

# Nigeria's Chemical & Paints Industry

## (An Analytical View)

Prepared by



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## The Nigerian Economy

Over the last few years, the Nigerian economy has experienced a series of reforms and restructuring of its key sectors. Such reforms include the financial, petroleum, power sector, among others. The financial sector reform has been the most noticeable as the banks and insurance companies have been mandated to recapitalise in line with government regulatory requirements. The telecommunications industry also experienced a major transformation when the general system for mobile telecommunications (GSM) was introduced in 2001. The deregulation of the downstream petroleum sector and privatization of many previously government-owned parastatals also represent some of the many structural changes that have been made in recent years.

The size of the Nigerian economy as measured by the country's GDP has increased by a compound annual growth rate (CAGR) of 20.68% (in nominal terms) between 2001 and 2006. A noticeable trend in the economy's growth pattern is the increasing contribution of the non-oil sector, particularly the agricultural and manufacturing sectors to the nation's GDP. It is expected that in the years ahead, other key sectors such as construction, consumer goods and tourism may begin to play more important roles in overall economic growth and development. As the on-going economic reforms continue to trickle down into other segments, and barring any unforeseen circumstances, we expect a much more balanced and self-sustaining economy in years to come.

Furthermore, consumer prices (year on year) declined sharply in 2005 due to the application of strict monetary and fiscal policy measures. With single digit inflation already being experienced, the economy is gradually moving towards a more stable and investor friendly position. This decline in inflation figures is further aided by the boost in agricultural production which has led to the general rise in the food supply resulting in reduced price level. Government's favorable monetary and fiscal policies have also contributed to the favourable consumer price index position.

The capital market has experienced a phenomenal growth over the past couple of years. The deluge of public offerings and rights issues have increased the overall level of activity in the market with volumes and values attaining unprecedented levels. The CBN enforced recapitalization drive (for banks) in 2005 is largely responsible for the bullish trend that has been experienced in recent times. With the Pension reforms having had its desired effect through the injection of fresh capital into the market by the PFAs and increase in private equity investments, the level of capital market activities have increase tremendously.

The country has experienced 8 years democratic rule for the first time in its recent history and for the first time in the post-independence period, political power has been successfully transferred from one civilian government to another. Furthermore, the country has retained its BB- credit rating by S&P and Fitch and has continued to receive rave reviews both as a result of its ongoing reforms and agendas. Sustainability of these initiatives will however remain a major challenge for the new administration in the years to come.

## Industry Overview

The chemical and paints industry has been in existence for a number of years. The industry has gone through various levels of development from the manual based processes to more technologically advanced production methods. However, the level of development of the sector in Nigeria is still low when compared to other countries with more advanced technical know-how. Countries like the US, Mexico and the United Kingdom have more developed paint making processes and as such derive more revenue from paint making.

The Nigerian paint sector is a highly competitive one. There is free entry and exit due to the rather 'friendly capital required' to set up a business. Also, operating costs are relatively low, thereby increasing the number and longevity of players that exist. With over 1,000 operators, the industry can be considered to be saturated. Many new entrants get attracted to paint making business due primarily to inefficient regulatory practices as well as the attractive capital requirement. This has inevitably led to the lowering of standards as most of the fringe players produce sub-standard paints, albeit at relatively cheaper cost which enables them to sell at a lower price.

Another major characteristic of the industry is the existence of various tiers which are determined by criteria such as market share, product quality, average turnover and reputation. Industry players can be placed into three broad categories: the first, second and third tiers. The first tier category consists of major players which control a large share of the market

and have been in existence for many years. Some of the companies within this category include:

- DN Meyer Plc
- Premier Paints Plc
- IPWA Plc
- Nigerian German Chemicals
- African Paints
- Berger Paints
- CAP Plc

There's a second category which consists largely of medium sized players with less control of market share. These companies are characterised by private ownerships with majority of the of the equity control in the hands of a few individuals. The third tier category comprises of companies with relatively larger customer patronage than their mid tier peers (due to lower price advantage) but are restricted based on quality. Unlike the more successful companies often regarded as 'premium paint makers', they concentrate more on emulsion (decoratives). The Standards Organisation of Nigeria (SON) is the major regulatory body for the chemical and paints industry. They have been at the forefront of maintaining standards within the sector but are challenged by the sheer number of operators.

Generally, based on recent government pronouncements as well as budgetary allocations to manufacturing, power and infrastructure, the hitherto neglected sector seems set for a gradual turnaround. Recent performances and the level of activity by quoted chemical and paint companies suggest an emerging interest in the industry. Baring any unexpected circumstance, we expect an aggressive and sustained growth in the years ahead.

## Critical Success Factors

### Quality Control

One major critical success factor for chemical and paints operators in Nigeria is quality control. Manufacturers in Nigeria are classified into tiers on the basis of the quality of their final products. The Standards Organisation of Nigeria (SON) has made stringent efforts to maintain minimum standards for paint manufacturing. Such standardization has improved the overall quality level of paints made in recent times. It therefore bestows on the lower tier companies to improve their quality levels in order to compete effectively with their more established counterparts.

