ApexAfrica CAPITAL LTD
Part of AXYS Group

July 2017

EABL FY17 Earnings Update

East African Breweries (EABL) Ltd
FY17 Earnings Update— 'Resilient'

EABL announced a 6.1% y/y increase in FY17 net earnings to KES 8.5B, on the back of a 5.0% y/y acceleration in volume. Net revenue grew 2.0% y/y (on a like-for-like basis) to KES 70.2B, driven by higher growth in Kenya and Uganda. EABL declared a final dividend of KES 5.50, leaving total dividend for the year unchanged y/y at KES 7.50.

Top line grows on higher volume: The group's volume accelerated 5.0% y/y driven by robust performance in mainstream spirits and value beer, with both segments positing double digit growth. Growth was dampened by weak sales in the group's bottled beer segment, where negative impacts from higher excise tax are taking effect. Despite the relative demand inelasticity of alcoholic products, the prevailing drought in East African countries directly impacted consumers' disposable income, resulting in a marked decrease in consumption. Growth in net sales was impacted by a negative revenue mix, as excise duty increases continue to drive downtrading across the region.

Regional Update: Sales in Kenya, Uganda soar as Tanzania falters. The group posted a 4.0% y/y growth in net sales in Kenya, while Uganda posted a 7.0% y/y growth net sales in local currency terms and 5.0% y/y growth in Kenyan Shillings. Growth in Uganda was powered by double-digit growth in Tusker Lite and strong performance in the mainstream spirit segment. EABL's Tanzanian unit posted a 12.0% y/y decline in net sales in local currency terms and 13.0% y/y decline in Kenyan Shillings. The group faced challenges in Tanzania, stemming from aggressive price competition in an increasingly saturated market.

On a brighter note, growth in consumption in Tanzania of RTDs is back in the green (+10.0% y/y). Kenya accounted for 75.0% of FY17 net sales, while Uganda and Tanzania accounted for 16.0% and 9.0% respectively.

Product update: Spirits pick up the slack as mainstream beer consumption declines. The group's premium (-7.0% y/y) and mainstream (-7.0% y/y) segments posted a marked decline in growth, however, the value beer segment bucked the trend, posting strong growth of 13% y/y and offsetting the decline in the premium and mainstream segment. As a whole, the group's beer segment posted flat growth for the year.

On the other hand, spirit consumption grew by a total of 13.0% y/y, driven by growth in reserve (+11.0% y/y), premium (+11.0% y/y) and mainstream (+29.0%) segments. Value spirits, posted a marginal 3.0% y/y drop in growth.

Bloomberg Ticker :	**EABL KN**
Reuters Ticker:	**EABL.NR**

Share Statistics	
Current Price (KES)	264.00
Issued Shares (M)	790.8
Market Cap (USD M)	1,672.8
Year End	30 June
Free Float (%)	54.6

Price Trend

Source: Bloomberg, ApexAfrica Research

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Cost of sales acceleration compresses gross margin: Cost of sales grew 7.0% y/y (when compared on a like-for-like basis) to KES 39.1B, as a result of a negative revenue mix. Excise duties climbed 5.0% y/y to KES 53.8B and COGS per unit improved 3.0% y/y despite headwinds in 2H17. The on-going drought in the region has resulted in a significant increase in input costs. Gross margin dipped to 44.3% in FY17 (FY16: 50.1%). The group realized an estimated KES 2.3B in savings from local sourcing, operational efficiencies and new investments.

Cost containment boosts bottom line: Selling and distribution costs declined 11.0% y/y to KES 5.4B, while staff costs tumbled 15.0% y/y to KES 5.2B. Administrative costs were down 9.0% y/y to KES 8.3B. Additionally, the group booked a KES 1.2B foreign exchange gain, up from a KES 400M loss in FY16. Consequently, operating profit was down a marginal 2.0% y/y to KES 16.5B.

Finance costs dip on lower borrowings: Net finance costs dipped 3.0% y/y to KES 3.2B, on the back of a 5.0% y/y decline in net borrowings to KES 24.4B. The group's effective interest rate on outstanding debt rose to 12.9% in FY17, up from 11.6% in FY16. Net debt to EBITDA strengthened to 1.20 in FY17, from 1.26 in the previous year.

While the group's leverage remains well within comfortable levels, we expect an uptick in the amount of debt EABL holds on its balance sheet given the expected commissioning of a KES 15B brewery in Kisumu, which is expected to be financed entirely by commercial debt.

Cash generated from core operations, declined 22.9% y/y to KES 21.5B, while the group's operating cash conversion ratio declined to 110.0% from 144.0% in FY16. It is noteworthy that the cash flow conversion ratio, remains within the group's sustainable long-term target of 104.0%.

The group spent a total of KES 5.7B (+14.0% y/y) on capital expenditure in FY17, to boost capacity and improve efficiency.

Net cash used in investing activities surged to KES 4.7B, up from KES 1.3B in FY16.

Looking ahead: EABL's FY17 performance was largely within expectations, and underscores the resilience of the group's business model in a challenging environment. While growth in the high-margin spirits segment is encouraging, the slower than anticipated recovery from higher excise duty in Kenya will force a revision of growth expectations in the coming financial year.

Additionally, Tanzania remains a challenging market for the group. While 4Q17, showed a marginal improvement in the overall business environment, we nonetheless revise our growth expectations for Tanzania downward.

