

Jamaica, West Indies

Jermaine Burrell – Senior Economist & Sovereign Research Manager

Desnoes & Geddes Ltd

The Global Recession, Increased SCT & Devaluation Affect Company Performance

Profit & Loss Summary

	6-Months ended Dec-31			3-Months ended Dec-31		
	2009	2008	% Change	2009	2008	% Change
	J\$M	J\$M		J\$M	J\$M	
Turnover	6939	6882	1%	3625	3707	-2%
Net Sales Value	5698	5946	-4%	2944	3192	-8%
Trading Profit	750	1336	-44%	419	631	-34%
Profit Before Tax	815	1424	-43%	434	678	-36%
Profit After Tax	551	980	-44%	301	551	-45%
EPS (Cents)	19.6	34.88	-44%	10.72	19.62	-45%

Source: Jamstockex.com, Company Financials

Latest Performance

The challenging economic environment, characterized by the global recession, has led to a below par performance by D&G for both the 6 and 3 month period ended Dec-31-2009. The pass through effect of the global crisis to the Jamaican economy has led to a contraction of disposable income and consequently spending across all consumer goods, including alcoholic beverages. Tax revenue growth for fiscal year 2009/10 was 8%, compared to projections for growth of approximately 18% at the beginning of the fiscal year. Further challenges include the increase in the Special Consumption Tax (SCT) rate on beer in 2009 which has negatively affected domestic volume going forward.

For the 3-month period ended Dec-31-09, compared to the similar period in 2008, net sales declined by 8%. The decline was attributed to the increase in the price of beer due to the increase in SCT and the above average devaluation of the currency (against the US\$) during the year which affected imported raw material prices. Trading profit for the period declined by 34%, reflecting the higher cost of sales and increased outlay for marketing—a reflection of the increased effort to drive sales. The decline in the above mentioned areas led to a 36% reduction in profits before tax and a 45% reduction in net profit.

The company's performance for the 6-month period was in line with the 3-month performance. However, cost of sales for the six month period increased by 5% (to J\$3.62 billion) due to a number of marketing initiatives. Additional investment in the leasing of new trucks (increasing route-to-market access) and a 6.5% increase in marketing cost due to the launch of "Red Stripe Bold" and the "Million Dollar Mawwin" promotion led to increased cost. Both initiatives represent the company's strategy of maintaining investment behind their brands despite the economic climate.

Key Ratios

Quarterly Data	FQ2-2010	FQ1-10	FQ3-09	FQ2-09	FQ1-09
EPS (aft XO items-cents)	10.72	8.88	5.99	19.62	15.26
Sales Growth (%)	-7.77	-0.001	7.73	10.80	4.04
Price/Book Value Per share	2.31	1.57	1.52	1.61	2.17
EBITDA	473.74	448.992	355.24	657.98	743.16

Source: JMMBIR estimates, company financial statements, Bloomberg.

Jamaica Money Market Brokers Limited.

All information contained herein is obtained by JMMB® Investment Research from sources believed by it to be accurate and reliable. All opinions and estimates constitute the Analyst's judgment as of the date of the report. However, neither its accuracy and completeness NOR THE OPINIONS BASED THEREON ARE GUARANTEED. As such NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS OR COMPLETENESS OF THIS REPORT IS GIVEN OR MADE BY JMMB® IN ANY FORM WHATSOEVER.



Your Best Interest At Heart. Full Stop.

RECOMMENDATION

HOLD

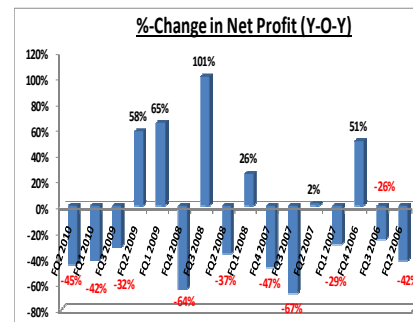
Price at May 13 2010 (J\$)	5.08
Price target (J\$)/Intrin. Value	5.20
52-week range (J\$)	3.31 – 5.25

Company Profile

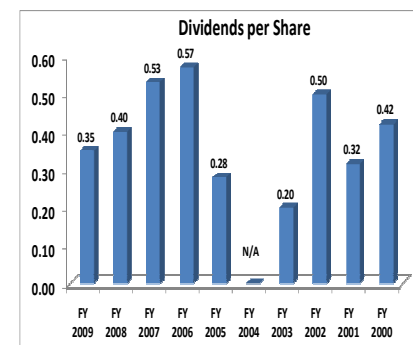
Red Stripe is the trading name & flagship brand of D&G. Red Stripe manufactures and markets a range of premium alcoholic beverages, including beers & stouts. Red Stripe was first brewed in Jamaica in 1928 & is now available in 20 markets worldwide. Red Stripe is brewed almost exclusively in Jamaica (except UK & Antigua).

