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Kenya Cement Sector: Initiation of Coverage

Time to de-commoditize cement…?

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Analyst(s):

Bernard Kiarie

bernard.kiarie@fib.co.ke

Samuel Njihia

samuel.njihia@fib.co.ke

Head Office

Crawford Business Park, Ground Floor

State House Road

Tel: (254-20) 7606026

www.fib.co.ke

P.O Box 45236, 00100

Nairobi.

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EXECUTIVE SUMMARY

We initiate coverage on Kenya's Cement Sector with a POSITIVE OUTLOOK.

In the last decade (2002-2012), cement production grew at a CAGR of 15.9% to 4.64 million tonnes, driven mainly by increased capacity by the incumbents and the new entrants. Consumption grew at a CAGR of 15.2% to 3.94 million tonnes over the same period, driven mainly by the growth in the building and construction industry, as well as public expenditure on infrastructural development.

Kenya's cement per capita consumption grew from 85 kg in 2011 to 92 kg in 2012, a level that is still very low compared to the global average per capita consumption of 513 kg. This provides headroom for significant growth.

From a raw materials perspective, the country is well endowed with limestone deposits that could last for about 200 years. Access to adequate raw materials, coupled with the financial muscles to increase production capacities, especially clinker will be a key differentiating factor amongst the players.

We see little headroom as far as the war on prices is concerned. All the new entrants at the time of being established had no integrated plants. They cannot survive the war on prices if they continue to depend on competitors for clinker production.

In the report, we outline the key industry growth drivers that we expect to accelerate cement consumption, mainly increased public infrastructural development and growth in the real estate sector.

Cemweek, a global cement industry consultancy and research house estimates cement consumption in Kenya to grow by 10.0% on average, hitting 6.3 million tpa by 2017.

Based on the foregoing, our recommendation on the listed companies is as follows:

Metric (2013)	**ARM**	**Bamburi**	**EAPCC**
P/E (x)	31.0	20.4	8.4
ROaE	17.6%	12.1%	30.4%
GPM	28.0%	22.5%	25.3%
NPM	9.5%	10.8%	19.3%
Price Target (KES)	***141.07***	***233.24***	***85.39***
Upside Potential	***66.9%***	***19.6%***	***-12.0%***
Recommendation	***BUY***	***BUY***	***NEUTRAL***

GLOBAL INDUSTRY OVERVIEW

Industry Structure

Cement industry is a regional industry and not a global integrated one

Transportation of the cement product is bulky, and therefore most plants are normally built near the source of key raw materials, leading to concentration in most regions. There is very minimal cross-border trading of the commodity, with only an estimated 3.0% of global production traded across borders.

69.0% of the world cement production facilities are located in China

According to the International Cement Review (ICR), the global industry consisted of 5,673 production facilities (both integrated and grinding) of which 3,900 (69%) were located in China and 1,733 (31%) across the rest of the world.

Industry characterized by high barriers to entry

Barriers to entry are relatively high, and fewer companies control a significant portion of the market share. According to the Economist (June 22, 2013 edition), a new 1 million tonnes per year plant, the smallest worth building, costs around USD 200 million.

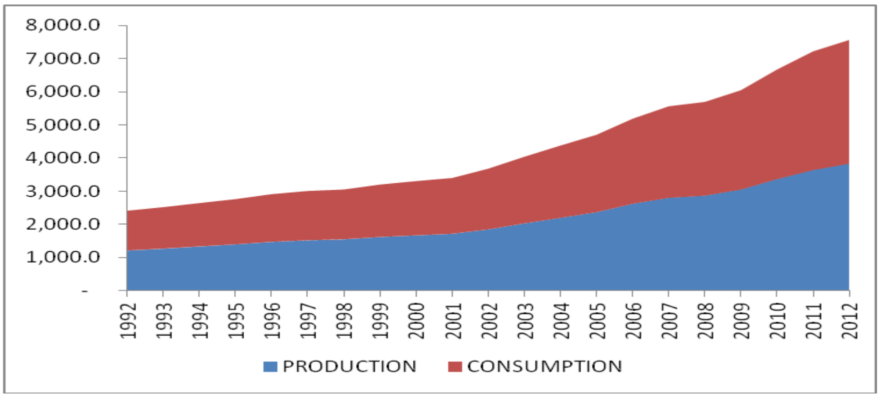
Main Global Players

The global cement industry is characterized by 6 multi-national companies namely: Lafarge (France)*, Holcim (Switzerland), Heidelberg (German), Cemex (Mexican), Italcementi (Italy) and Buzzi Unicem (Italy).

