect certain Nestle's product will face a stiff competition in the market except for Milo which has strong brand recognition for decades. Note that Horlicks, Vico and Ovaltine are among Milo's nearest competitor. In addition, Nestle's product for infant formula category (Lactogen, Nan), milk powder (Everyday) and culinary product (Maggie) will meet a strong rivalry against its peers (infant formula: Dutch Baby/Dumex, milk powder: Fernleaf/Dutch lady, culinary product: Mamee/Cintan).
- **Outlook.** The consumer sentiment index in Malaysia continued its sluggishness in 2Q15 after easing to 71 points from 72 points and we expect it to continue to be weak impacted by the weakening of Ringgit and murky economic outlook. In addition, the implementation of GST will also influence the consumer spending. In sum, we foresee Nestle will face a challenging situation to sustain their performance in 2H15 although depressed commodity prices will be able to offset the weak consumer spending to some extent.
- **Earnings outlook.** At this stage, we expect Nestle's PAT for FY15 and FY16 to grow by 3% and 2% respectively assisted by 1) favourable commodity prices, 2) innovation and renovation in new products and 3) aggressive marketing and promotion activities.

- **Valuation & recommendation.** Nestle is valued at RM61.50 based on 25x PER pegged to FY16 EPS of 246sen and the stock remains a **SELL** given the tough operating environment ahead. Re-rating catalyst may come from expansion in new products as the new plant (Sri Muda factory in Shah Alam) is now ready and will be in full operation in August 2015.

Table 1: Peers comparison (Calenderised)

Company	YE	Price (RM)	EPS (sen)		P/E (X)		P/BV (X)		ROE (%)	DY (%)	TP (RM)	Call
			FY15	FY16	FY14	FY15	FY15	FY16				
Parkson*	Jun	1.12	17	19	17	16	1	1	5	NA	1.20	Hold
Amway	Dec	9.94	69	73	17	16	9	8	55	3.4	10.50	Hold
Nestle	Dec	72.02	254	277	27	24	18	18	58	3.5	61.50	Sell
MSM	Dec	4.74	34	38	14	13	2	2	13	5.1	5.46	Buy
Dutch Lady	Dec	47.10	216	229	22	20	14	16	58	2.4	41.6	Sell
Padini*	Jun	1.35	15	18	13	11	3	3	24	5.0	1.45	Hold
Scientex	July	7.05	68	80	10	8	2	2	20	4.0	7.30	Hold
Zhulian	Nov	1.42	11	33	10	6	2	2	10	5.1	1.80	Buy
Aeon Co	Dec	2.71	18	19	23	21	3	3	14	1.4	NA	NA
QL Resources	Mac	4.00	16	18	19	17	3	3	15	1.0	NA	NA
Average					18	15	5	5				

Source: Bloomberg, M&A Securities

Table 2: Financial Forecast

YE: Dec (RM million)	FY12	FY13	FY14	FY15F	FY16F
Revenue	4,556	4,788	4,809	4,953	5,151
Gross Profit	1,553	1,698	1,700	1,751	1,839
Profit before tax	638	719	701	722	736
Net Profit	505	562	550	567	578
EPS (sen)	216	240	235	242	246
GP Margin	34%	35%	35%	35%	36%
PBT Margin	14%	15%	15%	15%	14%
PAT Margin	11%	12%	11%	11%	11%
P/E (x)	29.1	27.6	26.9	24.7	25.2
P/BV (x)	19.6	21.6	18.9	18.1	17.8
Dividend (RM)	2.1	2.35	2.35	2.4	2.45
Dividend yield (%)	2.86	3.1	3.2%	3.3%	3.4%
Dividend Payout	97.45	98.11	100%	99.2%	99.6%

