# EABL – 1H2014 Results Note

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Recommendation: **NEUTRAL**

## Investment Summary

We maintain our **NEUTRAL** recommendation on EABL based on its relatively high PE of 27.55x against the sector average of 27.09x.

We believe that the Uganda and Kenya markets will continue with their respective growth momenta given the increased investments in the brand.

Marginal growth is expected in the Tanzania unit during 2H2014 as the company finalizes on the changes in route to consumer. However, profitability from the export market hangs in the balance given that political stability in South Sudan remains highly volatile.

## Key Results Highlights

- **Impact of VAT on Kenya growth:** Implementation of the excise tax on Senator Keg at the beginning of the second quarter led to a significant volume reduction of 85.0%.
- **Uncertainty surrounding future performance of the export market**: Although the export market registered a 6.0% growth, we note that it is shy of the 28.0% growth registered during the 1H2013 period.
- **Lower interest rates tame finance costs growth:** Finance costs remained relatively unchanged to stand at KES 2.0 billion on the back of lower interest rates during 1H2014.

## East African Breweries Ltd. 1H2014 Earnings Update

| Income Statement (KES Million) | 1H2012 | 1H2013 | % Change |
|---|---|---|---|
| Net revenue | 30,633 | 31,858 | 4.0% |
| Cost of sales | (16,234) | (16,127) | -0.7% |
| **Gross Profit** | **14,399** | **15,731** | **9.3%** |
| **Gross Profit Margin** | **47.0%** | **49.4%** | |
| Selling & distribution costs | (2,541) | (3,047) | 19.9% |
| Administrative expenses | (3,564) | (4,507) | 26.5% |
| Other operating income/(expense) | (436) | (50) | -88.5% |
| **Operating profit** | **7,858** | **8,127** | **3.4%** |
| Net finance income/(costs) | (2,061) | (2,043) | -0.9% |
| **Profit before tax** | **5,797** | **6,084** | **5.0%** |
| Income tax expense | (1,815) | (1,923) | 6.0% |
| **Profit after tax** | **3,982** | **4,161** | **4.5%** |

### 1H2014 Results Highlights

**Marginal top-line growth:** EABL's top line profitability indicators depicted marginal growth with net sales edging up 4.0% to KES 31.9 billion in 1H2014.

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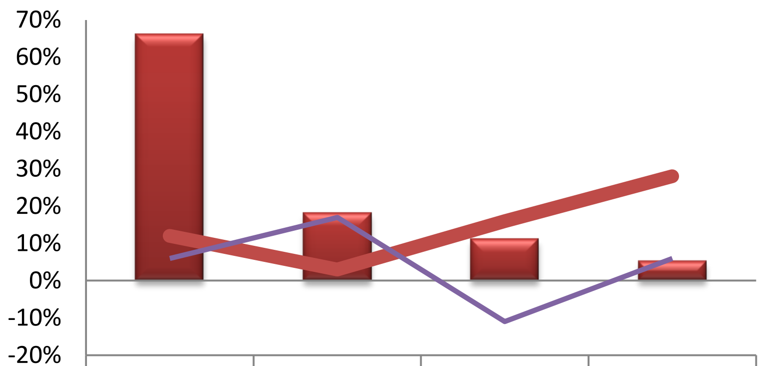
The growth was mainly attributed to a 17.0% growth in the Uganda business unit that represented 18.0% of net sales volume, 6.0% growth shared by both the Kenyan business unit and the export markets which represented 66.0% and 5.0% respectively of the net sales volume. The Tanzanian business unit however recorded negative growth of 11.0% representing 11.0% of net sales volume.




| | Kenya | Uganda | Tanzania | Export Market |
|---|---|---|---|---|
| Sales Volume 1H2014 | 66% | 18% | 11% | 5% |
| % Growth 1H2013 | 12% | 3% | 16% | 28% |
| % Growth 1H2014 | 6% | 17% | -11% | 6% |

Implementation of the excise tax on Senator Keg at the beginning of the second quarter led to a significant volume reduction of 85.0%.

**Impact of VAT on Kenya growth:** Implementation of the excise tax on Senator Keg at the beginning of the second quarter led to a significant volume reduction of 85.0%. This has led to closure of about 25.0% of outlets (3,000 outlets) and has put a further 25.0% at risk of closure.

