Uchumi Supermarket

6th February 2013

... And the growth story continues

Analyst:

Samuel Mugacha

E-mail: samuel.mugacha@fib.co.ke

Head Office:

Crawford Business Park, Ground floor

State House Road Tel: 0207606026-37

www.fib.co.ke

P.O Box 45236, 00100
Nairobi.

Bloomberg ticker	UCSP KN
Price per share	19.15
(5/02/2013)	
Target price	23.78
Issued Shares(Mill)	265.4
Market Cap (Kshs) millions	5,082.9
Free float	54.0%

Graph showing share price performance against the NSE 20 share index

Vision 2030 projects to foster economic growth

Uchumi intends to come to the market to raise KES 1.5 billion

Investment Summary

We maintain our **BUY** recommendation for Uchumi Supermarkets (Uchumi) with a target price of **KES 23.78** providing a **24.2%** upside from the current share price of KES 19.15.

Although the previous year's results for the company were below our expectation, we remain optimistic of the retail chain's growth in earnings going forward driven by:

- ✓ **New Branches:** We are likely to see future growth of the Supermarket being driven by the new branches being opened coupled with the optimization of the current branches.
- ✓ **Growing Middle class:** As the middle class segment of the economy continues to grow, so will the demand for high quality goods and services offered largely by retail supermarket chains such as Uchumi.
- ✓ **GDP Per Capita Growth:** Since the year 2008 and 2011 the GDP per capita of Kenya has been constantly expanding growing from KES 36,983 in 2008 to KES 38,970 in 2011. We are likely to see this growth in GDP per capita continue going forward.
- ✓ **Devolution:** With the devolution of the central government to the county level in line with the new constitutional dispensation, retail trade benefits from counties that will be opened up enabling expansion into those areas.
- ✓ **Vision 2030:** The many vision 2030 flagship projects that have been kick-started by the government are set to foster economic growth of the country through the opening up of counties thereby enabling expansion of branches in these areas.

In this report we highlight the poor performance of the subsidiaries which saw the retailer record a 21.7% drop in profit before tax to KES 403.3 million. This was attributed to the slower than expected optimization of new branches coupled with the delayed opening of new branches.

We further note that Uchumi intends to come to the market to raise approximately KES 1.5 billion through a rights issue which we expect to significantly change the capital structure of the company.

Year to 31 Dec	2011A	2012A	2013F	2014F
Gross Margin	17.6%	18.2%	17.5%	17.5%
Net Income Margin	3.6%	2.0%	2.0%	3.2%
Net Income (Kshs Mn)	390.4	274.0	340.3	636.5
EPS (Kshs)	1.47	1.03	1.28	2.40
ROE	17.1%	10.3%	11.5%	16.1%
ROA	9.8%	5.5%	6.5%	9.6%
Cost/Revenue Ratio	16.9%	19.4%	18.7%	17.7%

Source: Uchumi Financial report & Faida Estimate

Uchumi Supermarkets

Uchumi share price has gone past our valuation of KES 15.86

Since our initiation of coverage of Uchumi Supermarkets, Rewriting a growth story, 28th December 2011, we have seen the share price soar in value past our initial valuation of KES 15.86 to its current share price of KES 19.15 (As at 5th February 2013). However, we note that the FY2012 results released were below our expectations, which can be attributed to the poor performance recorded by the subsidiaries which we have analysed in detail in this report.

Our forecast for sales stood at KES 13.1 billion

Our forecast for FY2012 sales stood at KES 13.1 billion against recorded sales of KES13.8 billion. This shows that we were highly conservative given that, according to the company sales growth was slower than expected due to the late opening of new branches.

Our forecast for total expenses stood at KES 2.2 billion

Total expenses recorded for FY2012 stood at KES 2.7 billion, while our forecast stood at KES 2.2 billion. This is due to higher than expected one off non recurrent staff and establishment costs. During FY2012, the retailer increased remuneration packages for its staff including offering them pensions which they were not entitled to during receivership.

Ratio of cost to revenue went up to 19.4%

Additionally, the retailer suffered one off establishment costs where they bought equipment for new stores planned to be opened which ended up being delayed. Consequently, the ratio of cost to revenue for the retailer went up to 19.4% compared to 16.9% level and 16.4% level recorded in FY2010 and FY2011.

