CardinalStone

Nigeria | Equity Research | Consumer Goods | Sector Commentary

Highlighting sustainability considerations in FMCG companies

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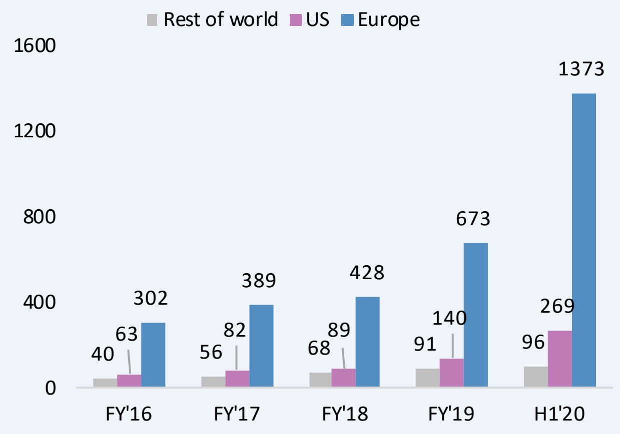
Sustainable investing is increasingly becoming the new normal

According to the European Commission, research on future scenarios suggests that climate changes could have notable effects on environments, plants, animals, and sectors that depend on agriculture, aquatic life, energy, tourism, and water. In line with this position, countries/ international agencies are ardently pushing for a renewed commitment to sustainability via initiatives like the UN SDGs[1], the COP[2] climate summits, and the Glasglow Financial Alliance for Net Zero (GFANZ). In addition, a few fund managers have mandates that are influenced by ESG (Environmental, Social, and Corporate Governance) considerations. Therefore, this class of investors is likely to pay greater attention to fundamentally sound and value-adding companies that simultaneously tick the boxes on ESG.

The increasing ESG focus is also highlighted by the material growth in the AUM of sustainable funds between FY'2016 and Q2'2020 (See figure 1 below). These AUMs have surged 4.3 times within the review period, with Europe and US linked sustainable funds accelerating by 4.4x on average. Notably, Europe accounted for 74.0%-79.0% of global sustainable funds across the five years.

Figure 1: AUM of sustainable funds from 2016 to 2020 (Unit: $'billion)



Source: UNCTAD based on Morningstar and TrackInsight data

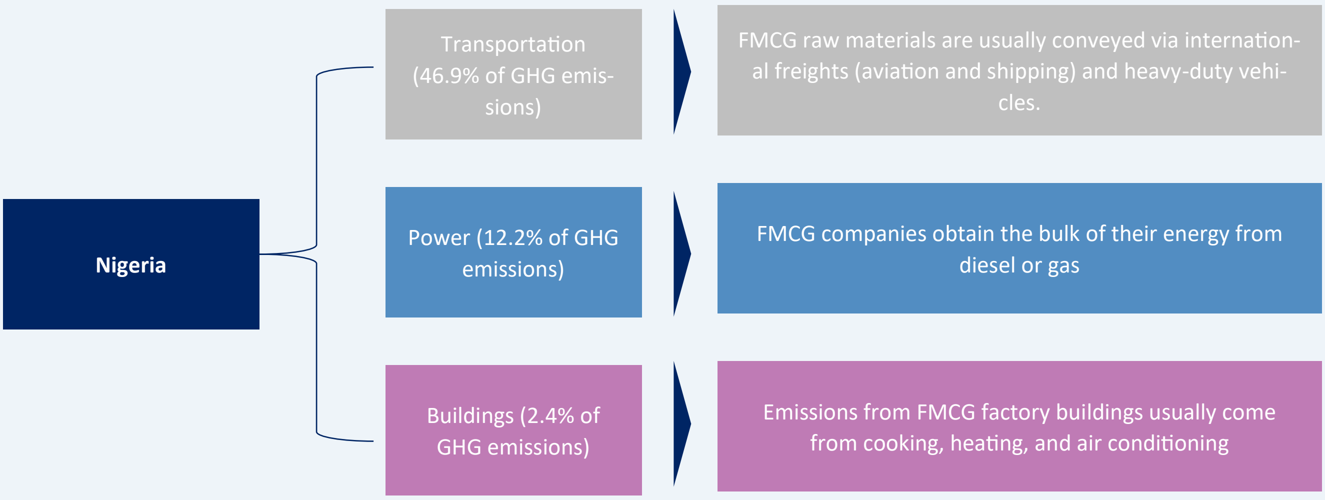
[1] UN SDG- Sustainability Development Goals, in which Goal 13 is related to Climate Action

[2] COP- Conference of the Parties. COP 26 was the most recent annual climate change conference

ESG in FMCG[2] companies

Coming closer home, we assess our Consumer Goods coverage to ascertain the level of ESG considerations in decision-making. From raw material gathering to final delivery, FMCG companies inadvertently contribute to greenhouse emissions across the value chain. In response to this growing concern, a few of our coverage companies have set individual targets geared towards combating environmental and social degradation that their business operations could provoke.

Figure 2: Key drivers of greenhouse gas (GHG) emission in Nigeria



Source: CardinalStone Research; Crippa, M., Guizzardi et al, “GHG emissions of all world countries - 2021 Report”.