### Capital Adequacy

Capital adequacy is one of the determinants of success in the chemical and paint industry in Nigeria and among manufacturers generally. The bigger and more successful firms are the ones with more ready access to financial capital either through internally generated sources or via facilities from financial institutions and/or the capital market. Capital, if not readily available could lead to inability of producers to expand operating and distributive capacities as well as meet up to the ever growing demand of the buying public.

### Distributive Capacity

An effective and efficient distribution network is a key requirement for the success of paint manufacturers in Nigeria. Since paints are in high demand in virtually all areas of the country, it is pertinent that the end product gets to the final consumer as at when needed. Distribution therefore remains a key success factor.

## Challenges & Risk Factors

### Access to Facilities

Unlike in other industries, many chemical and paint manufacturers do not have established relationships with financial institutions. This limits their ability for organic growth with many of the firms limiting their financing sources to internally generated funds. Also, many of the companies in the sector are not publicly quoted and as such cannot easily generate funds from the Nigerian capital market when needed. This is one of the reasons for the high inequality among paint manufacturers in Nigeria.

### Concentration Risk

Many producers run the risk of concentrating on a rather limited income stream with products such as paints, adhesives, wood finishes and other allied products making up a large portion of their product portfolios. The companies are therefore not well diversified and therefore cannot take advantage of risk spreading. Many of the smaller companies that concentrate solely on paint making have either been forced out of business or face difficult financial circumstances during out-of-season periods.

### Neglect of the Sector

Over the years, the Nigerian manufacturing industry has experienced large scale neglect. The real sector contribution to overall GDP has been declining at faster rates each year as the Federal Government has been more active in the monetary sector. Recent developments however suggest that a turnaround might be in the offing with government's increased fiscal spending on the manufacturing sector.

## Key Players

The paint industry currently comprises of over 1000 operators with many of them struggling to make a name for themselves. These numerous operators can be classified on the basis of their financial capabilities and quality level. The lower tier companies have a sizeable market share but are undone by the low standards of their products and their quest for success without financial sacrifice. Intense competition therefore exists mainly within the various tiers.

The first tier category is majorly made up of quoted companies due to their ready access to capital market funds and other factors. Such benefits include increased patronage due to public awareness of the existence and operations of such companies. Due to sufficient capital adequacy, the quality level of their products surpasses minimum standards set by the regulatory bodies. The SON ISO 9001 certification which is the most revered has been received by just a few companies, most of who belong to this category of producers.

The second category consists of mid-sized companies with a much less market share. Their products meet up with certain minimum requirements, but do not have the capacities to attain higher levels attained by their counterparts. Despite their experience in the market, lack of adequate distributive capacities makes it difficult for them to transform into premium manufacturers. The lowest grade of manufacturers comprise companies when combined, have a significant market share but cannot compete with any of their more established peers due to several inherent restrictions.

Chemical and Allied Products Plc (CAP Plc) is one of the largest paints manufacturers<sup>1</sup> in Nigeria. The company which has British roots has been in existence for over 50 years and continued to dominate its sector since then. CAP Plc is a fully owned Nigerian paints operator after its 37.5% sale of the equity holdings of Imperial Chemical Industries<sup>2</sup> (UK).

DN Meyer which has been in existence since 1960 is one of the largest companies in its sector by installed capacity. The company which produces an average of 15 million liters annually has built a reputation as a formidable brand with several brand loyal customers. The company's products which include paints, wood finishes and adhesive products are highly regarded as some of the best in terms of quality.

Berger Paints, a company formerly known as British Paints (W.A.) Limited is the first paint manufacturing company to be quoted on the floor of the Nigerian Stock Exchange (1973) and the first to commission its factory in Nigeria (1962). By virtue of its many 'firsts', Berger paints is therefore one of the dominant and leading paints companies in Nigeria.

IPWA, incorporated in 1961 and listed on the NSE in 1978 is also one of the largest companies in the paints sector. Although the company sustained losses in its most recent financial year ended December 2006, they can leverage on their vast experience as well as budding customer base to remain one of the top rated manufacturers of paints and allied products in the country.

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<sup>1</sup> By Market Capitalisation

<sup>2</sup> CAP Plc's former parent company

## CAP Plc

Current Price (N) <sup>3</sup>	66.25
Shares Outstanding (million)	210
Market Capitalisation (N'bn)	13.91
Trailing PAT (N million)	312
Trailing EPS (N)	1.69
Trailing P/E ratio (x)	39.14
Expected PAT (N million)	298
Forecast P/E ratio (x)	46.65
Forecast Earnings Yield (%)	1.8
Forecast Dividend Yield (%)	0.9
6 Month Target Price (N)	90
12 Month Target Price (N)	95

### Recommendation

Short Term	<b>BUY</b>
Long Term	<b>HOLD</b>

### Analyst

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## Company Profile

Chemical and Allied Products Plc a subsidiary of United African Company Plc (UACN) commenced Nigerian operations in 1957. The company has its roots in the British multinational Imperial Commercial Industries (ICI) – highly regarded as one of the largest paint manufacturing concerns in the world. In 1997, ICI divested 60% of its equity ownership to the Nigerian public and subsequently changed its name to CAP Limited. In 1992, ICI sold its remaining 40% equity to UAC plc and the Nigerian public. The company successfully converted from private to public, hence its current name – CAP Plc.