EABL recently introduced Jebel Gold and Senator Dark Extra in a bid to regain lost market share.

EABL recently introduced Jebel Gold and Senator Dark Extra in a bid to regain lost market share. We view this as a positive reactive move but are yet to see how effective these mitigating strategies are in relation to defending and claiming back lost ground in the lower market segment of the target market.

We expect Jebel Gold to be received well by the market given its affordability but maintain reservations on the introduction of Senator Dark Extra to which management indicated would be slightly costlier than the Senator brand that has been adversely affected by the VAT act.

We are of the view that EABL should play a more active role in regard to the lobbying and formulation of relevant excise tax laws that may negatively impact both revenues of the company and the Government in the form of tax receipts.

Growth in Ugandan market propelled by strong performance on Waragi Gin

**Uganda recorded strong growth:** The 17.0% growth in the Ugandan market was propelled by strong performance on Waragi Gin and better performance on premium beer. We are encouraged by the improved growth (3.0% growth registered in 1H2013) in Uganda and maintain a cautious positive outlook given the succesful launch of the reserve portfolio and the new campaign on Bell premum beer.

**Changes in route to consumer linked to negative growth in Tanzania**: Management attributed the -11.0% growth in Tanzania to changes in route to consumer that led to destocking in the wholesaler channel.

Marginal increase in selling and distribution costs

EABL intends to take a more proactive approach in its distribution channels which we see as a good move in order to make up for lost market share as a result of the changes. However we do expect a marginal increase in selling and distribution costs going forward as the company recruits and trains distributors.

**Uncertainty surrounding future performance of the export market**: Although the export market registered a 6.0% growth, we note that it is shy of the 28.0% growth registered during the 1H2013 period.

Subdued demand from export markets

Management attributed the slowed growth to subdued demand in Rwanda following reduced donor funding and the conflict in South Sudan. Management intimated that South Sudan accounts for a large portion (75.0%) of the export market in terms of volume. Should the current impasse persist in South Sudan, export market performance is highly expected to be compromised and full year growth may deteriorate further.

**Lower interest rates tame finance costs growth:** Finance costs remained relatively unchanged to stand at KES 2.0 billion on the back of lower interest rates during 1H2014.

The company was recently in the market to raise KES 5.4 billion through a commercial paper at the rate of the 182 day t - bill + 100 basis points or the 364 day t - bill + 120 basis points.

Interest coverage ratio at 3.98

We continue to monitor the interest coverage ratio (EBIT/Interest expense) that declined by 58 basis points y-o-y to stand at 3.86 in FY2013. 1H2014 interest coverage currently stands at an improved position of 3.98 as opposed to the 1H2013 position of 3.81.

We expect finance cost growth to be marginal in the mid term should the Eurobond achieve succesful subscription rates.

**Cost of sales dropped marginally as Selling and distribution costs rise:** Cost of sales dropped 0.7% to KES 16.1 billion in 1H2014 due to lower costs of raw materials and increased efficiency.

The 19.9% growth in selling & distribution costs to KES 3.0 billion was primarily due to increased investments in brands, sales force and route to consumer. Adminsitrative expenses rose 26.5% to KES 4.5 billion as a result of a one-off cost in organization restructuring and investments in the Uganda unit back office.

**KES 4.5 billion Capital Expenditure:** In a bid to contain costs, EABL is investing in a warehouse facility that is set to lower distribution and warehosuing expenses and increase efficiency through brewhouse optimization. The warehouse project is close to completion. In addition to this, the company is also investing in a new spirits line and a mash cooker in the Tanzania unit.

## Outlook

We believe that the Uganda and Kenya markets will continue with their respective growth momenta given the increased investments in the brand.

Marginal growth expected in Tanzania

Marginal growth is expected in the Tanzania unit during 2H2014 as the company finalizes on the changes in route to consumer. However, profitability from the export market hangs in the balance given that political stability in South Sudan remains highly volatile.

We still belive that the EABL can optmise its top-line by increasing investments in products that are heavily consumed by the majority and are easy to push in terms of volumes.

We maintain our **NEUTRAL** recommendation on EABL based on its relatively high PE of 27.55x against the sector average of 27.09x.