ESG ranking of FMCG companies

To provide an insight into the ESG inclination of our coverage FMCG companies, we compare their ratings on CSR Hub and Risk Insights. The result of this exercise revealed that NESTLE appears to be ahead of its peers on the ESG front (96.0% score on CSR Hub). The company is closely trailed by NB, which obtained a 71.0% score on CSR Hub and a GOOD rating from Risk Insights.

96.0%,	71.0%,
Excellent	Good
NESTLE’s ESG rating according to CSR Hub and Risk Insights, respectively.	NB’s ESG rating according to CSR Hub and Risk Insights, respectively.

[3] FMCG – Fast-Moving Consumer Goods

Figure 3: FCMG companies and their ESG Ratings

Ticker	ESG-Ranking (CSR HUB)	2020 ESG GPS Ranking (Risk Insights) Poor ⟵⟶ Excellent	Achievements
NESTLE	96%	□ □ □ ■	⇒ 90% of NESTLE's forest-risk commodities (palm oil, pulp and paper, soya) have been assessed as deforestation-free. In addition, 88% of its packaging by weight is reusable or recyclable.
UNILEVER	46%	□ □ □ ■	⇒ Unilever has plans to ensure that all its plastic packaging is reusable, recyclable, or compostable. It also aims to use at least 25% recycled plastic in its packaging activities by 2025.
NB	71%	□ □ ■ □	⇒ NB has reduced carbon emissions per hectolitre by 51% since 2008 and aims to achieve a net-zero emission by 2030. It is also committed to increasing renewable energy in production, including renewable electricity and renewable thermal energy.
FLOURMILL	42%	□ □ ■ □	⇒ FLOURMILL is phasing out old energy-intensive assets in favour of assets that support a low carbon economy. It also designed fit-for-purpose initiatives to reduce, reuse, or recycle waste generated from its operations.
DANGSUGAR	71%*	□ □ ■ □	⇒ DANGSUGAR has reduced thermal, electrical energy consumption by 7.0%. It has also embarked on a tree planting initiative at DSR Numan operations to preserve the environment.
GUINNESS	45%	□ ■ □ □	⇒ GUINNESS has made significant progress in the post-consumer recycling initiative for all its formats (cans, bottles, and PETS).
UACN	3%	□ ■ □ □	⇒ UACN has formulated its products in an eco-friendly manner without compromising their quality and standards.

Source: CardinalStone Research, Companies' Sustainability Reports; CSR HUB-ESG Ranking; Risk Insights- ESG Ranking; .

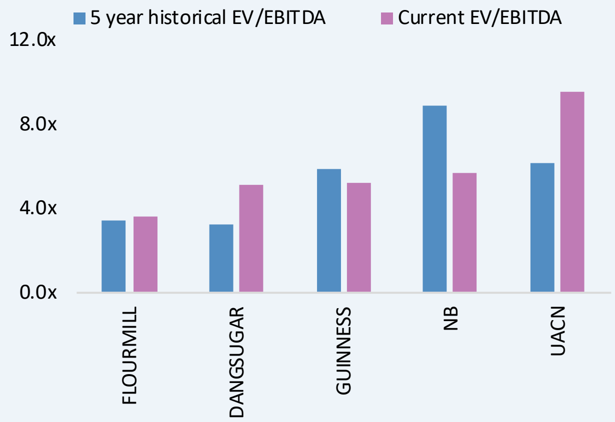
*We adopted the average rating of companies under Dangote Industries for DANGSUGAR

Valuation and Financial Metrics

Cherry-picking for long-term returns

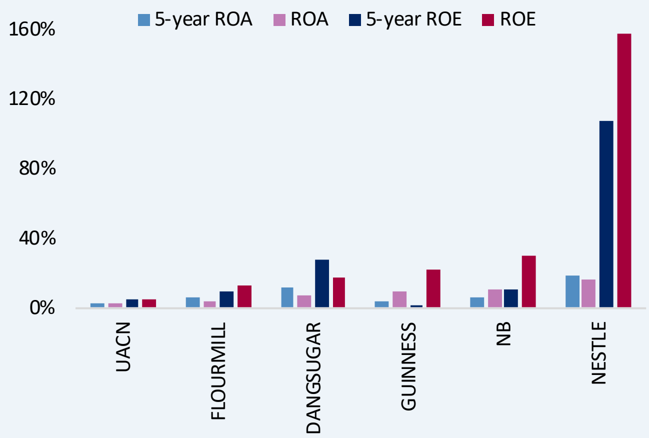
In addition to their favourable ESG ratings, NESTLE and NB are trading at material discounts relative to their historical five-year EV/EBITDA even though their respective returns on equities are significantly higher. Elsewhere, GUINNESS has an EV/EBITDA 10.4% lower than its historical five-year mean level. The company's ESG ratings (as per CSR Hub and Risk Insights) are also a few layers below those of Nestle and NB. Overall, we see considerable cherry-picking opportunities for ESG-sensitive investors within the Consumer Goods space.

Figure 4: Five year mean and current EV/EBITDAs of FMCG companies



Source: Capital IQ; CardinalStone Research

Figure 5: Five-year mean and current ROAs and ROEs of FMCG companies



Source: Capital IQ; CardinalStone Research

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