CAP Plc engages primarily in the manufacture and sale of paint and allied products. Its product portfolio includes Dulux and Caplux paints, Industrial and protective coatings and Caprinol wood care range of products. An ISO 9001 certified company, CAP Plc has built a strong reputation as one of the major players in Nigeria's paint market. Today, CAP plc is a Nigerian company operating primarily in the coatings business.

## Investment Strategy

CAP Plc posted N223.6 million as its Q3 PAT for 2007. Its expected full year 2007 PAT when extrapolated, stands at N298.21 million, translating to a 2007 YE P/E ratio of 46.65x and EPS of N1.42. Its Net Assets per Share is N4.08. All these indices compare favourably with peer averages of 65.12x, N0.67 and N2.83. Besides, the company is currently priced at a 29% discount off its 52 week high of N93.00. Based on the above analysis, we place a **BUY/HOLD** recommendation on the shares of CAP Plc for investors with short and long term horizons respectively.

<sup>3</sup> Prices are as at 8<sup>th</sup> April 2008

## DN Meyer Plc

Current Price (N)	19.00
Shares Outstanding (million)	291
Market Capitalisation (N'bn)	5.54
Trailing PAT (N million)	57
Trailing EPS (N)	0.20
Trailing P/E ratio (x)	96.76
Expected PAT (N million)	57
Forecast P/E ratio (x)	95.77
Forecast Earnings Yield (%)	0.5
Forecast Dividend Yield (%)	1.0
6 Month Target Price	12
12 Month Target Price (N)	16

### Recommendation

Short Term	<b>SELL</b>
Long Term	<b>HOLD</b>

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## Company Profile

DN Meyer ("the company"), an offshoot of Hagemeyer Nigeria Limited is into the manufacturing and marketing of various brands of paints, flooring products, wood finishes, autopaints and adhesives. The company was incorporated as Hagemeyer in 1960 but subsequently acquired by Dunlop Nigeria Plc in 1994. In 2003, Dunlop divested its controlling interest in DN Meyer thereby making it independent and wholly owned by the Nigerian public.

With an installed capacity of about 15 million tonnes p.a., DN Meyer is one of the largest paint manufacturers in Nigeria. The company therefore has the capacity to turn out large volume in decorative, automotive woodcare products as well as industrial and marine paints. DN Meyer is the recipient of several awards including 'ISO 9002 certification' (1999), 'NSE president's award' (2002), 'SON Gold Medal award' (2002) and the 'best environmental friendly award' by LASEPA (2001).

## Investment Strategy

Despite its reputable standing in the industry, the company's performances have been rather unimpressive. Its YE expected PE valuation leaves it trading at multiples of 95.77 times its projected earnings. This is by far above its sector average of 65.12x. Using earnings valuation model, we derived a fair price for the company at N12.77, depicting an overvalued stock to the tune of 54.62%. With a dividend yield of 0.5% (peer average – 0.81%), the company is currently trading at an 8.03% deviance from its 52 week high. We therefore recommend a **SELL/HOLD** for the shares of the company.



## Berger Paints Nigeria Plc

Current Price (N)	19.90
Shares Outstanding (million)	217
Market Capitalisation (N'bn)	4.33
Trailing PAT (N million)	81
Trailing EPS (N)	0.37
Trailing P/E ratio (x)	53.14
Expected PAT (N million)	82
Forecast P/E ratio (x)	52.24
Forecast Earnings Yield (%)	1.9
Forecast Dividend Yield (%)	1.0
6 Month Target Price (N)	17
12 Month Target Price (N)	24

### Recommendation

Short Term	<b>SELL</b>
Long Term	<b>HOLD</b>

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## Company Profile

Berger Paints Nigeria Plc was incorporated on the 9<sup>th</sup> of January 1959 and commenced commercial operations in 1961. The company operated under the name 'Berger Paints (West Africa)', - a fully owned subsidiary of British Paints. Berger Paints imported its paints from its parent company's head-office in Newcastle (United Kingdom).

The company is currently structured around four major subsidiaries which include:

- Robbialac Paints Ltd
- Berger Construction Ltd
- Berger Registrars Ltd
- Berger Cargo Ltd

DN Meyer has 20 Depots located in various parts of the country and has a product portfolio which cuts across Decoratives, Industrial Paints, Marine Paints and Wood Finishes. In 1999 and 2000, the company received the SON ISO 9001:2000 certification.

## Investment Strategy

Year to date, Berger Paints has gained by 81% in capital appreciation from N11 to its current price of N19.90. Year 2007 to date, the company has appreciated by 370% making it one of the fastest moving stocks in its industry. Berger Paints is currently trading at a FYF PE valuation of 52x and Price to Book valuation of 16.2x – both below peer averages. Its forecast dividend yield of 1% is the highest amongst its peers. Considering its closeness to its year high price of N23.35, we place a **SELL/HOLD** recommendation on the shares of Berger paints.



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