The announcement of a new brewery in Kisumu marks the opening of a new chapter in the group's history. The new brewery which is expected to be operational in 2 years, and financed entirely out of commercial debt; will significantly increase the brewer's capacity. The group has cited the need to increase investment in capacity growth coupled with higher innovation and marketing to target an increasingly product-savvy customer base. An additional 1M people are expected to reach drinking age every year for the next decade, highlighting the need for heavy expansion to maintain the group's competitive edge in the industry. However, macroeconomic challenges continue to pose a threat to the group's overall strategy. The prevailing drought in the region has put pressure on consumption, while an increasingly difficult excise duty environment continues to compress margins. EABL holds an attractive position in the region and increased investment in tandem with continuous innovation is expected to cement the group's prominent position within the region's alcoholic beverage space. We do not anticipate a significant change in stock price in the wake of FY17 results, given that the numbers were largely within market expectations. EABL's current share price of KES 265.00, sees the group trade at 27.3 times FY17 earnings and 19.4 times FY17 book value.

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Financials

Condensed Income Statement	FY13	FY14	FY15	FY16	FY17
	KES M	KES M	KES M	KES M	KES M
Net revenue	59,062	61,292	64,420	64,322	70,247
Cost of sales	(31,563)	(31,099)	(32,389)	(32,110)	(39,117)
Gross profit	27,499	30,193	32,031	32,212	31,130
Total costs	(16,384)	(19,787)	(17,880)	(18,593)	(17,823)
Profit before tax	11,115	10,406	14,151	13,619	13,307
Income tax expense	(4,593)	3,548	(4,616)	(5,598)	(4,793)
Profit after tax (from continuing operations)	6,522	6,858	9,535	8,021	8,514
Profit from discontinued operations	-	-	40	2,249	-
Profit after tax (for the year)	6,522	6,858	9,575	10,270	8,514
Basic EPS (KES)	8.55	8.22	11.32	12.20	9.71

Condensed Balance Sheet (KES M)	FY13	FY14	FY15	FY16	FY17
Total equity	7,599	9,101	13,353	10,867	11,988
Non-current liabilities	23,515	26,304	27,325	26,847	32,694
	31,114	35,405	40,678	37,714	44,682
Assets					
Non-current assets	39,127	43,059	40,118	44,127	44,532
Working capital					
Current assets	18,594	19,807	25,038	21,556	22,135
Current liabilities	(26,607)	(27,461)	(24,478)	(27,969)	(21,984)

Condensed Cash Flow Stat. (KES M)	FY13	FY14	FY15	FY16	FY17
Cash generated from operations	16,871	15,181	21,197	27,934	21,524
Net interest paid	(4,019)	(4,320)	(4,074)	(3,265)	(3,174)
Tax paid	(4,550)	(4,668)	(3,563)	(6,092)	(4,435)
Net cash from operating activities	**8,302**	**6,193**	**13,560**	**18,577**	**13,915**
Net cash used in investing activities	(6,048)	(6,738)	(4,684)	(1,330)	(4,668)
Net cash generated from/ (used) in financing activities	(6,948)	4,775	(10,784)	(18,225)	(992)
Net decrease in cash & cash equivalents	(4,694)	4,230	(1,908)	(978)	8,255
At start of period	(194)	(4,887)	(657)	(1,392)	(3,954)
Foreign exchange impact of translation	-	-	1,173	(1,584)	(983)
Net decrease in cash and cash equivalents	(4,694)	4,230	(1,908)	(978)	8,255
Cash & cash equivalents at end of the year	(4,888)	(657)	(1,392)	(3,954)	3,318

Source: Company Filings, ApexAfrica Research

Valuation Ratios	FY13	FY14	FY15	FY16	FY17
P/E (x)	34.5	34.1	25.6	23.0	27.2
P/B (x)	29.6	25.7	18.4	21.7	19.3
Dividend yield	1.9%	2.0%	2.6%	2.7%	2.8%
Pay-out ratio	64.3%	66.9%	66.3%	61.5%	77.2%
Gross margin	46.6%	49.3%	49.7%	50.1%	44.3%
Current ratio	0.70	0.72	1.02	0.77	1.01
Return on equity (Adj.)	85.8%	75.4%	71.4%	73.8%	71.0%
Return on assets (ROA)	11.3%	10.9%	14.7%	15.6%	12.8%
Average share price (Adj)	295.00	280.00	290.00	280.00	264.00

Per Share Data	FY13	FY14	FY15	FY16	FY17
EPS (KES)	8.55	8.22	11.32	12.20	9.71
Dividend per Share (DPS)	5.50	5.50	7.50	7.50	7.50
Book value per share (KES)	9.96	10.91	15.79	12.91	13.67
Wtd. Avg. No. of Shares (Est.) (M)	762.81	834.31	845.85	841.80	876.83

Growth Rates (y/y)	FY13	FY14	FY15	FY16	FY17
Sales revenue	6.4%	3.8%	5.1%	-0.2%	9.2%
Cost of sales	10.1%	-1.5%	4.1%	-0.9%	21.8%
Pre-tax earnings	-4.2%	-6.4%	36.0%	-3.8%	-2.3%
PAT (Cont. operations)	-41.7%	5.2%	39.0%	-15.9%	6.1%
EPS (KES)	-2.3%	-3.9%	37.7%	7.8%	-14.2%
Cash generated frm ops.	15.5%	-10.0%	39.6%	31.8%	-22.9%
Shareholder equity	-12.8%	19.8%	46.7%	-18.6%	10.3%

Source: Company Filings, ApexAfrica Research

Appendix

Investment ratings

✦ **Buy:** A total return is anticipated in excess of the market's long-term historic annual rate (approximately 10%). Total return expectations should be higher for stocks that possess greater risk.

✦ **Hold:** Hold the shares with neither a materially positive total return nor a materially negative total return anticipated.

✦ **Sell:** Stock should be sold as materially negative total return is anticipated.

Disclaimer

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