Our forecast for profit before tax stood at KES 623.8 million compared to a profit before taxation of KES 403.3 million which was attributed to high non recurring costs of opening the new branches. It is worthy to note that the Kenyan branches alone returned a profit before tax of KES 621.9 million.

KEY THEME

Regional Subsidiaries

Uchumi- Uganda and Uchumi-Tanzania accounted for a combined loss before tax of KES 218.6 million

During FY2012, we note that the regional businesses of Uchumi, i.e. Uchumi-Uganda and Uchumi-Tanzania, accounted for a combined loss before tax of KES 218.6 million as shown in the table below.

A Table showing regional subsidiaries in the region

Subsidiary Financials	KES '000			
Year ended 30th June 2012	**Kenya**	**Uganda**	**Tanzania**	**Group**
Sales	11,849,709	1,592,186	360,296	13,802,191
Profit/(Loss) before tax	***621,909***	***(75,857)***	***(142,709)***	***403,343***
PBT Margin	***5.2%***	***-4.8%***	***-39.6%***	***2.9%***
Current Assets	1,731,936	309,007	87,860	1,594,146
Non Current Assets	3,083,620	304,426	164,821	3,347,742
Total Segment Assets	***4,815,556***	***613,433***	***252,681***	***4,941,888***
Current Liabilities	1,708,125	603,310	415,257	2,203,769
Non Current Liabilities	80,309	-	-	80,309
Total Segment Liabilities	***1,788,434***	***603,310***	***415,257***	***2,284,078***
Working Capital	***23,811***	***(294,303)***	***(327,397)***	***(609,623)***

Source: Uchumi Financial report

Kenya returned a combined profit before tax of KES 621.9 million

During the same period, the branches in Kenya returned a combined profit before tax of KES 621.9 million compared to losses before tax of KES 75.9 million and KES 142.7 million recorded by the Uganda and Tanzania branches respectively.

Uchumi – (Uganda)

Uganda	FY2010	FY2011	FY2012	FY2011- FY2012 % Change
Sales	970,381	976,520	1,592,186	63.0%
Profit/(Loss) before tax	***8,494***	***32,749***	***(75,857)***	***-331.6%***
PBT Margin	0.9%	3.4%		-100.0%
Segment Assets				
Current Assets	178,353	157,323	309,007	96.4%
Non Current Assets	22,686	69,675	304,426	336.9%
Total Segment Assets	***201,039***	***226,998***	***613,433***	***170.2%***
Segment Liabilities				
Current Liabilities	120,432	133,370	603,310	352.4%
Non Current Liabilities		-	-	
Total Segment Liabilities	***120,432***	***133,370***	***603,310***	***352.4%***
Working Capital	***57,921***	***23,953***	***(294,303)***	
Net Assets	***80,607***	***93,628***	***10,123***	
ROA	***4.2%***	***14.4%***	***-12.4%***	

Source: Uchumi Financial report

The Uganda subsidiary grew its branch network to 3 branches by June 2012

The Uganda subsidiary which had previously operated as one branch grew its branch network to three branches by 30th June 2012 and five branches by the end of December 2012. This expansion was necessary in order to reduce the high unit operating cost the subsidiary had when operating one store.

The list of the new branches in FY2012 and FY2013 is as follows:

- ✓ Gulu – Opened in August 2011
- ✓ Freedom City – Opened in June 2012
- ✓ Kabalagala – Opened in November 2012
- ✓ Natete – Opened in December 2012

Uganda sales grew by 63.0%

During FY2012, Uchumi Uganda sales grew by 63.0% to KES 1.6 billion compared to KES 976.5 million recorded during the previous financial year. However, the branches in the country cumulatively returned a loss of KES 75.9 million which was a 331.6% drop when compared to a profit of KES 32.7 million recorded during the review period. This was attributed to the high non-recurrent expenses incurred by the firm due to the expansion. Some of these expenses included the pre ordering of capital items as well as recruiting and training staff before the branches were opened.

