

Nestle (Malaysia) (NESZ MK)

Cost inflationary challenges

SELL

| | |
|-----------------------|-------------------|
| Share Price | MYR 136.40 |
| 12m Price Target | MYR 101.20 (-26%) |
| Previous Price Target | MYR 101.20 |

Maintain SELL with an unchanged TP of MYR101.20

Consumer consumption is expected to improve in FY22 in absence of pandemic-led operational disruption and better consumer mobility. However, margins will continue to be suppressed if commodity prices remain elevated and no product price hikes are made. We keep our earnings estimates, SELL call and DCF-TP of MYR101.20 (WACC: 6.3%, LT growth: 2.5%).

Domestic and export sales improved YoY

During NESZ's results briefing, management shared that 4Q21 group revenue growth of 7% YoY was due to higher sales in various domestic F&B categories (eg. ice cream, coffee and Maggi) and increased export sales (+5% YoY) from improved demand as its export-partners' economies reopened.

Broad-based commodity price increases

Group margins have come under pressure in FY21 given elevated commodity prices and this could remain the case in FY22. Most of NESZ's main cost components (eg. coffee, milk, palm oil, freight/logistics) have risen. Hence, the group may push through selected product price adjustments in FY22. COVID-19 related expenses (FY21: MYR93m) are expected to be significantly lower going forward as the group transitions to home self-testing versus on-site testing previously.

Focusing on new product launches

NESZ plans to accelerate new product launches and conduct larger scale marketing engagements for its core brands to drive topline growth in FY22. Product demand is anticipated to be stronger as the group experiences improving domestic out-of-home consumption and ongoing increases in export sales (FY21: 20% of group revenue). E-commerce sales contribution has also grown to c.5% of NESZ's group revenue currently. In line with management's guidance, we lift FY22 capex assumption to MYR268m (from MYR173m previously).

| FYE Dec (MYR m) | FY20A | FY21A | FY22E | FY23E | FY24E |
|------------------------------|--------|-------|-------|-------|-------|
| Revenue | 5,412 | 5,734 | 6,021 | 6,322 | 6,638 |
| EBITDA | 932 | 884 | 1,114 | 1,175 | 1,209 |
| Core net profit | 558 | 580 | 665 | 701 | 737 |
| Core EPS (sen) | 237.9 | 247.2 | 283.5 | 299.1 | 314.3 |
| Core EPS growth (%) | (16.4) | 3.9 | 14.7 | 5.5 | 5.1 |
| Net DPS (sen) | 232.0 | 242.0 | 282.3 | 297.9 | 313.0 |
| Core P/E (x) | 58.4 | 54.3 | 48.1 | 45.6 | 43.4 |
| P/BV (x) | 58.5 | 54.0 | 54.6 | 54.4 | 54.1 |
| Net dividend yield (%) | 1.7 | 1.8 | 2.1 | 2.2 | 2.3 |
| ROAE (%) | 90.5 | 100.0 | 113.8 | 119.5 | 125.0 |
| ROAA (%) | 20.0 | 19.8 | 21.9 | 22.6 | 23.3 |
| EV/EBITDA (x) | 35.6 | 36.2 | 29.2 | 27.7 | 26.8 |
| Net gearing (%) (incl perps) | 62.5 | 58.1 | 65.5 | 54.3 | 43.8 |
| Consensus net profit | - | - | 653 | 695 | na |
| MKE vs. Consensus (%) | - | - | 1.8 | 1.0 | na |

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Company Description

Nestlé (Malaysia) Bhd. is an investment holding company, which engages in the manufacture, marketing, and sale of food products.

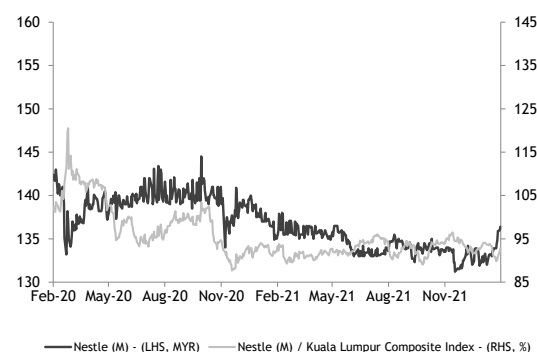
Statistics

| | |
|------------------------|---------------------|
| 52w high/low (MYR) | 138.00/131.20 |
| 3m avg turnover (USDm) | 2.0 |
| Free float (%) | 17.0 |
| Issued shares (m) | 235 |
| Market capitalisation | MYR32.0B USD7.6B |

