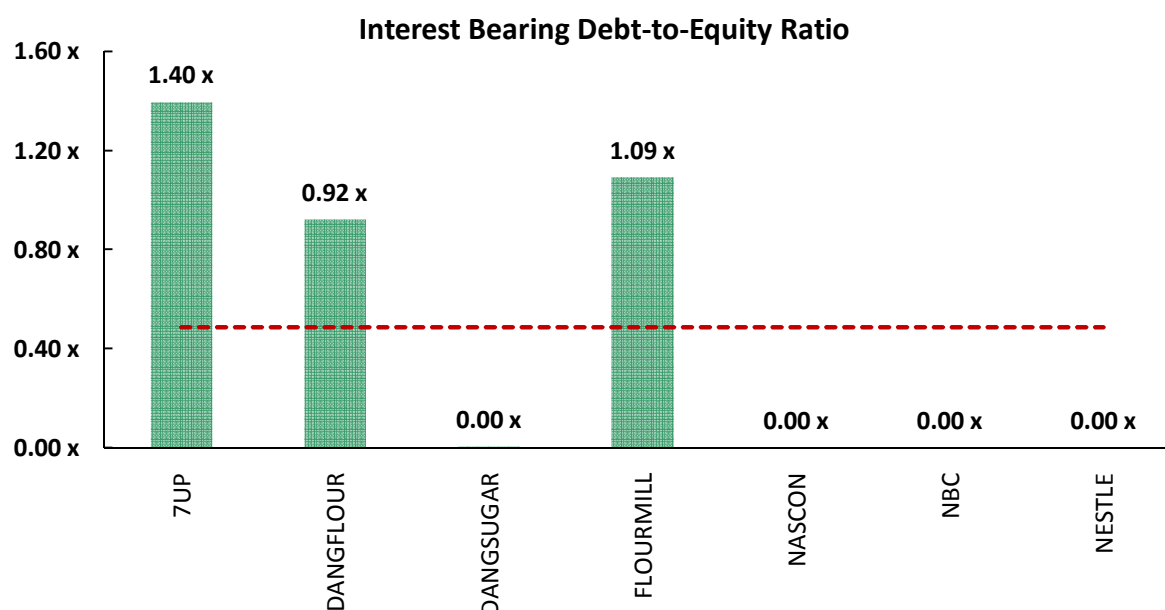


## Fast Moving Consumer Goods (FMCG)

### A Play of Resilience

#### Investment Thesis

**a: Low Interest Rate Exposure.** The FMCG sector exhibits a moderate exposure to the cash drain effect of high interest rate environment, typical of what currently operates in the Nigerian financial sector. The peer average of interest bearing debt to equity ratio stands at 0.46x.



Source: Company Reports, Meristem Research

However, we are upbeat, using this metric, on DANGSUGAR, NASCON, NBC and NESTLE as they remain the least vulnerable to rising cost of funds, exhibiting relatively **high safety margin** with an almost zero interest bearing debt translating to superb interest rate coverage.

NSE Tickers	Interest Bearing Debt/Equity	Interest Coverage
7UP	1.40 x	4.1 : 1
DANGFLOUR	0.92 x	1.8 : 1
DANGSUGAR	0.00 x	14921.1 : 1
FLOURMILL	1.09 x	5.5 : 1
NASCON	0.00 x	272.1 : 1
NBC	0.00 x	11.3 : 1
NESTLE	0.00 x	299.2 : 1
<b>Peer Average</b>	<b>0.49 x</b>	<b>2216.4 : 1</b>

Source: Company Reports, Meristem Research

## b. Prices oversold beyond justified level of exposure to economic cycle.

NSE Tickers	MRQ	Price (NGN)	P/E Ratio (x)		BVPS(NGN)		P/BV (x)	
			Trailing	Forward (2008/09e)	2007/08FYE	2008/09e	2007/08	2008/09e
7UP	2008FYE	36.00	11.47 x	10.43 x	14.09	15.99	2.55 x	2.25 x
DANGFLOUR	2008Q3	7.08	9.10 x	7.38 x	8.86	9.82	0.80 x	0.72 x
DANGSUGAR	2008Q3	11.10	6.01 x	5.38 x	2.16	2.62	5.13 x	4.23 x
FLOURMILL	2008Q1	13.64	3.48 x	4.27 x	13.44	15.36	1.01 x	0.89 x
NASCON	2008Q3	2.96	4.53 x	4.54 x	1.57	1.80	1.88 x	1.64 x
NBC	2008Q2	22.47	7.95 x	6.65 x	17.43	19.45	1.29 x	1.16 x
NESTLE	2008Q3	120.70	10.53 x	8.71 x	11.80	14.57	10.23 x	8.28 x
<b>Peer average</b>			<b>7.95 x</b>	<b>6.65 x</b>	<b>11.80</b>	<b>14.57</b>	<b>1.88 x</b>	<b>1.64 x</b>