Uganda presents various opportunities for the retailer as they set up branches in the country, such as:

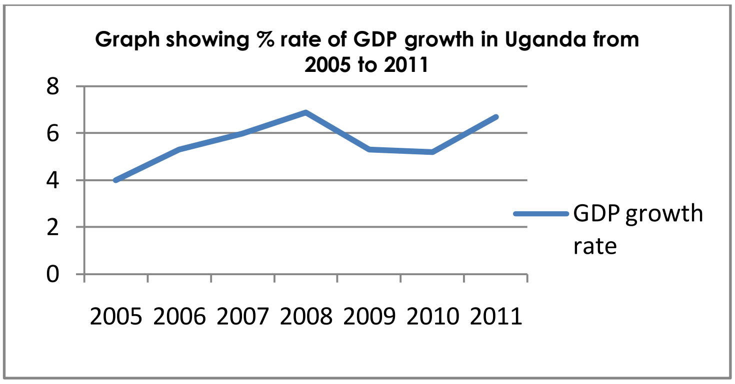
Longer time to understand the local business better

- ✓ **First Mover Advantage:** Currently supermarket chains in Uganda are dominated by South African and Kenyan companies. Uchumi opened its Uganda branch in 2002 while Nakumatt opened in 2009 while Massmart and Shoprite opened stores in 2004. This presents Uchumi with the unique opportunity of having a longer time to understand the local business better than its competitors who have been in the country for a lesser time.

Annual GDP has grown steadily over the years

- ✓ **Gross Domestic Product:** The annual Gross Domestic Product (GDP) for Uganda has grown steadily over the years as shown by the graph below. This growth has been driven by increased investments in infrastructure coupled with a relatively stable government.

Graph showing the rate of GDP growth in Uganda from 2005 to 2011



World Bank estimates the GDP of Uganda to improve by 4.9% in 2014

Going forward, the World Bank projects real GDP growth in Uganda to improve to 4.9% in 2013, driven by better prospects in the oil sector.

✓ **Urbanization:** According to The World Bank the annual rate of urbanization (projected as the average rate of change of the urban population over a given period of time) in Uganda is at 4.8%. Furthermore, the urban population accounted for 13% of the total population in 2010.

This shows the potential that lies therein for supermarkets in the area hence benefitting from the burgeoning middle class in the region.

Uchumi Supermarkets – (Tanzania)

Tanzania	FY2011	FY2012	% Changed
Sales	-	360,296	
Profit/(Loss) before tax	***(11,683)***	***(142,709)***	***1121.5%***
Segment Assets			
Current Assets	46,796	87,860	87.8%
Non Current Assets	145,436	164,821	13.3%
Total Segment Assets	***192,232***	***252,681***	***31.4%***
Segment Liabilities			
Current Liabilities	-	415,257	
Non Current Liabilities	-	-	
Total Segment Liabilities	***-***	***415,257***	
Working Capital	***46,796***	***(327,397)***	
Net Assets	***192,232***	***(162,576)***	
ROA	***-6.1%***	***-56.5%***	

Source: Uchumi Financial report

Tanzania branch was opened in July 2011

The Tanzania subsidiary began operations in July 2011 with the opening of a hypermarket in Dar Es Salaam, Quality Mall.

During 2012, the mall occupancy was at below 50%

The business recorded sales of KES 360.3 million and a loss before tax of KES 142.7 million. According to management, this loss can be attributed to slow offtake of sales vis-a-vis operating costs. During most of FY2012, the mall occupancy was at below 50% partly because of poor advertising of the mall.

It is worthy to note that according to the management, during the 1H2013 the subsidiary recorded gross sales of KES 450 million while the gross sales for FY2012 stood at KES 466 million. This can be attributed to increased advertising of the mall coupled with increased occupancy of the mall as a whole.

Company plans to increase branch network

Going forward, the company plans to increase the branch network in the country with another branch slated for the capital, Dar Es Salaam by December 2013.

We highlight the following growth drivers for the Tanzania business:

Annual rate of urbanization in Tanzania is at 4.7%

- ✓ **Urbanization:** Just as was highlighted in Uganda, Tanzania also benefits from having an increase in urban areas. The World Bank puts the annual rate of urbanisation in Tanzania at 4.7% and the percentage of urban population to the total population of the country at 26.0%.