Major shareholders:

| | |
|--------------------------|-------|
| Nestle SA | 72.6% |
| Employees Provident Fund | 9.5% |
| Public Mutual Bhd. | 1.2% |

Price Performance



| | | | |
|-----------------------|-----|-----|------|
| | -1M | -3M | -12M |
| Absolute (%) | 3 | 2 | 1 |
| Relative to index (%) | (0) | (1) | 0 |

Source: FactSet

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Tear Sheet Insert

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| | |
|--|---|
| Risk Rating & Score ¹ | 19.4 (Low) |
| Score Momentum ² | -0.4 |
| Last Updated | 23 Dec 2021 |
| Controversy Score ³ (Updated: 05 Jan 2021) | 1 - Business ethics (IP) & ops (emissions) incidents |

Business Model & Industry Issues

- NESZ's long-term goal to eliminate its usage of non-recyclable packaging sets an example for its peers to emulate but this could prove to be a costly exercise given that higher demand for recycled flakes may drive its costs above virgin plastic materials. Furthermore, upon fully converting to recyclable packaging, more research still needs to be done in order to address the root of the global plastic wastage problem as only c.10% of recyclable goods are actually recycled with the remaining c.90% accumulating in landfills or littered in the natural environment.
- There is growing pressure from end-consumers for the F&B industry to adopt sustainable sourcing solutions. To that end, NESZ is a leader in this aspect with a clear framework in place to promote raw material traceability and sustainable farming practices while being socially responsible in uplifting the livelihood of farmers that they work with.
- NESZ's ESG strategy is comparable to its industry peers with formal guidelines to soften its environmental and social impact on society relating to waste management, pollution and product health & safety.

Material E issues

- NESZ has committed to converting all its packaging to recyclable and reusable materials by 2025 and zero environmental impact by 2030. Two-thirds of its total plastic packaging are now designed to be recycled.
- NESZ's goal of reducing plastics was enhanced in 2020 where the company successfully introduced 100% paper straws across their entire UHT range while also redesigning various Nescafe and Milo products for more efficient uses of plastic.
- Nespresso launched coffee capsules that use 80% recycled aluminium for its Master Origin Colombia variant in 2020, aiming to fully convert its entire range to recycled aluminium by end-2021.
- 100% of the wastewater at its factories is treated to remove 96% of organic load before the water is discharged. NESZ has reduced its water usage per tonne of product by 20% since 2015.
- NESZ is committed to zero deforestation; internally striving towards 100% responsibly-sourced palm oil by 2020 and 100% RSPO certified palm oil by 2023.

Material S issues

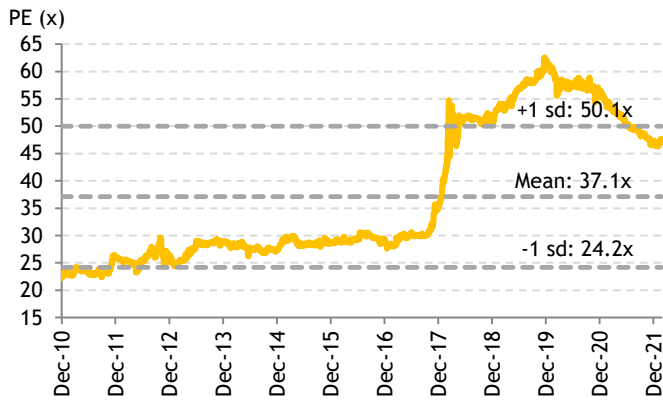
- To uphold consumer confidence in the health and safety of its products, an extensive framework was implemented across its supply chain in 2018 under its global Responsible Sourcing Standard (RSS), aligned with standards set forth by the OECD for multinational enterprises and the United Nations' Sustainable Development Goals.
- Raw materials are pivotal to product quality. As such, NESZ supports local farmers through rural development programmes, sourcing directly through contract farming initiatives that provide hands-on assistance and training to improve both quantity and quality of crop yields. NESZ has on-going programmes for local growers of chilli, paddy and coffee at present.
NESZ's staff gender composition comprises of 65% male and 35% female. In 2020, over 50% of leadership positions within the organisation were held by women.