Source: Company Reports, Meristem Research

## c. Strong cash generating potential and eye-catching dividend yield.

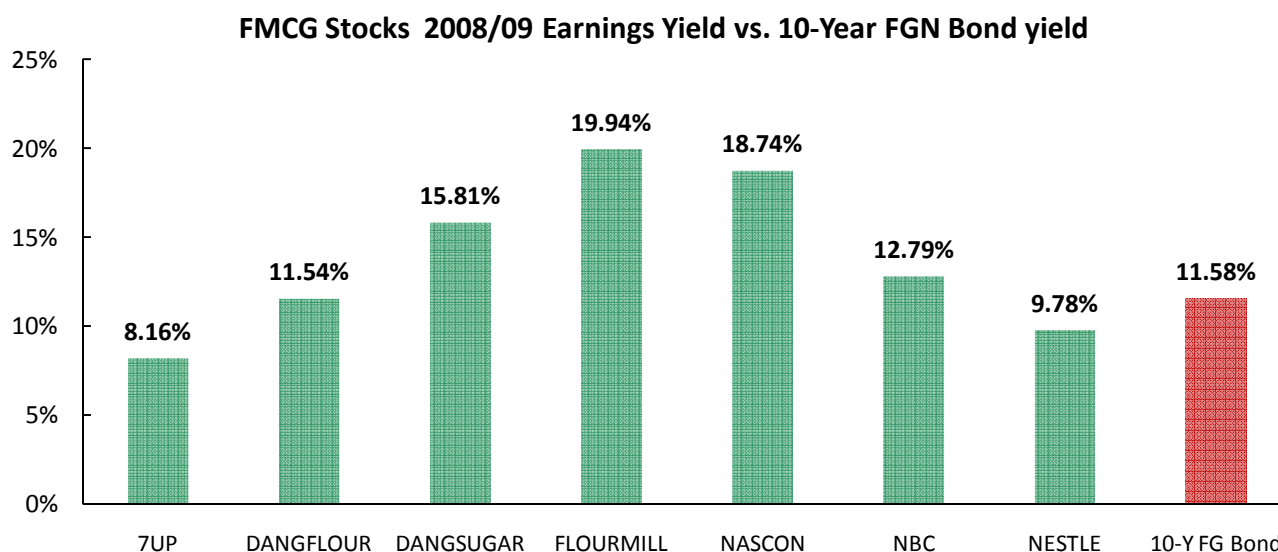
With an average Return on Average Equity (ROaE) spread of 4.58 percent over an average cost of equity of 17 percent, generating attractive **economic profit**, the sector has a strong **cash generating potential** with cash flow from operations averaging 1.4x earnings. Average dividend yield of 6.45 percent appears more attractive than the yield on 91-day T-bill of 5 percent.

NSE Ticker	Dividend Yield	Forward P/BV (x)	2008/09e ROaE	CFO/Earnings
7UP	4.17%	2.25 x	22.94%	3.78 x
DANGFLOUR	0.00%	0.72 x	10.28%	-22.40 x
DANGSUGAR	15.32%	4.23 x	86.12%	1.82 x
FLOURMILL	7.33%	0.89 x	22.19%	0.70 x
NASCON	13.51%	1.64 x	38.63%	1.44 x
NBC	3.34%	1.16 x	18.32%	2.60 x
NESTLE	6.79%	8.28 x	105.13%	1.43 x
<b>Peer Median</b>	<b>6.79%</b>	<b>1.64 x</b>	<b>22.94%</b>	<b>1.44 x</b>

Source: Company Reports, Meristem Research

## d. FMCG vs. 10-Year FG Bond: Which is Cheaper?

Using an adaptation of the Fed Model, the FMCG sector currently appears **cheaper** than investment in the 10-Year FGN bond. Adjusting earnings for inflation expectations at 17.5 percent, the expected earning yields of **DANGSUGAR, FLOURMILL, NASCON and NBC** at current market prices dwarf the yield on the 10-Year FGN Bond which stands at 11.58 percent. The investment concern is whether the yield spreads justify the risk exposure to equity investment.



Source: Meristem Research estimates

## e. Forex and inflation: To what extent is downside risk?

Foreign exchange (Forex) volatility remains a likely snag on earnings growth in the medium term given the dependency of some key players in the sector on imported raw materials such as wheat and raw sugar.

While the Naira has gone through 20 percent devaluation between December 2008 and February 2009 yet with no compelling economic signals for imminent reversal, domestic prices have surged significantly with inflation hovering around 16 percent.

The impact of rising cost on profit margin is likely to be mild due partly to falling commodity prices at the global market and the relatively low demand elasticity facing most FMCG companies, making a shift of cost burden to the final consumers a likely price reaction.

## Our Investment Case

From the foregoing, we make a positive investment case for Companies in the FMCGs, specifically: **DANGSUGAR, NESTLE, FLOURMILL, and NASCON**. These are defensive Companies that thrive during economic slowdown as their earnings are less exposed to waning economic variables. Consistent and moderate earnings vis-a-vis spectacular dividend yields are good attractions for medium to long term investors who seek regular income streams and growth. After a comparative analysis with 10 –year government bonds (risk free) and 17.5 percent adjustment for inflation, investment in a few of these stocks still looks pretty attractive!

## Appendix

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#### Fair Value Estimate

We estimate stock's fair value by computing a weighted average of projected prices derived from intrinsic and relative valuation methodologies. The choice of relative valuation methodology (ies) usually depends on the firm's peculiar business model and what in the opinion of our analyst is considered as a key driver of the stock's value from a firm specific as well as an industry perspective. However, we attach the most weight to discounted cash flow valuation methodology.

#### Ratings Specification

- BUY:** Fair value of the stock is above the current market price by at least **20 percent**
- HOLD:** Fair value of the stock ranges between **-20 percent and 20 percent** from the current market price.
- SELL:** Fair value of the stock is more than 20 percent below the current market price.

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