Diageo holds the majority shares in D&G & is listed on the London & New York Stock Exchanges.

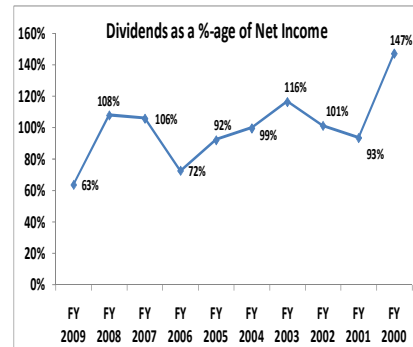
Profitability



Dividends Per Share



Dividends as %-age of Net Income



What Do We Like About The Stock?

D&G is an **aggressive dividend payment company** as evidenced by its dividend per share averaging 43 cents over the last five years and a dividend yield of 7.41% and 4.92% for 2008 and 2009 (the highest in the local manufacturing category). Dividends as a percentage of net income is also relatively high, averaging 88% over the last five years. Consequently the stream of cash flow for investors is a major positive.

D&G manufactures and markets a range of premium alcoholic beverages, including Guinness, Red Stripe, Red Stripe Light, Malta, Heineken, Baileys, Smirnoff Ice and Johnnie Walker. The company exports to the USA, Great Britain, Canada, Sweden and Continental Europe (Belgium France, Italy, Switzerland, Norway & Spain). Consequently both **product and market diversification** is a key positive for the company.

The company has set as one of its major targets, **the doubling of the size of the business** despite the global challenges. To drive this growth, Diageo has appointed a set of new managers including GM Alan Barnes who replaces Mark McKenzie. This strategic move shows a clear proactive approach to management which may bear fruit for the company.

Challenges

Strategic moves and aggressive dividend payments aside, we are in a global recession. While earlier projections (**Figure 1**) suggested a rebound in global growth, the recent Greek crisis, its spill off effects on the Eurozone and its impact on global growth—suggests that forecasts may be revised downwards. In fact the current weakness of the Euro against the US-dollar is a clear indication that markets are not convinced that there will be a quick solution to the current Euro crisis despite the IMF and Eurozone announcing a €720 billion bailout package. This will undoubtedly have negative implications for disposable income and spending across consumer goods.

Global Economic Growth Projections (Y-O-Y) %-age change

Figure 1	Projections		
	2009	2010	2011
Global Output	-0.8	3.9	4.3
United States	-2.5	2.7	2.4
Euro Area	-3.9	1	1.6
Canada	-2.6	3.1	3.2
Jamaica	-3	0.5	1

Source: IMF World Economic Outlook, JMMBIR

Is The Stock Properly Priced?

The poor performance by D&G accompanied by the domestic and global challenges makes the recent price increase somewhat surprising; year to date the stock has gained 52%. A look at key ratios from the sector (**Figure 2**) indicates that D&G's EPS is below the industry average of 1.9 and ranks 5th among the 8 companies. The recent price increase has also pushed the P/E ratio above the industry average, forcing us to ask why we should pay a premium for D&G. The only factor that could justify this move is the company's aggressive dividend policy. The company's dividend yield on average over the last two years is the highest in the industry. Consequently shareholders seem to have placed a high premium on cash flow given the current recession.

Intrinsic Value

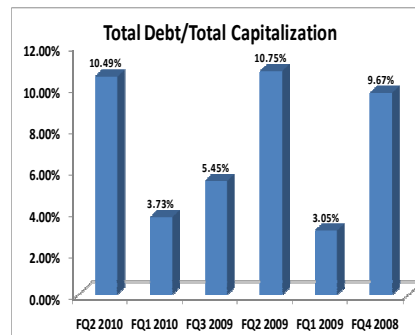
The intrinsic value of the company was difficult to calculate and justify theoretically using the two stage DDM because while dividends were consistently high, the dividend growth rate (a key input to the model) was inconsistent (sometimes erratic). The free cash flow of the firm/to equity may have been the more appropriate model, however given its complexities it may have led us to erroneous conclusions. Consequently we employed a smoothing/long run average technique to complement the single stage DDM and along with our assumptions for economic growth, EPS, dividends per share and the aggressive dividend payout ratio, concluded that the long run intrinsic value of the company was J\$4.22. Using the EPS & P/E ratio for the last four quarters the price came in at J\$5.20; consequently this represents our price range for the company (J\$4.22 to J\$5.20).

