

TO BUY OR NOT TO BUY THE EQUITY OF NESTLÈ MALAYSIA BERHAD

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Abstract

Amira Lee has been newly appointed as a financial analyst for Melati Investors Berhad. Being an analyst, she is given a task to provide recommendation whether to buy or not to buy the equity of Nestlè Malaysia Berhad. Amira's consideration whether to buy Nestlè's equity or not, was not quite straightforward task because she might have to look at more than one year financial statements and apply dividend discount model to value the equity. If she could not made her decision within a week, Melati Investors Berhad may lose the opportunity to buy equities of Nestle (i.e. larger and long-established companies that would have probably paid higher dividends) given that the closing date of trading the equities will be due in next seven days.

Keywords: Financial Analyst, Dividend Discount Model, Nestlè Malaysia Berhad

Introduction

“ What should I do?” Amira Lee is monoloqueing with her self. She has been newly appointed as a financial analyst for Melati Investors Berhad. She just got back to her office after a management meeting to decide whether to buy the share of Nestlè Malaysia Berhad. Amira needs to decide urgently as the top managements require her to provide a report which support the recommended decision for Melati Investors Berhad, the largest independent investment financial institution by equity trading value and volume in Selangor. Specifically, the company is performing regulated activities of fund management dealing mainly in securities and others in unit trust, bonds and loans. For Amira Lee, it is not an easy task for a financial analyst to value the equity of Nestlè Malaysia Berhad by solely using the reported profits and losses, earnings per share and total assets and liabilites obtained from the financial statements.

Hence, Amira’s consideration whether to buy Nestlè’s equity or not, was not quite straightforward because she might have to look at more than one year financial statements and apply dividend discount model to value the equity. Within a week, Amira needs to present her decision to the top management because Melati Investors Berhad would like to find investment opportunities in Nestlè Malaysia Berhad. If Amira Lee could not made her decision within a week, Melati Investors Berhad may lose the opportunity to buy equities of Nestle (i.e. larger and long-established companies that would have probably paid higher dividends) given that the closing date of trading the equities will be due in next seven days.

Background of Company

Nestlé's commitment to providing quality products to Malaysians dated back almost 100 years ago. Nestlé began in Malaysia in 1912 as the Anglo-Swiss Condensed Milk Company in Penang and later, growth and expansion made a move to Kuala Lumpur

necessary in 1939. Since 1962, with its first factory in Petaling Jaya, Nestlé Malaysia now manufactures its products in 8 factories.

The Company was publicly listed on the KLSE now known as Bursa Malaysia Berhad on 13 December, 1989. Today, the Company employs more than 5000 people and manufactures as well as markets more than 300 Halal products in Malaysia. Its brand name such as MILO, NESCAFÉ, MAGGI, NESPRAY and KIT KAT have become trusted household names and enjoyed for generations. The main office of Nestlé Malaysia is placed at Mutiara Damansara. It have manufacturing facilities throughout Malaysia, including those located in Petaling Jaya and Shah Alam in Selangor, Chembong in Negeri Sembilan and Kuching in Sarawak. Its national distribution center is located at Bukit Raja, Klang, Selangor.

The financial performance for Nestlé Malaysia Berhad based on five years financial highlight beginning 2011 to 2015, the revenue, profit before tax and profit after tax had been consistently increased except for the year 2014. The year of 2014 can be characterized as a challenging year for the Company, exerted by external and internal factors. The year started on a very positive note with the previous year's (i.e. 2013) strong momentum which carried through to the first half and to a certain extent into the third quarter of the year. During these periods, most of the economic indicators were showing an encouraging trend despite many challenges the country faced, including the two airline-related tragedies, slower consumer spending and concerns over the impending Goods and Services Tax (GST) implementation in 2015.

The challenging global economic environment as well as a softening in demand for some export categories (e.g. confectionery, liquid drinks and ice cream) has significantly impacted the export turnover. The situation was further compounded by the fact that Indonesia and the Philippines have invested in their local manufacturing facilities for products previously imported from Malaysia. For the financial year ended 31 December 2014, the Nestlé Malaysia Berhad total turnover of RM4.8 billion represents a 0.4% increase against the previous year.

Nestlé Malaysia Berhad's employment of asset demonstrated an unstable fluctuating trend, with a falling trend in the recent past three years, suggesting that the company's management of asset is underperformed, due to negative working capital. Meanwhile, share capital for Nestlé Malaysia Berhad had remained the same for the five consecutive years, indicating there is no issuance of shares via bonus issue or right issue. Reserves for shareholders increased for the years 2011 to 2013 but decreased in the recent years 2014 and 2015. Nevertheless, Nestlé Malaysia Berhad had made an effort to maintain low debt financing and high equity financing. The company had settled a large portion of its borrowing in the early years, leading to a lower amount of debt financing. However, the capital structure seems to be grown slowly due to a large amount of paid dividend that results to lower shareholders' funds and lower internal financing.