GDP has grown from USD 20.7 billion to USD 23.71

- ✓ **GDP growth:** Over the last three years the gross domestic product for Tanzania has grown from USD 20.72 billion in 2009 to USD 23.71 billion in 2012. This can be attributed to political stability, considerable resources and sound macroeconomic management. Mining, tourism, trade and communication have seen the overall economic growth of the country average at 7% over the last decade. However, it is worth to note that the rapid population growth in the country has resulted in the poverty rate declining only marginally despite the economic growth. According to World Bank 2012 estimates, the annual percentage change in the population, surplus (or deficit) of births over deaths and the balance of migrants entering and leaving the country, for Tanzania stood at 1.96%.

Uchumi – (Kenya)

Kenya	FY2010	FY2011	FY2012	FY2011- FY2012 % Change
Sales	8,589,301	9,794,441	11,849,709	21.0%
Profit/(Loss) before tax	***424,698***	***493,767***	***621,909***	***26.0%***
PBT Margin	4.9%	5.0%	5.2%	4.1%
Segment Assets				
Current Assets	1,015,214	1,193,531	1,731,936	45.1%
Non Current Assets	1,937,258	2,391,959	3,083,620	28.9%
Total Segment Assets	***2,952,472***	***3,585,490***	***4,815,556***	***34.3%***
Segment Liabilities				
Current Liabilities	1,174,006	1,408,817	1,708,125	21.2%
Non Current Liabilities	320,140	183,368	80,309	-56.2%
Total Segment Liabilities	***1,494,146***	***1,592,185***	***1,788,434***	***12.3%***
Working Capital	***(158,792)***	***(215,286)***	***23,811***	
Net Assets	***1,458,326***	***1,993,305***	***3,027,122***	
ROA	***14.4%***	***13.8%***	***12.9%***	

Source: Uchumi financial report

Sales have grown by 38.0%

Since FY2010, the Kenya subsidiary has grown from a sales position of KES 8.6 billion to sales of KES 11.8 billion recorded in FY2012, a 38.0% increase. This can be attributed to the increased branch network during the review period coupled with branch optimization during the three financial years.

One branch was opened during FY2012

During FY2012, the retailer opened only one branch (Taj Mall Hypermarket) closing the financial year with 18 branches in the country. An additional 4 branches are expected to be opened during the current financial year (FY2013), Eldoret (December 2012), Kisii (January 2013), Mombasa (March 2013) and Kisumu (June 2013).

Going forward, we are likely to see the increased branch network in the country coupled with optimization of current and new branches resulting in improved sales figures and better margins reported by the company.

Profit before tax margins have improved from 4.9% to 5.2%

During the three financial years, the profit before tax margins of the Kenya business improved from 4.9% in FY2010 to the 5.2% level recorded in FY2012 due to improved efficiency coupled with increased customer numbers in the Kenyan branches.

The branches in Kenya closed the year on a positive working capital of KES 23.8 million compared to a negative working capital of KES 215.3 million recorded in FY2011.

Uchumi Supermarket (Group) Growth Drivers

We highlight the following growth drivers for Uchumi Supermarkets in the upcoming financial years:

Sales growth to be buoyed by new branches

- ✓ **New branches:** As highlighted in our initiation of coverage report for Uchumi Supermarkets, Rewriting a growth story, an increase in the branch network of the retailer contributed to the growth in sales over the years. During FY2012, branch network increased by 1 branch in Kenya, 3 branches in Uganda and 1 branch in Tanzania. This increased branch network saw the retailer's sales increase by 28.1% to KES 13.8 billion compared to KES 10.8 billion recorded during the previous financial year.
  The branches that have been opened during the current financial year, FY2013, include, Ongata Rongai (Kenya), Eldoret (Kenya), Freedom City (Uganda), Natete (Uganda) while Kisii branch (Kenya) is slated to be opened sometime before the end of the financial year.
  We are likely to see sales growth going forward being buoyed by the increased branch network coupled with the optimization of new branches that were opened during the previous financial year.

Heavy investment in infrastructure pushing for growth inGDP per capita

- ✓ **GDP per capita growth:** As the gross domestic product per capita of the country continues to grow facilitating a wider middle class, the purchasing power also improves and hence the demand for high quality goods and services offered largely by retail supermarket chains such as Uchumi. Since the year 2008 and 2011 the GDP per capita of Kenya has been constantly expanding, growing from KES 36,983 in 2008 to KES 38,970 in 2011. We expect to see the trend continue given the heavy investment in infrastructure coupled with other enablers being spearheaded by the government to push for this growth.