Jamaica Money Market Brokers Limited.

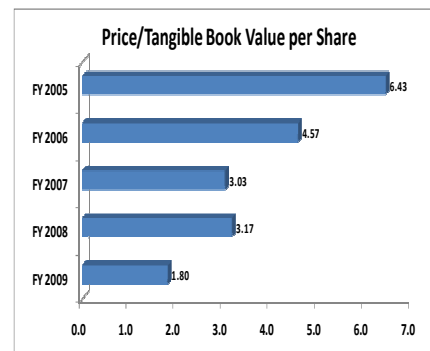
All information contained herein is obtained by JMMB® Investment Research from sources believed by it to be accurate and reliable. All opinions and estimates constitute the Analyst's judgment as of the date of the report. However, neither its accuracy and completeness NOR THE OPINIONS BASED THEREON ARE GUARANTEED. As such NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS OR COMPLETENESS OF THIS REPORT IS GIVEN OR MADE BY JMMB® IN ANY FORM WHATSOEVER.



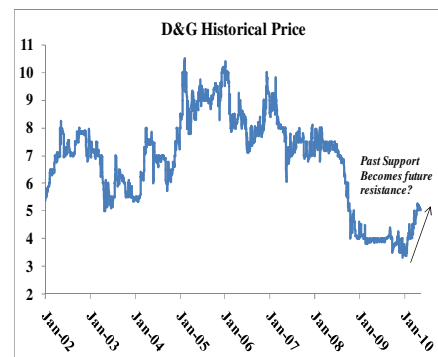
Debt Ratios



Price to Book Value Per Share



Price Movements



Key Ratios Manufac. Sector

<i>Figure 2</i>	YTD % change	His. EPS Last 4 Qtrs	His. P/E Last 4 Qtrs	Book Value	Price to Book	Dividend Yield 2009	Dividend Yield 2008
Berger	166.67%	0.13	24.62	1.91	1.67	0.00%	10.50%
Carib Cement	17.50%	-0.31	-15.16	4.13	1.14		0.00%
D&G	51.64%	0.49	10.40	2.30	2.21	4.92%	7.41%
Jam. Broilers	40.28%	1.26	5.56	4.60	1.52	1.57%	4.06%
Mobay Ice	0.00%	-1.09	-14.68	20.67	0.77		0.00%
Salada Foods	-29.03%	1.04	10.58	4.40	2.50		
Seprod	36.11%	2.53	9.68	13.51	1.81	1.84%	2.53%
TCL	-26.39%	8.15	6.50	79.93	0.66	0.00%	7.18%
Average	32.10%	1.90	7.45	16.43	1.54		

Source: Jamstockex.com, company financials, JMMBIR

Conclusion

Investors seem to have placed a high premium on cash flow given the global recession. This may be justified but the important question is whether the company will be able to continue its aggressive dividend payment policy given the environment. In our opinion the answer is clearly no; this is evident from the last set of end of year financials (09) where dividends as a percentage of net profit has declined to 63%, the lowest in 10 years. Essentially aggressive dividend payments cannot continue in an environment of reduced profitability. However given the ownership structure, some dividends should flow to investors. This view is strengthened by the fact that in 2009, D&G had the highest dividend yield in the sector and was one of only 3 companies that actually paid dividends from a total of 8 companies.

The recession, while daunting will not last forever. Going forward, once the economic climate improves and consumer purchasing power returns investors in D&G should reap the benefits (dividends). Our conclusion is that the stock at the current price of J\$5.02 is a hold. Our maximum price based on our current view is J\$5.20.

Jamaica Money Market Brokers Limited.

All information contained herein is obtained by JMMB® Investment Research from sources believed by it to be accurate and reliable. All opinions and estimates constitute the Analyst's judgment as of the date of the report. However, neither its accuracy and completeness NOR THE OPINIONS BASED THEREON ARE GUARANTEED. As such NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS OR COMPLETENESS OF THIS REPORT IS GIVEN OR MADE BY JMMB® IN ANY FORM WHATSOEVER.