Key G metrics and issues

- In 2020, NESZ's Board comprised of 7 directors, the majority of whom are independent directors - 4 independent directors, 1 non-independent director and the group CEO and CFO who are executive directors.
- The Chairman of the Board and the CEO are held by separate individuals.
- 3 out of 7 members of the Board are held by women, representing 43% female representation.
- NESZ's constitution states that one-third of the groups Directors shall retire from the Board by rotation on an annual basis but Directors are allowed to offer themselves for re-election, if eligible.
- Annual shareholders' approval is required for independent directors serving beyond 9 years. At the moment, no Directors have served as Independent Directors beyond 12 years.
- The governance, nomination and compensation committee is led by the Chairman of NESZ, deviating from industry norms of having an independent director chairing the committee.
- The group CEO's total remuneration package (MYR4.4m) represents 0.6% of NESZ's reported group pretax profit in 2020.
- NESZ's is audited by KPMG PLT. To ensure the independence of external auditors, the groups audit committee requires that its lead audit partner is rotated once every 7 years.
- NESZ enters into recurring related party transactions (RPT) mostly involving purchases of raw materials, semi-finished and finished food products from other Nestle affiliated companies globally. Other recurring RPT's include those involved in payment of royalties for the usage of trademarks of food products, and payments for shared services in IT.

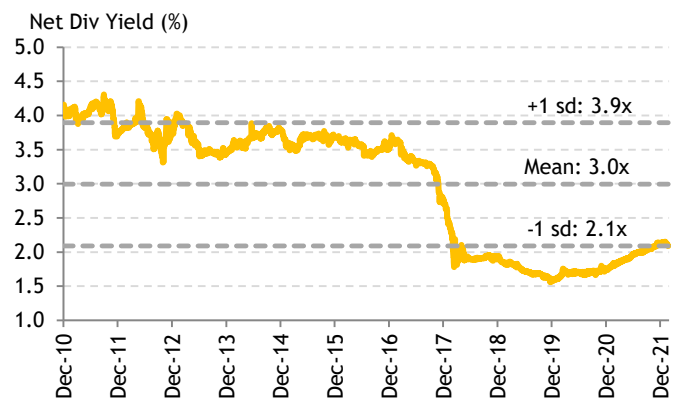
¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company's exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company's enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company's score since the last update - a **negative** integer indicates a company's improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Fig 1: One-year forward PER



Source: Bloomberg, Maybank IBG Research

Fig 2: One-year forward dividend yield



Source: Bloomberg, Maybank IBG Research

Risk statement

There are several risk factors for our earnings estimates, price target, and rating for Nestle (Malaysia). A spike in raw material prices may impact earnings for Nestle (Malaysia). Additionally, sharp appreciation of USD against MYR will also affect its earnings, for about 50% of its raw material requirements are denominated in USD. Its export sales, which account for about 20% of total sales, should however provide some natural hedge.

