

WEDNESDAY, 15 JANUARY 2014

Sector Review

Consumer Sector Outlook: Continued outperformance not expected

The consumer sector was the best performing sector in 2013, with the consumer stocks in our coverage list rising by a weighted average of 34.8% vs. the PSEi's increase of only 1.3%. Share price performance was supported by rapid earnings growth as consumer companies benefited from strong domestic consumption which received an extra boost from election spending and falling commodity prices which led to higher margins.

In 2014, the consumer sector is still expected to post robust growth compared to the different sectors that we cover. However, growth is expected to decelerate relative to 2013. Revenue growth could slow down coming from an election year in 2013. Higher inflation could also act as a headwind. Moreover, unlike 2013, consumer companies may not benefit from further improvement in margins as prices of some commodities are rising. The depreciation of the peso would also lead to higher cost of imported raw materials. Finally, valuations of consumer companies are unattractive, with consumer stocks trading at an average of 26.8X 14E P/E, a premium relative to the market average 14E P/E of 16.2X. Most consumer stocks that we cover are also trading close to or at par with our fair value estimates.

Revenue growth to normalize, coming from a high base in 2013. After growing by an estimated average of 17.2% in 2013, we forecast revenue growth of consumer companies in our coverage list to normalize to 11.1% in 2014. Recall that 2013 was an election year during which private consumption got a boost from election spending. Rising inflation also presents an added hurdle as rising prices will lead to lower purchasing power of consumers. Inflation jumped to a two-year high of 4.1% in December following the impact of typhoon Yolanda. According to the BSP, inflation is forecast to reach 4.5% in 2014 from 3.0% in 2013 with risk skewed on the upside given the potential increase in food prices and utility rates.

Exhibit 1: Consumer sector revenue forecast

in PhpMil	2012	2013E	% growth	2014E	% growth
JFC	71,059	79,447	11.8	87,257	9.8
PGOLD	57,467	76,350	32.9	85,182	11.6
PIP	19,494	22,130	13.5	24,517	10.8
RFM	10,998	10,160	(7.6)	11,106	9.3
URC*	71,202	81,712	14.8	91,748	12.3
Average			17.2		11.1

Source: COL estimates, company data, Bloomberg

*Figures shown are for 3QFY13 and 9MFY13

Expecting limited improvement in margins. After expanding by an estimated average of 180 basis points in 2013, we expect further margin improvement in 2014 to be minimal. Margin expansion during 2013 was largely due to declining commodity prices with the price of the agricultural basket ETF falling by 15.6% during the year. For 2014, we forecast gross margins to expand by only 40 basis points.

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While prices of most global commodities should remain subdued in 2014 amid improving supply conditions, the prices of some select commodities are expected to increase. For example, demand continues to outpace supply of cocoa, one of URC's top raw materials. The price of beef, accounting for roughly 10% of JFC's raw materials is also expected to increase as supplies decline. Additionally, the depreciation of the peso will result to an increase in the cost of imported raw materials. The peso is currently trading at Php44.6/US\$, 5.39% weaker compared to its 2013 average of 42.3.

On the local front, prices of basic consumer goods jumped following typhoon Yolanda. The NSO reported that inflation in food products accelerated from 3.2% in October to 3.9% in November and 4.8% in December. As URC's top raw material, sugar, and JFC's top raw material, chicken, are both sourced locally, the rising cost of the said raw materials could negatively impact the margins of these companies moving forward.

Valuations unattractive. Although earnings growth is expected to remain robust in the sector, valuations are not compelling with consumer stocks trading at an average 14E P/E of 26.8X, a premium to the PSEi's average 14E P/E of 16.2X. After adjusting our risk free rate assumption, we downgraded our ratings on PGOLD and URC to HOLD and reduced our FV estimates to Php41/sh and Php117/sh, respectively. At current prices, most stocks are also trading at close to, above or at par with their fair value estimates.

Exhibit 2: Consumer sector valuation

	Current Price	2014E P/E	FV estimate
JFC	167.5	32.5	126.0
PGOLD	39	22.8	41.0
URC	119.5	24.6	117.0
Average		26.8	

*consensus estimates

Although we continue to like the long term fundamentals of consumer companies, we would only be buyers at more attractive valuations. We would be buyers of JFC at Php109.60/sh, PGOLD at Php35.70/sh and URC at Php101.70/sh.

Investment Rating Definitions

BUY	HOLD	SELL
<p>Stocks that have a BUY rating have attractive fundamentals and valuations, based on our analysis. We expect the share price to outperform the market in the next six to twelve months.</p>	<p>Stocks that have a HOLD rating have either 1.) attractive fundamentals but expensive valuations; 2.) attractive valuations but near term earnings outlook might be poor or vulnerable to numerous risks. Given the said factors, the share price of the stock may perform merely inline or underperform the market in the next six to twelve months.</p>	<p>We dislike both the valuations and fundamentals of stocks with a SELL rating. We expect the share price to underperform in the next six to twelve months.</p>

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