

23 February 2018 | Briefing Note

Nestlé (Malaysia) Berhad

Earnings improvement in FY18

Maintain NEUTRAL

Unchanged Target Price (TP): RM116.50

INVESTMENT HIGHLIGHTS

- **Commendable FY17 financial performance**
- **Optimisation initiatives cushioned the impact of higher costs**
- **Earnings to improve further in FY18, driven by a more aggressive marketing campaign**
- **Maintain NEUTRAL stance with unchanged TP of RM116.50**

Commendable performance despite challenging environment.

To recall, Nestlé Malaysia Holdings Bhd's (Nestlé) 4QFY17 reported close to a +100%yoy growth in earnings to RM133.5m. Nevertheless, full year FY17 earnings rose at a modest pace of +1.4%yoy to RM645.8m. Despite a resilient revenue growth of +4.0%yoy, earnings for FY17 were mainly impacted by high cost of sales contributed by the: (i) uptrend of commodity costs and; (ii) the weakening of Ringgit.

Optimisation initiatives resulted in costs saving. Nestlé has undergone aggressive operating efficiency initiatives implementation over the past two years. The company has implemented a quicker ordering process, more efficient logistic handling and a global procurement hub to leverage on its economies of scale. These ensure that the internal systems are more efficient to deliver cost savings. For instance, the simplification of its ordering process where the use of latest technology helped to increase automation and make the process twice as fast. This resulted in faster payment from customer. Such initiatives contributed to the decline in operating expenses of -9.7%yoy which partially buffered the +8.6%yoy increase in cost of sales.

FY18 earnings to grow at a steady pace. We expect a higher revenue growth for FY18 driven by a more aggressive advertising and promotional (A&P) expenses. Due to the recent stabilising commodity prices and strengthening Ringgit, more spending is expected to be channelled to A&P activities to boost customer purchase. We expect that the A&P expenses for FY18 will be significantly higher than FY17. In addition, effective tax rate is expected to be sustained at 21% going forward as most tax incentives such as the Halal tax incentives had been fully claimed. All in, we expect that earnings will remain at a steady state of growth in FY18.


Impact to earnings. No change to our earnings assumption at this juncture

RETURN STATS

Price (22nd February 2018)	RM122.20
Target Price	RM116.50
Expected Share Price Return	-4.7%
Expected Dividend Yield	+2.4%
Expected Total Return	-2.3%

STOCK INFO

KLCI	1,855.07
Bursa / Bloomberg	4707/ NESZ MK
Board / Sector	Main/Consumer
Syariah Compliant	Yes
Issued shares (mil)	234.5
Market cap. (RM'm)	28,491.75
Price over NA	44.52x
52-wk price Range	RM75.4-RM123.0
Beta (against KLCI)	0.50
3-mth Avg Daily Vol	0.26m
3-mth Avg Daily Value	RM27.1m
Major Shareholders (%)	
NESTLE SA	72.61
EPF	6.92
PNB & Associated Funds	2.72

Maintain NEUTRAL stance with an unchanged TP of RM116.50. Nestlé's price has risen approximately +21% since the public announcement of its inclusion into MSCI Malaysia and FBM KLCI Index in November 2017. Nevertheless, valuation is currently stretched with a forward PER of more than 40x in comparison to the average three-year PE of 28x prior to the inclusion. We believe that the improved earnings in the 4QFY17 and expectation of better earnings prospect in FY18 have been priced into the current valuation. We are maintaining our **NEUTRAL** call on Nestlé with an unchanged target price of **RM116.50** per share. Our target price is based on dividend discount model with the assumption that required return on equity is of 5.0% and sustainable dividend growth rate of 2.4%. 