Table 3: Results Analysis

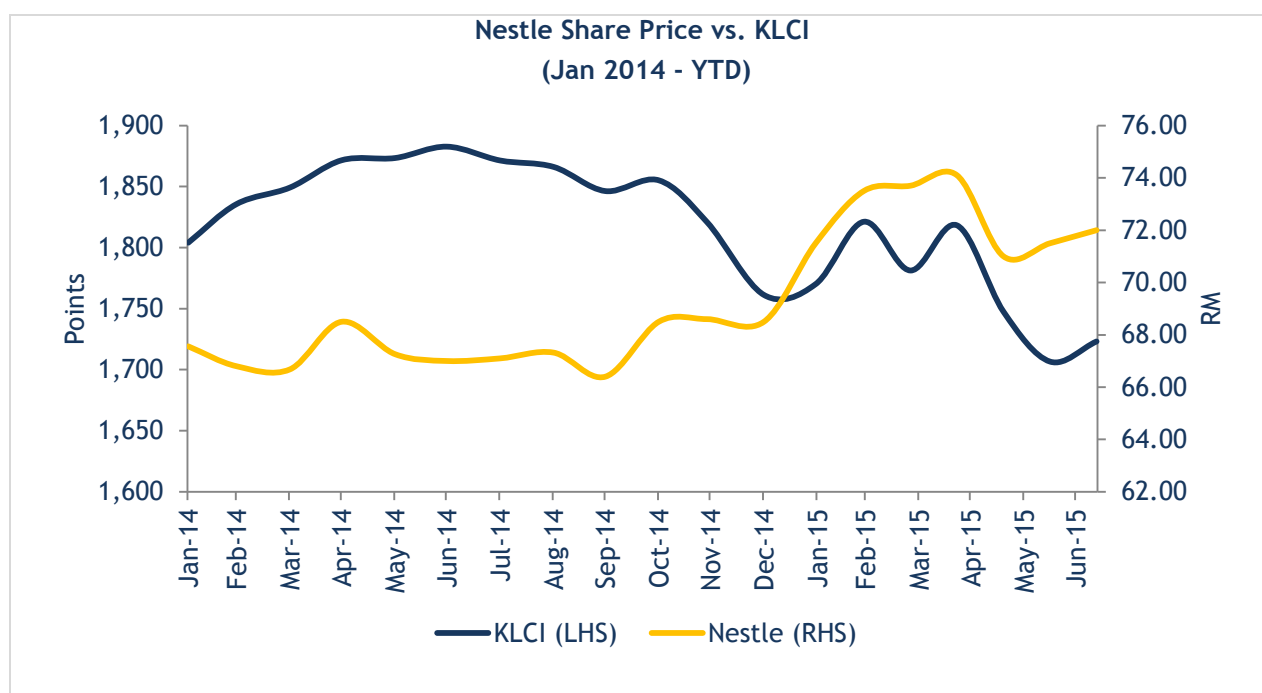
YE: Dec (RM million)	2Q15	2Q15	1Q14	q-o-q	y-o-y	6M15	6M14	y-o-y
Revenue	1,143	1,270	1,278	-10.6%	-10.0%	2,421	2,543	-4.8%
Gross Profit	446	424	498	-10.6%	5.0%	944	898	5.2%
Operating Profit	167	160	251	-33.5%	4.0%	418	404	3.5%
Profit before tax	160	155	244	-34.7%	2.9%	404	394	2.5%
Net Profit	124	118	188	-34.1%	4.6%	312	302	3.2%
EPS (sen)	53	51	80	-34.0%	4.6%	133	129	3.2%
GP Margin	39%	33%	39%			39%	35%	
PBT Margin	14%	12%	19%			17%	15%	
PAT Margin	11%	9%	15%			13%	12%	

