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FCFF vs FCFE Valuation in Indian FMCG Sector : Empirical Evidence from Firms

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Abstract

The paper makes an assessment of the firm and intrinsic valuation of companies in the Indian FMCG sector for the financial years 2019 and 2020 with the use of the discounted cash flow techniques, Free Cash Flow to the Firm (FCFF) and Free Cash Flow from Equity (FCFE) to validate the accuracy of these techniques. The study utilizes a two-phase growth model with an explicit high growth period of ten years followed by a perpetual stage of stable growth with valuation inputs from the company's last ten year financial statements. A random selection of thirty companies from the BSE S&P FMCG index constituents was chosen to represent the sector. The valuation of companies was computed and their intrinsic values were compared with the mean closing market prices of the corresponding month of its year-ending financial statements to determine the prediction errors.

I. Introduction

INDIA IS THE TENTH-LARGEST economy in the world in the face of impediments such as the high levels of economic and political uncertainty, instability of capital markets, restrictions in the flow of capital, and inflation. The FMCG sector is the fourth-largest in the economy which has recorded growth even at times of recession and is regarded as one of the pertinent sectors for investment. The sector is chosen for valuation as it involves mandatory household spending dealing with products involving basic needs and has witnessed an unprecedented rise in rural and online segments. Valuation of companies in this sector involves dealing with many multinational and domestic companies who are seasoned players in the market creating brand loyalty for their products which are mostly perishables. The FMCG sector includes Food and Beverage, Healthcare, and Household and Personal Care which accounts for nearly half of its income.

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