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|
| Key Metrics | | | | | |
| P/E (reported) (x) | 59.5 | 55.5 | 48.1 | 45.6 | 43.4 |
| Core P/E (x) | 58.4 | 54.3 | 48.1 | 45.6 | 43.4 |
| P/BV (x) | 58.5 | 54.0 | 54.6 | 54.4 | 54.1 |
| P/NTA (x) | 66.1 | 60.6 | 61.1 | 60.7 | 60.2 |
| Net dividend yield (%) | 1.7 | 1.8 | 2.1 | 2.2 | 2.3 |
| FCF yield (%) | 1.9 | 2.0 | 2.0 | 2.5 | 2.6 |
| EV/EBITDA (x) | 35.6 | 36.2 | 29.2 | 27.7 | 26.8 |
| EV/EBIT (x) | 43.9 | 40.7 | 36.0 | 34.0 | 32.5 |
| INCOME STATEMENT (MYR m) | | | | | |
| Revenue | 5,412.2 | 5,733.8 | 6,020.5 | 6,321.5 | 6,637.6 |
| EBITDA | 932.5 | 884.3 | 1,114.2 | 1,174.8 | 1,209.4 |
| Depreciation | (175.2) | (193.0) | (208.0) | (216.0) | (210.3) |
| Amortisation | (1.3) | (1.2) | (1.1) | (1.1) | (1.1) |
| EBIT | 756.0 | 786.1 | 905.1 | 957.7 | 998.0 |
| Net interest income / (exp) | (31.9) | (35.0) | (34.0) | (38.5) | (32.3) |
| Associates & JV | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 |
| Exceptionals | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other pretax income | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax profit | 724.8 | 751.8 | 871.8 | 919.9 | 966.4 |
| Income tax | (172.1) | (182.0) | (207.0) | (218.4) | (229.5) |
| Minorities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Discontinued operations | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Reported net profit | 552.7 | 569.8 | 664.8 | 701.5 | 736.9 |
| Core net profit | 557.9 | 579.8 | 664.8 | 701.5 | 736.9 |
| BALANCE SHEET (MYR m) | | | | | |
| Cash & Short Term Investments | 9.4 | 6.9 | 7.3 | 26.3 | 86.8 |
| Accounts receivable | 472.7 | 377.1 | 395.9 | 415.7 | 436.5 |
| Inventory | 597.3 | 745.0 | 771.0 | 803.3 | 838.2 |
| Reinsurance assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Property, Plant & Equip (net) | 1,423.8 | 1,534.3 | 1,593.9 | 1,551.5 | 1,514.9 |
| Intangible assets | 64.5 | 63.3 | 62.2 | 61.1 | 60.0 |
| Investment in Associates & JVs | 5.6 | 5.9 | 6.7 | 7.4 | 8.1 |
| Other assets | 288.1 | 252.3 | 252.3 | 252.3 | 252.3 |
| Total assets | 2,861.4 | 2,984.8 | 3,089.3 | 3,117.7 | 3,196.9 |
| ST interest bearing debt | 257.7 | 245.7 | 245.7 | 245.7 | 245.7 |
| Accounts payable | 1,480.8 | 1,626.1 | 1,682.8 | 1,753.3 | 1,829.6 |
| Insurance contract liabilities | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| LT interest bearing debt | 100.0 | 100.0 | 145.0 | 100.0 | 100.0 |
| Other liabilities | 466.0 | 430.0 | 430.0 | 430.0 | 430.0 |
| Total Liabilities | 2,304.2 | 2,402.1 | 2,503.9 | 2,529.4 | 2,605.6 |
| Shareholders Equity | 557.1 | 582.7 | 585.4 | 588.3 | 591.3 |
| Minority Interest | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total shareholder equity | 557.1 | 582.7 | 585.4 | 588.3 | 591.3 |
| Total liabilities and equity | 2,861.4 | 2,984.8 | 3,089.3 | 3,117.7 | 3,196.9 |
| CASH FLOW (MYR m) | | | | | |
| Pretax profit | 724.8 | 751.8 | 871.8 | 919.9 | 966.4 |
| Depreciation & amortisation | 176.5 | 194.1 | 209.1 | 217.1 | 211.4 |
| Adj net interest (income)/exp | 31.9 | 35.0 | 34.0 | 38.5 | 32.3 |
| Change in working capital | 133.0 | 83.9 | 11.9 | 18.4 | 20.5 |
| Cash taxes paid | (175.0) | (189.0) | (207.0) | (218.4) | (229.5) |
| Other operating cash flow | 26.2 | (1.7) | 0.0 | 0.0 | 0.0 |
| Cash flow from operations | 909.3 | 887.5 | 919.1 | 974.8 | 1,000.4 |
| Capex | (294.1) | (267.5) | (267.5) | (173.7) | (173.7) |
| Free cash flow | 615.2 | 620.0 | 651.5 | 801.1 | 826.7 |
| Dividends paid | (656.6) | (544.0) | (662.1) | (698.6) | (733.9) |
| Equity raised / (purchased) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Change in Debt | 105.6 | 15.0 | 45.0 | (45.0) | 0.0 |
| Other invest/financing cash flow | (31.5) | (34.6) | (34.0) | (38.5) | (32.3) |
| Effect of exch rate changes | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net cash flow | 32.8 | 56.3 | 0.4 | 19.0 | 60.5 |