Source: Bursa Malaysia, M&A Securities

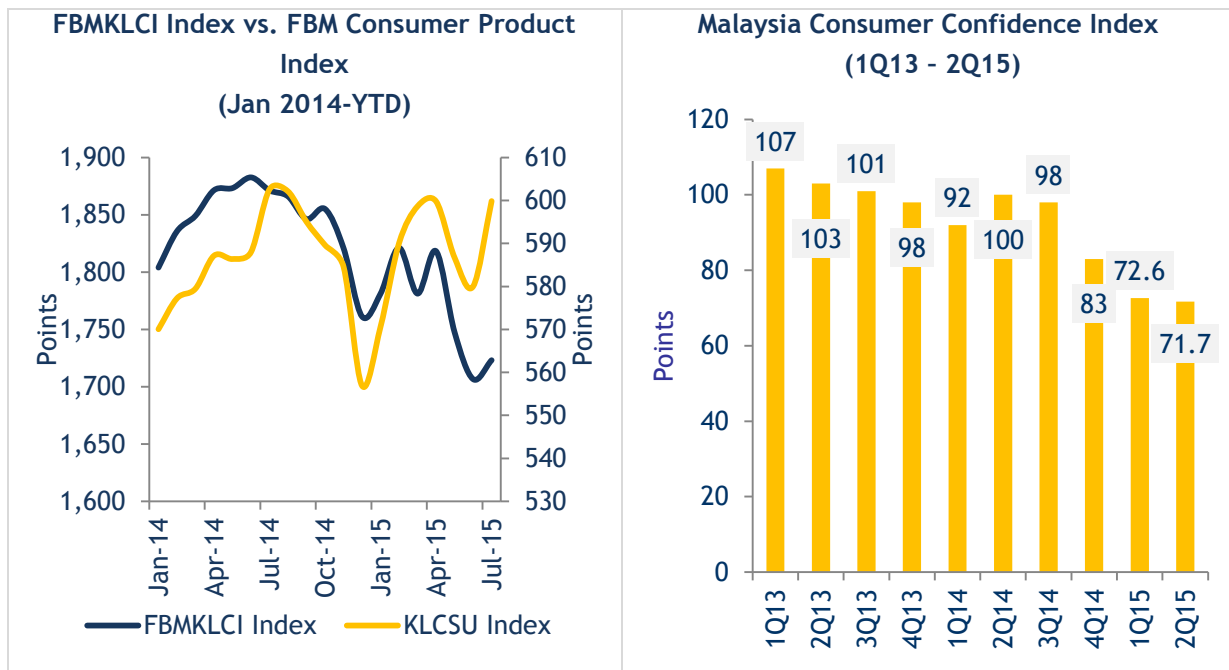
Table 4: Segmental Analysis

YE: Dec (RM million)	Sales			Operating Profit		
	6M15	6M14	y-o-y	6M15	6M14	y-o-y
Food & Beverages	1,939	2,076	-7%	344	329	5%
Others	482	467	3%	74	74	0%
Total	2,421	2,543	-4.8%	417	402	4%

Source: Bursa Malaysia, M&A Securities

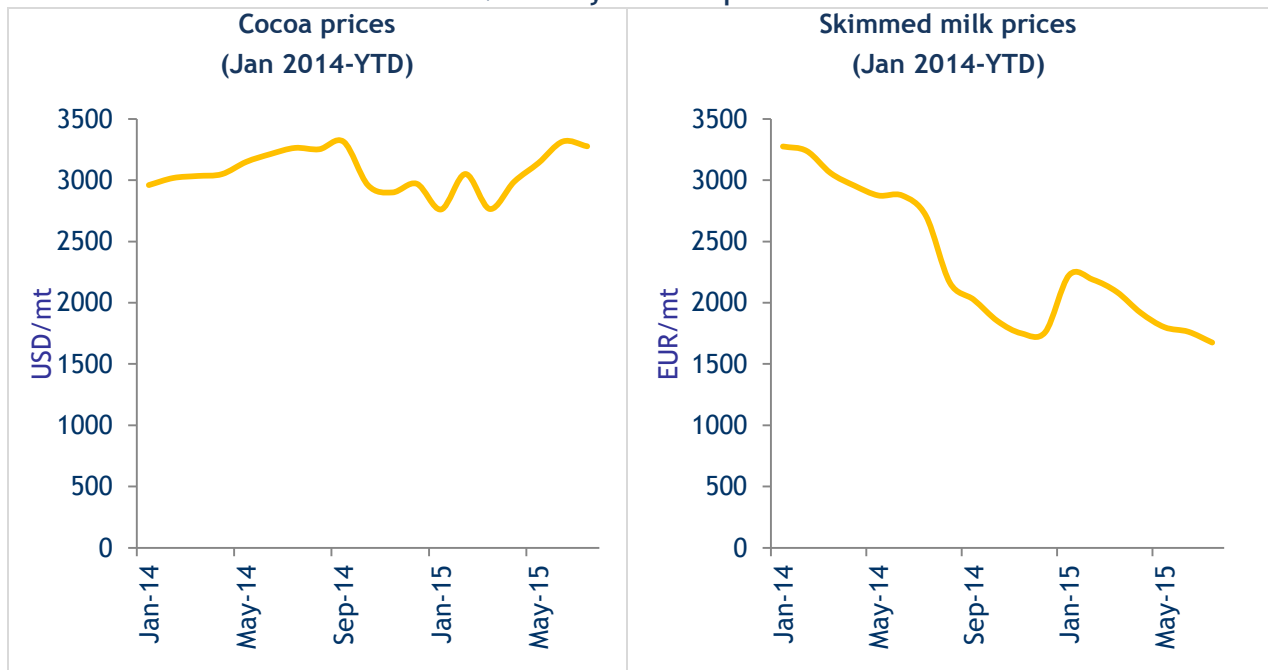


Source: Bloomberg, M&A Securities



Source: Bloomberg, M&A Securities

Nestle key material prices





Source: Bursa Malaysia, M&A Securities

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD	Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL	Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL	The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the FBM KLCI over the next 12 months.

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