

## SECTOR UPDATE

### Consumer – Malaysia

Palatable Valuations And Improved Earnings Visibility Underpin OVERWEIGHT Call

Margin compression tied to inflationary pressure and lofty commodities prices has appeared to have bottomed out. Given the margin compression and moderating commodities prices, we expect the eventual improved earnings visibility to potentially catalyse the sector, anchoring our OVERWEIGHT call on the sector. The sector is also trading below its -1SD to its five-year mean while offering resilient and attractive growth. Top picks for the sector are F&N, Heineken Malaysia and Mr. DIY.

#### WHAT'S NEW

- **Limited downside risk.** Commodities prices have declined from multi-year highs. Apart from sugar (3.6%) and barley (12.5%), soft commodities have softened by up to 20% vis-à-vis ytd averages. Based on our channel checks, it appears that current prices have largely reflected higher costs. Apart from the usual annual revision, no companies under our coverage intend to revise their prices over the near term. Downside risk to margins appears limited at this juncture. While 3Q22 operating margins are of 12.9%, 1.0ppt lower vis-à-vis 3Q19, it was flattish on a qoq basis. This suggests that margins have found a bottom. Instead, a potential margin expansion from lower commodities prices are likely to be realised closer to mid-23, following the depletion of inventory and hedging positions. The improved earnings visibility could be a re-rating catalyst for the sector.

#### ACTION

- **Maintain OVERWEIGHT on the sector, backed by improving earnings visibility and attractive valuations.** While potential tightened purse strings from inflationary pressures, recessionary fears and potentially lower subsidies from the government are already present or emerging, they are outweighed by these factors, namely: a) valuations are trading below -1SD, backed by double-digit earnings growth of 13.0%, b) inflationary pressure, including commodities that have a direct and significant impact that clouded earnings visibility, is subsiding, c) our preference is skewed towards staples which command resilient demand amid a downshift in the economy, including quasi-staples such as Mr. DIY that managed to grow sales even throughout the pandemic, and d) beneficiaries of gradually recovering tourist arrivals. This confluence of factors underlines our OVERWEIGHT call for the sector.
- **F&N, Heineken Malaysia and Mr. DIY are our top picks.** We have a preference for consumer staples and staple-like derived demand amid emerging headwinds and beneficiaries of lower commodities prices. Top picks for the sector include F&N, Heineken Malaysia and Mr. DIY. In addition, F&N and Heineken Malaysia are beneficiaries of the gradually recovering tourism and the latter offers an appealing dividend yield of 5.1-5.5%.

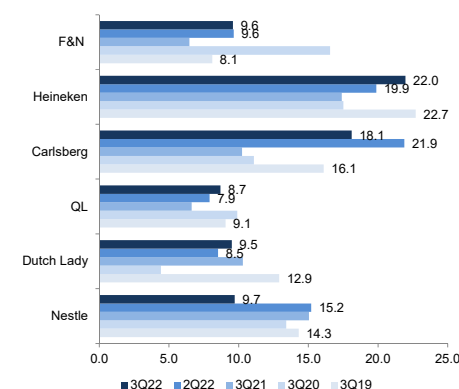
#### PEER COMPARISON

Company	Tickers	Rec	Share Price 7 Dec 22 (RM)	Target Price (RM)	Market Cap (RMm)	PE (x) FY22F	PE (x) FY23F	P/BV (x) FY21F	Div Yield (%) FY22F	Div Yield (%) FY23F
British American Tobacco	ROTH MK	BUY	11.24	16.05	3,209	12.4	10.1	8.4	8.1	9.9
Carlsberg Brewery	CAB MK	BUY	22.84	29.00	6,983	20.7	19.8	33.3	4.8	5.0
Farm Fresh	FFB MK	HOLD	1.58	1.54	2,936	39.2	29.5	4.4	0.6	0.8
F&N Holdings	FNH MK	BUY	21.00	23.60	7,702	18.1	17.0	2.4	3.1	3.2
Heineken Malaysia	HEIM MK	BUY	25.12	32.00	7,589	19.6	18.9	19.2	5.1	5.3
Mr DIY Group	MRDIY MK	BUY	2.06	2.30	19,425	39.4	31.7	13.7	1.1	1.6
MyNews	MNHB MK	BUY	0.61	0.66	416	25.8	14.0	1.7	0.9	1.8
Nestle	NESZ MK	HOLD	137.60	143.00	32,267	49.7	43.3	52.5	1.9	2.2
QL Resources	QLG MK	HOLD	5.56	5.90	13,531	45.8	43.4	5.0	0.6	0.6
<b>Average</b>					<b>10,450.9</b>	<b>30.1</b>	<b>25.3</b>	<b>15.6</b>	<b>2.9</b>	<b>3.4</b>