| FYE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|--|--------|--------|--------|--------|--------|
| Key Ratios | | | | | |
| Growth ratios (%) | | | | | |
| Revenue growth | (1.9) | 5.9 | 5.0 | 5.0 | 5.0 |
| EBITDA growth | (13.6) | (5.2) | 26.0 | 5.4 | 2.9 |
| EBIT growth | (17.1) | 4.0 | 15.1 | 5.8 | 4.2 |
| Pretax growth | (17.2) | 3.7 | 16.0 | 5.5 | 5.1 |
| Reported net profit growth | (17.9) | 3.1 | 16.7 | 5.5 | 5.1 |
| Core net profit growth | (16.4) | 3.9 | 14.7 | 5.5 | 5.1 |
| Profitability ratios (%) | | | | | |
| EBITDA margin | 17.2 | 15.4 | 18.5 | 18.6 | 18.2 |
| EBIT margin | 14.0 | 13.7 | 15.0 | 15.1 | 15.0 |
| Pretax profit margin | 13.4 | 13.1 | 14.5 | 14.6 | 14.6 |
| Payout ratio | 98.4 | 99.6 | 99.6 | 99.6 | 99.6 |
| DuPont analysis | | | | | |
| Net profit margin (%) | 10.2 | 9.9 | 11.0 | 11.1 | 11.1 |
| Revenue/Assets (x) | 1.9 | 1.9 | 1.9 | 2.0 | 2.1 |
| Assets/Equity (x) | 5.1 | 5.1 | 5.3 | 5.3 | 5.4 |
| ROAE (%) | 90.5 | 100.0 | 113.8 | 119.5 | 125.0 |
| ROAA (%) | 20.0 | 19.8 | 21.9 | 22.6 | 23.3 |
| Liquidity & Efficiency | | | | | |
| Cash conversion cycle | (53.7) | (57.5) | (59.5) | (59.2) | (59.2) |
| Days receivable outstanding | 32.6 | 26.7 | 23.1 | 23.1 | 23.1 |
| Days inventory outstanding | 60.0 | 64.0 | 69.8 | 69.6 | 69.6 |
| Days payables outstanding | 146.3 | 148.1 | 152.4 | 151.9 | 151.8 |
| Dividend cover (x) | 1.0 | 1.0 | 1.0 | 1.0 | 1.0 |
| Current ratio (x) | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Leverage & Expense Analysis | | | | | |
| Asset/Liability (x) | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 |
| Net gearing (%) (incl perps) | 62.5 | 58.1 | 65.5 | 54.3 | 43.8 |
| Net gearing (%) (excl. perps) | 62.5 | 58.1 | 65.5 | 54.3 | 43.8 |
| Net interest cover (x) | 23.7 | 22.4 | 26.6 | 24.9 | 30.9 |
| Debt/EBITDA (x) | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 |
| Capex/revenue (%) | 5.4 | 4.7 | 4.4 | 2.7 | 2.6 |
| Net debt/ (net cash) | 348.3 | 338.8 | 383.4 | 319.4 | 258.9 |

Source: Company; Maybank

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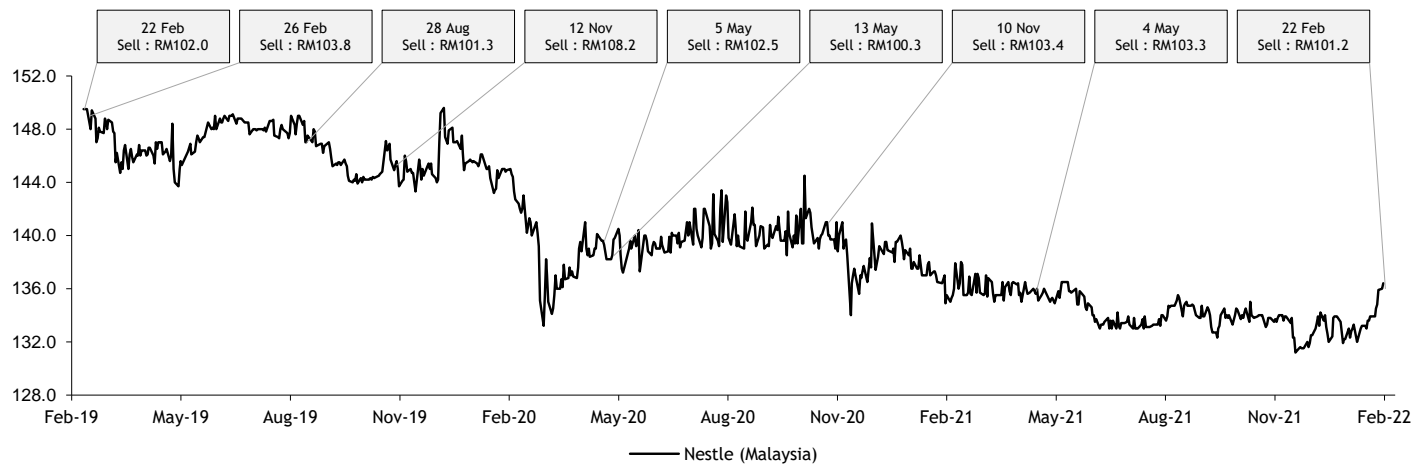
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