Background of Issue

Amira's consideration of whether to buy or not the share of Nestlé Malaysia Berhad may not be a straightforward decision. The price per share of Nestlé Malaysia Berhad was RM75.12 as at 17 February 2016. Nestle Berhad has been making profits for many years with high EPS and share prices. Specifically, the share prices of Nestle (M) Berhad were traded between RM74 and RM77 during the months of January to May 2016 as shown in Figure 1. Will this price continuously increase in the next future years?

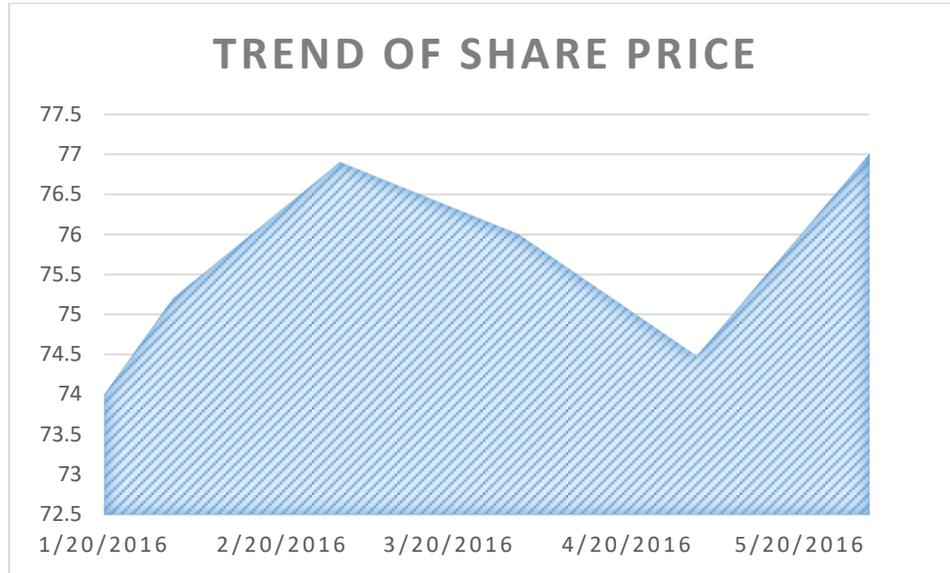


Figure 1: Trend of share price

Hence, equity valuation is an important objective for Amira given that reliable estimates of value enable Amira to make a “buy or not decision” on the securities of Nestlé Malaysia Berhad. Equity valuation is a process of estimating value of a firm or some component of a firm (Gibson, 2013). Furthermore, Subramanyam (2014) defines valuation to estimating the intrinsic value of a company or its stock. Applying a present value theory, he states that the value of a security is equaled to the sum of all expected future payoffs from the security which are discounted to the current date at an appropriate discount rate.

Amira Lee may adopt dividend discount model to value the security of Nestlé Malaysia Berhad. Dividend discount model is the most common valuation model. This model is always true that the value of an equity is equaled to the discounted present value of future dividends. In other words, the dividend discount model has focused on dividend as the only source of cash flow from an investment of an equity. Hence, this model is the most uncontroversial and generally accepted statement about how much a share is theoretically worth (Barker, 2001). A study by Amiri, Ravanpaknodezh, and Jelodari (2016) indicates that an intrinsic price is nearly similar to the market price under dividend discount model, although this model is very sensitive to assumptions of cost of capital and growth rates (Penman, 2013).

Conclusion

Amira Lee needs to value the equity of Nestlè Malaysia Berhad. It is not an easy task for her, as a financial analyst, to make decision whether to buy or not to buy the equity of Nestlè Malaysia Berhad. She might have to review and analyse at more than one financial statements and apply dividend discount model to value the equity. Using this model, Amira Lee will provide a report which supports the recommended decision to Melati Investors Berhad. Consequently, within a week, Amira needs to present her decision to the top management of Melati Investors Berhad. If she could not made her decision within a week, Melati Investors Berhad may lose the opportunity to buy equities of Nestle (i.e. larger and long-established companies that would have probably paid higher dividends) given that the closing date of trading the equities will be due in next seven days. Nevertheless, Amira Lee may apply residual income model and cash flow model in valuing the equity of Nestlè Malaysia Berhad if she has more than a week to provide her recommendation.

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