Devolution will foster growth of businesses and development of industries at county level

- ✓ **Devolution and county governments:** With the devolution of the central government to the county level in line with the new constitutional dispensation, retail trade is likely to benefit from opening up of counties which will see improved income levels of the residents of those areas thereby sustaining a case for expansion. With the upcoming March 4th 2013 elections, the county government will become a reality thereby fostering this growth of businesses and development of industries at a county level hence boosting retail trade.

- ✓ **Vision 2030 projects:** During the year 2012 and 2013, a number of vision 2030 flagship projects have been kick-started, such as the groundbreaking of the Lamu port, the Official opening of the Thika Superhighway, the Opening of the Syokimau Railway station and the groundbreaking of the Konza City which is planned to be Africa's own Silicon valley. These foster economic growth in the country which enables the growth of demand for goods and services and opens up regions for the expansion of the branch network.

Uchumi has stuck to its strategy of stocking more of FMCG's

- ✓ **Fast Moving Consumer Goods:** Uchumi has stuck to its strategy of stocking a large proportion of its inventory as fast moving consumer goods. This has enabled the company to maintain its average days of inventory on hand at about 34 days in FY2012. This strategy coupled with good supplier relationships whereby the retailer is able to substitute slow moving goods from suppliers for faster moving ones enables the company turn their goods into cash well before the cash is required by the suppliers. This is informed by our calculated average day's of payables which stood at 51 days in FY2012.
  Notably the management has a plan to negotiate for longer days of payables which will see the retailer have more time to reinvest the cash

received on sales before it is due to suppliers. Some scenarios that the retailer can use to optimize its payables are:

- **Interest Earning assets:** Some of the relatively secure interest earning assets include bank deposits and treasury bills.
- **Expansion:** The retailer can also use the funds to increase the stock of some goods and set up new branches depending on the size of the store and the stock being purchased.

Financial Analysis

Uchumi Supermarkets Limited Group Income statement	FY2011	FY2012	% Change	FY2013F
REVENUES				
Sales	10,770,961	13,802,191	28.1%	16,700,651
Income from redemption of loyalty points	69,767	116,339	66.8%	124,473
Total Revenue	10,840,728	13,918,530	28.4%	16,825,124
Cost of Sales	(8,943,513)	(11,407,227)	27.5%	(13,902,166)
Gross Profit	**1,897,215**	**2,511,303**	**32.4%**	**2,922,958**
Gross Profit Margin	***17.6%***	***18.2%***	**0.6%**	***17.5%***
Change in value of investment property	160,721	250,000	55.5%	309,079
Other income	290,840	378,407	30.1%	447,545
Total Income	*2,348,776*	*3,139,710*	*33.7%*	*3,679,581*
EXPENSES				
Administration and establishment	(1,727,672)	(2,572,249)	48.9%	(2,962,114)
Selling and distribution	(102,641)	(139,036)	35.5%	(168,234)
Total Expenses	*(1,830,313)*	*(2,711,285)*	*48.1%*	*(3,130,348)*
Profit from Operating Activities	518,463	428,425	-17.4%	549,233
Finance Costs	(3,630)	(25,082)	591.0%	(63,106)
Profit Before Tax	***514,833***	***403,343***	***-21.7%***	***486,127***
Income tax Expense	(124,408)	(129,366)	4.0%	(145,838)
Profit for the Year	***390,425***	***273,977***	***-29.8%***	***340,289***

Source: Uchumi Financial report & Faida estimates

Profit before tax dropped by 21.7%

Uchumi Supermarkets released its FY2012 results which showed a 21.7% drop in profit before tax to KES 403.3 million compared to KES 514.8 million recorded during the previous financial year. The profit before tax margin dropped to 2.9% in FY2012 compared to 4.7% in FY2011 and 4.5% recorded in FY2010.

Sales grew by 28.1%

Total sales grew by 28.1% during the year under review to KES 13.8 billion compared to KES 10.8 billion recorded in FY2011. This growth was attributed to increased customer numbers to 2.2 million brought about by the 5 new branches opened by the retailer during the year under review, 1 branch in Tanzania, 3 branches in Uganda and 1 branch in Kenya.

