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Don't put your chocolate firm eggs in one basket

Dipping into the profits made by the leading confectioners is a little more complicated than buying shares, writes Joe Brennan.

CONFECTIONERS have been licking their lips at the thought of making a killing as customers munch through a stack of Easter eggs today. So is it worth buying shares in a chocolate maker such as Cadbury Schweppes, Nestlé and Hershey's? "Easter and Christmas are important sales periods for confectionery makers and Easter eggs are high-margin products compared with basic chocolate bars," said Julian Hardwick, a London-based analyst with the Dutch bank ABN Amro.

"But you're not going to buy a stock in one of these firms based on their performance during two parts of the year and, besides, most of the big players aren't pure confectioners."

Sweets and chocolate make up just half of Cadbury Schweppes' business and a little more than 10% of that of Nestlé — which has KitKat and Smarties in its stable of brands — but they are areas that are doing well, says Hardwick.

"If you look at Cadbury's recent results, you see that the confectionery business is performing pretty strongly," he said.

At Cadbury Schweppes, confectionery sales rose 6% last year underpinning 4% growth in like-for-like group sales as the other main business area, beverages, only managed to scrape out a 2% increase in turnover. The group's share price has jumped 23% over the past 12 months and is hovering at about £5.23 (€7.53).

"One of the main advantages for confectioners is that they are able to push through price increases regularly, which boosts their sales and earnings," said a London-based analyst with a large US brokerage.

"Companies that do well are those that come through with innovative products. Cadbury's, for example, launched its very exciting Cadbury's Snaps last year, where the consumer ends up paying much more for a gram of chocolate than if they bought a plain bar."

The analyst believes the Cadbury Schweppes stock looks attractively valued. "It is trading at 13 times prospective earnings, while US peers such as Hershey's and Wrigley are trading at about 27 times," he said.

James Amoroso, an analyst at Helvea, a Swiss broker, is not a fan of the company. "Cadbury Schweppes is basically stuck in fully developed confectionery markets and has to pump money into innovation to bring about growth," he said. "The main way it can increase its earnings is through cost-cutting and increasing efficiency."

Kraft, the company behind Toblerone, Daim and Terry's Chocolate Orange, is not on **Amoroso's** list of favourites either, as it is made up of too many brands in fragmented areas. "Kraft's biggest problem is its rising exposure to the North American market," he said. "It also has a huge chunk of the stagnant German market with its Milka brand."

Amoroso is keen on Hershey's, the US confectionery king, for its ability to continue to grow despite obesity worries gnawing away at its home market. Sales at the group have risen by an average of 4.3% annually over the past six years. The stock is trading at about \$61 (€47), having risen by almost 50% since this time last year.

Amoroso likes Nestlé too, as it has much greater exposure to the fast-growing markets of Asia, Latin America, the Middle East and eastern Europe. "Concerns about obesity, which is increasingly affecting demand in western markets, are not an issue in developing markets," he said.

Eugene Kiernan, the head of asset allocation at Irish Life Investment Managers, agrees that companies that focus on newer markets will reap the rewards. "Growth in the sector is flat in Europe, but the emerging markets are expanding by about 7% annually," he said.

Bucking that trend on the continent is Lindt, the Swiss giant.

"Lindt's operating profits rose 12.6% last year," said **Amoroso**. "Most food companies can only dream of such growth, which is due to its position at the premium end of the market. Ironically, it is concern about obesity that is helping the company. People may be cutting back on quantity, but when they indulge, they want to indulge in quality."

A decision to buy stocks is taken primarily on the basis of valuation and, although Lindt is trading at 22 times prospective earnings, having soared 40% over the past 12 months to SFr18,150 (€11,700), **Amoroso** is still keen. "I still rate it as a stock you can buy, as the downside risk is fairly low and the company seems to be almost immune to economic weakness and a hostile trading environment," he said.

Although companies in the sector generate a lot of cash, Hardwick notes their dividend yields are not too enticing for investors. Nestlé's stock has a dividend yield of 2.5%, while Hershey's is yielding 1.4%, Kraft 2.5%, Cadbury Schweppes 2.4% and Lindt 1%.

Kiernan says his company is a holder of Cadbury Schweppes, Unilever and Nestlé within the broader sector. "That is because of valuation grounds rather than any fetish we might have about chocolate," he said.