Source: Bloomberg, UOB Kay Hian

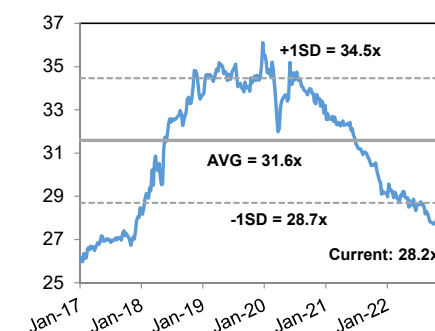
## OVERWEIGHT (Maintained)

#### 3Q22 EBIT MARGINS ACROSS CONSUMER STAPLES



Source: Respective companies

#### SECTOR VALUATIONS



Source: Bloomberg, UOB Kay Hian  
Includes: BAT, Carlsberg, F&N, Heineken, Nestle and QL. The rest do not have a 5-year historical record.

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### COMMODITIES PRICES ARE DOWNTRENDING

	2021	YTD	YTD22 vs 2021	Current	Last close vs 2021	Key Companies (% of raw material)
Sugar (US\$/lb)	17.9	18.7	4.9	19.6	4.4	F&N, Power Root
Cocoa (US\$/MT)	2494	2454	-1.6	2432	-0.9	Nestle, Guan Chong
Robusta (US\$/MT)	1764	2120	20.2	1899	-10.4	Power Root, Nestle
Milk Powder (US\$/MT)	3364	3930	16.8	3100	-21.1	F&N, Farm Fresh, Dutch Lady
CPO (RM/MT)	4434	5236	18.1	4003	-23.5	Nestle
Wheat (US\$/MT)	701	914	30.3	716	-21.7	Kawan Food (up to 50%)
Barley (INR/quintal)	1982	2871	44.8	3235	12.7	Breweries
Aluminium (US\$/MT)	2483	2738	10.3	2523	-7.9	Breweries, F&N
Corn (USD/Bushel)	581	698	20.1	631	-9.7	QL
Soybean (USD/Bushel)	1375	1559	13.4	1448	-7.1	QL

Source: Bloomberg, Respective companies, UOB Kay Hian  
As of 6 Dec 22

### ESSENTIALS

#### • Key developments in 1H23.

- Farm Fresh expects its Taiping capacity expansion to be completed by the year end.** This will ease other bottleneck processes. In totality, total production output is expected to increase by 25-30% in 1Q23. This will bode well for Farm Fresh as sales are currently supply limited.
- MyNews is on the cusp of turning profitable.** After 10 loss-making quarters that was brought about by the pandemic, we expect MyNews to turn profitable over the near term. This could spark further interest into the convenience store operator.
- Recognition of Cocoland by F&N.** F&N's Cocoland acquisition was completed in November and will be earnings accretive to F&N in 1Q23. Based on consensus earnings projection and F&N's stake of 72%, we estimate that the acquisition is a +2% earnings accretion to F&N's FY23 earnings.
- Site preparation of F&N's upstream dairy farming venture in 2023.** F&N will be planning and preparing its land before producing crop plantation in 2024 for its dairy cows. F&N targets a first milking in Dec 24. Its initial first phase target of 5,000 milking cows will position it to the likes of the industry's current market leader, Farm Fresh.

- Staples and retail offer outperformance after the General Elections.** After the General Election (GE) 15 in Malaysia, we look back at the past five GEs in Malaysia and the corresponding share price performances of consumer companies relative to the FBMKLCI over a three-month period before and after the GE. Specifically, the staple and retail segments have outperformed the FBMKLCI by 6.4% and 1.9% respectively. Given that sector valuations are trading below -1SD of its five-year mean PE, backed by decent earnings growth, this may be replicated again.

### SHARE PRICE PERFORMANCE VS FBMKLCI THREE MONTHS BEFORE AND AFTER GENERAL ELECTION

	----- 3 Months Before GE Performance vs FBMKLCI -----				----- 3 Months After GE Performance vs FBMKLCI -----			
	Staples	BAT	Breweries	Retail	Staples	BAT	Breweries	Retail
1999	(0.4)	9.9	(0.1)	3.2	(3.8)	(26.3)	(11.4)	0.9
2004	(7.0)	(1.7)	(4.8)	48.2	13.8	17.3	4.1	9.9
2008	12.2	16.4	8.2	11.0	17.3	5.0	5.7	1.2
2013	(0.1)	3.2	15.8	2.7	2.9	(3.1)	(3.2)	(1.1)
2018	12.0	(29.5)	6.9	8.6	1.6	(4.3)	(3.0)	(1.3)
Average	3.3	(0.3)	5.2	14.7	6.4	(2.3)	(1.5)	1.9

Staples: Dutch Lady, F&N, Nestle and QL  
Breweries: Heineken and Carlsberg  
Retail: Padini and Aeon  
Source: Bloomberg

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