Cost of sales increased by 27.5%

Cost of sales increased by 27.5% to KES 11.4 billion compared to KES 8.9 billion recorded during the previous financial year. During the year under review, the gross profit margin improved to 18.2% compared to a gross profit margin of 17.6% recorded in FY2011.

Other income went up by 30.1%

Other income went up by 30.1% to KES 378.4 million compared to KES 290.8 million recorded during the first half of the previous financial year. This was driven by a 33.5% growth in speciality shop income to KES 207.4 million coupled with a 45.0% growth in miscellaneous income to KES 96.1 million.

Total income grew by 33.7%

This saw total income grow by 33.7% in FY2012 to KES 3.1 billion compared to KES 2.3 billion recorded during the previous financial year while total expenses went up by 47.2% to KES 2.7 billion compared to KES 1.8 billion recorded in FY2011.

Establishment costs went up by 44.9% to KES 875.7 million compared to KES 604.3 million recorded in FY2011. General expenses also increased by 36.9% y-o-y to KES 385.1 million both of which can be attributed to the branch expansion.

Depreciaton of property and equipment went up by 141.3%

Depreciation of property and equipment went up by 141.3% to KES 190.8 million compared to KES 79.1 recorded during the previous financial year.

Selling and distribution expenses went up by 35.5% to KES 139.0 million compared to KES 102.6 million recorded during the previous financial year.

Total cost to revenue rose to 19.1%

During the financial year under review, the total cost to revenue for the retailer rose to 19.1% compared to 16.9% recorded during the previous financial year. This increase was attributed to the heavy non recurrent initial operating costs for the new branches opened in the E.A region coupled with the slower than expected maturity of the these new branches during the review period.

Management expects these new branches to reach their revenue potential in the current financial year, FY2012/2013.

Peer Comparison

A table showing how the peers performed in FY2012

	Current P/E	Current P/B	ROE	ROA	Gross Margin	Net Income Margin
Shoprite Holdings	**27.78X**	**7.08X**	**30.5%**	**11.7%**	**20.5%**	**3.7%**
Massmart Holdings	**32.09X**	**8.98X**	**28.4%**	**6.5%**	**18.4%**	**1.9%**
Clicks Group Ltd	**22.21X**	**11.40X**	**59.6%**	**15.3%**	**22.5%**	**4.5%**
Pick N Pay Stores	**33.02X**	**10.40X**	**48.8%**	**9.7%**	**18.0%**	**2.0%**
Uchumi Supermarket	**18.41X**	**1.90X**	**10.3%**	**5.5%**	**18.0%**	**2.0%**
Victory Supermarket	**11.79X**	**1.81X**	**26.2%**	**10.4%**	**23.3%**	**3.2%**

Source: Bloomberg

Peers in the region operated relatively well during FY2012

As the table above shows, Bloomberg peers in the region have operated generally well during FY2012 with Clicks Group coming out as the best performing as it recorded the highest ROE (59.6%), ROA (15.3%), gross margin (22.5%) and Net income margin (4.5%).

We see more room for efficiency gains for Uchumi in the gross margins and overall net margins as it remained below its peers such as Shoprite and Clicks.

Furthermore, the retailer has the lowest ROE and ROA in our peer group at 10.3% and 5.5% respectively.

FORECAST

Uchumi Supermarkets Limited Group Income statement	FY2012	FY2013F	% Change	FY2014F
REVENUES				
Sales	13,802,191	16,700,651	21.0%	20,207,788
Total Revenue	13,918,530	16,825,124	20.9%	20,358,400
Cost of Sales	(11,407,227)	(13,902,166)	21.9%	(16,821,621)
Gross Profit	**2,511,303**	**2,922,958**	**16.4%**	**3,536,779**
Gross Profit Margin	***18.2%***	***17.5%***		***17.5%***
Other income	378,407	447,545	18.3%	541,150
Total Income	*3,139,710*	*3,679,581*	*17.2%*	*4,558,698*
EXPENSES				
Administration and establishment	(2,572,249)	(2,962,114)	15.2%	(3,376,624)
Selling and distribution	(139,036)	(168,234)	21.0%	(203,563)
Total Expenses	*(2,711,285)*	*(3,130,348)*	*15.5%*	*(3,580,187)*
Profit from Operating Activities	428,425	549,233	28.2%	978,511
Finance Costs	(25,082)	(63,106)	151.6%	(69,279)
Profit Before Tax	***403,343***	***486,127***	**20.5%**	***909,231***
Income tax Expense	(129,366)	(145,838)	12.7%	(272,769)
Profit for the Year	***273,977***	***340,289***	***24.2%***	***636,462***