INVESTMENT STATISTICS

FYE Dec (RMm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	4,838.0	5,063.5	5,260.5	5,534.7	5,811.4
Cost of sales	(2,972.5)	(3,066.1)	(3,330.1)	(3,392.7)	(3,559.5)
Gross profit	1,865.5	1,997.5	1,930.3	2,141.9	2,251.9
PBT	727.7	766.5	814.1	867.8	918.2
PAT	590.7	637.1	645.8	694.2	734.6
EPS (sen)	251.9	271.7	275.4	296.1	313.2
Net Dividend (sen)	260.0	270.0	275.0	295.0	320.0
Gross profit margin (%)	38.6	39.4	36.7	38.7	38.8
PBT margin (%)	15.0	15.1	15.5	15.7	15.8
PAT margin (%)	12.2	12.6	12.3	12.5	12.6
EPS Growth (%)	7.3	7.9	1.4	7.5	5.8
Dividend yield (%)	2.1	2.2	2.3	2.4	2.7
PER (x)	48.2	44.7	44.1	41.0	38.8

Source: Company, MIDFR

DAILY PRICE CHART



Nestlé (Malaysia) Bhd: 4QFY17 Results Review

FYE Dec (RMm)	Quarterly results					Cumulative results		
	4QFY17	3QFY17	4QFY16	YoY (%)	QoQ (%)	FY17	FY16	YoY (%)
Revenue	1,281.7	1,323.3	1,249.9	2.5	(3.1)	5,260.5	5,063.5	3.9
Cost of sales	(819.3)	(872.4)	(792.3)	3.4	(6.1)	(3,330.1)	(3,066.1)	8.6
Gross profit	462.4	450.8	457.6	1.1	2.6	1,930.3	1,997.5	(3.4)
Operating expenses	(287.5)	(297.1)	(367.2)	(21.7)	(3.3)	(1,082.4)	(1,198.7)	(9.7)
Operating profit	175.0	153.7	90.4	93.6	13.8	847.9	798.8	6.1
Finance costs	(9.5)	(9.3)	(8.8)	7.9	2.5	(36.0)	(33.8)	6.4
Finance income	0.4	0.4	0.3	37.8	13.5	1.4	1.1	26.6
Share of results of associated company	(0.1)	0.3	(0.4)	(77.3)	(130.6)	0.8	0.4	91.5
PBT	165.8	145.1	81.5	103.4	14.3	814.1	766.5	6.2
Taxation	(32.2)	(25.3)	(14.6)	121.4	27.2	(168.3)	(129.4)	30.1
PAT	133.5	119.7	66.9	99.5	11.5	645.8	637.1	1.4
Basic EPS (sen)	57.0	51.1	28.6	99.5	11.5	275.4	271.7	1.4
				<i>+ / (-) ppts</i>				<i>+ / (-) ppts</i>
Gross profit (%)	36.1	34.1	36.6	(0.5)	2.0	36.7	39.4	(2.8)
Operating profit margin (%)	13.6	11.6	7.2	6.4	2.0	16.1	15.8	0.3
PBT margin (%)	12.9	11.0	6.5	6.4	2.0	15.5	15.1	0.3
PAT margin (%)	10.4	9.0	5.4	5.1	1.4	12.3	12.6	(0.3)
Effective Tax rate (%)	19.4	17.5	17.9	1.6	2.0	20.7	16.9	3.8
Segmental Results								
Revenue								
Food & Beverages	1,035.3	1,068.5	1,001.0	3.4	(3.1)	4,225.7	4039.1	4.6
Others (Nutrition, Nestle Professional & Nespresso)	246.5	254.7	248.9	(1.0)	(3.2)	1,034.8	1024.4	1.0
Operating Profit								
Food & Beverages	149.6	119.8	81.0	84.8	24.8	698.5	644.6	8.4
Others (Nutrition, Nestle Professional & Nespresso)	24.2	34.9	8.3	191.1	(30.6)	149.4	153.9	(2.9)
Operating profit margin (%)								
Food & Beverages	14.4	11.2	8.1	6.4	3.2	16.5	16.0	0.6
Others (Nutrition, Nestle Professional & Nespresso)	9.8	13.7	3.3	6.5	(3.9)	14.4	15.0	(0.6)

Source: Company, MIDFR

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).
(Bank Pelaburan)
(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein. This document may not be reproduced, distributed or published in any form or for any purpose.

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.