Source: Uchumi financial report & Faida estimates

We forecast a 20.5% rise in profit before tax

In FY2013, we forecast Uchumi to report a 20.5% increase in profit before tax to KES 486.1 million compared to KES 274.0 million recorded during the previous financial year. This is to be driven by the new branches being opened coupled with the optimization of the current branches.

Total expenses to rise by 15.5%

We forecast the total expenses for the firm to rise by 15.5% to KES 3.1 billion as they continue with the expansion of branches in Kenya and in the region. We see the cost to sales ratio of the firm drop to 18.7% and 17.7% in FY2013 and FY2014 respectively. This ratio stood at 19.4% in FY2012.

We do not foresee a dividend payment in the near term

We are not likely to see the company pay a dividend in the near term as we expect them to have a high retention ratio for expansion so as to maximize shareholder returns. Uchumi currently has a low return on equity of 10.3% which we forecast to go up slightly to 11.5% in FY2013 and 16.0% in FY2014 holding the capital structure of the company constant.

VALUATION

P/E Multiple Valuation	
Market Price (05.02.13)	19.15
Trailing EPS: FY2012	1.03
Forecasted EPS: FY2013	1.28
Trailing P/E	18.55
Target Price	**23.78**
Upside/ (Downside)	**24.2%**

PE valuation method was used

We valued Uchumi by multiplying its trailing PE and it with our forecasted FY2013 EPS of the company arriving at our target price of KES 23.78 per share representing an 24.2% upside from the current share price of KES 19.15.

Investment Risks

We have seen competition in the supermarket retail chain industry intensify

- ✓ **Competition:** Over the years we continue to see competition in the retail supermarket chain industry continue to intensify, with other region's supermarket chains such as Shoprite and Pick N' Pay setting up in East Africa while others such as Massmart looking to open shop. This can be attributed to the growing economy in the Eastern African region coupled with an expanding middle class. Furthermore, local retailers such as Nakumatt are also widening their geographical footprint with branches in Tanzania, Uganda and Rwanda. Innovation also continues to play a major part in supermarket strategy to improve margins, we have seen Nakumatt launching branded products with the name Nakumatt. This is likely to improve the company's gross margins by lowering cost of goods sold and increasing customer numbers due to increased variety of goods.

There lies political risk ahead of the upcoming elections

- ✓ **Political Risk:** Uchumi being a Kenyan company with a large network of branches in Kenya, is susceptible to the current political environment. Kenya is conducting its general election in March 4th 2013. Given that the previous election resulted in violence, there lies political risk ahead of the upcoming poles with a fear of a re-occurrence of violence. This can result in depressed sales numbers in case of political instability as demand for goods and services may reduce and supply of these goods and services may also be hampered.

Low ROE of 10.3% in FY2012

- ✓ **Low ROE:** During FY2012, Uchumi recorded a return on equity of 10.3% this low ROE can be attributed to the conversion of the supplier and government debt into equity in FY2010. We are likely to see this strained in the short term given the upcoming rights issue. However, we expect it to rise steadily in the medium to long term as the firm continues to expand its branch network and optimise the current ones.

Upcomming rights issue

- ✓ **Rights Issue:** Uchumi is planning to come the market to raise money through a rights issue. The supermarket is planning to raise approximately KES 1.5 billion from the market which it plans to use in order to increase its branch network, so far branch network has been financed by internally generated funds. There is a potential investment risk depending on the discount that will be given to shareholders and potential dilution if one does not take up the rights. However, the increase in branch network will see the company's earnings grow with margins holding constant resulting in steady ROE growth in the medium to long term.

CONCLUSION

BUY recommendation

We maintain our **BUY** recommendation of Uchumi Supermarket with a target price of KES 23.78, which represents a 24.2% upside from the current share price of KES 19.15.

It is worthy to note that, Uchumi Supermarket intends to come to the market to raise approximately KES 1.5 billion through a rights issue which we expect to significantly change the capital structure of the company.