Company	Cement Capacity 2012(Mtpa)	Geographical Presence (Countries)	Cement Sales(Mt)-2012	Cement Plants	2012 Revenues (€M)
Lafarge**	223.0	58	141.0	116	15,816
Holcim**	206.2*	70	142.3	142	17,487
Heidelberg	122.0	Over 40	89.0	103	14,020
Cemex	94.8	Over 50	66.0	69	10,777
Italcementi	65.0	22	45.9	53	4,480
Buzzi Unicem	44.7	11	27.4*	39	2,813

Sources: ICR, Company reports:*2013
**Announced a merger

Trend Analysis (Production vs. Consumption)



Source: ICR

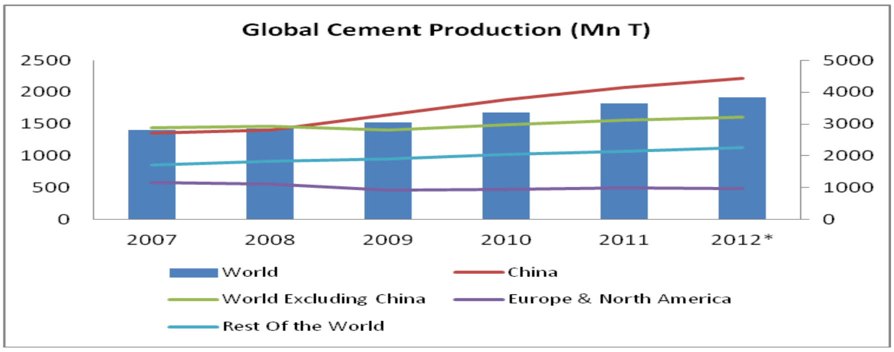
Global cement production grew at a CAGR of 8.4% in the last decade

The trend in the global production and consumption of cement has been on the rise over the past 2 decades.
Production grew at a CAGR of 4.8% (to 1,848 million tonnes) in the 1992-2002 decade and at a relatively higher rate of 8.4% (to 3,831 million tonnes) in the 2002-2012 decade.

China's production accounted for 58.0% of global output

From a regional perspective, China accounted for 58.0% of the global cement output, most of which was produced by local firms, evidenced by the presence of the largest number of plants in the country.

The table below indicates the trend in regional production.



Sources: ICR

Global consumption grew at a CAGR of 8.2% in the same decade

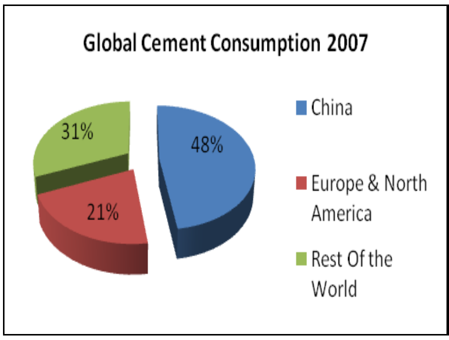
Global cement consumption grew at the same CAGR of 4.8% (to 1,834 million tonnes) in the 1992-2002 decade, and at a higher CAGR of 8.2% (to 3,736 million tonnes) in the last decade.

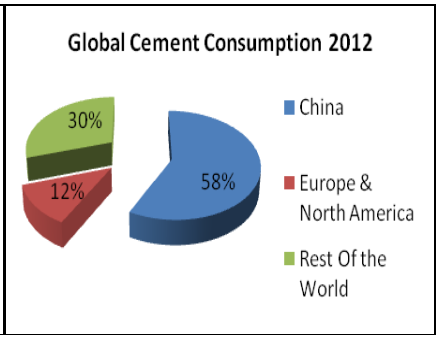
Middle East countries found to be having some of the highest per capita consumption levels

ICR's 2011 global per capita consumption data reveal that the Middle East countries- Qatar, Oman, Saudi Arabia and Kuwait had the highest per capita consumption at 2,981; 1,777; 1,683 and 1,596 kg respectively. These levels were well above the global per capita consumption of 513kg.

China consumed 58.0% of global total consumption

However, in terms of total consumption, China was still the largest consumer of cement globally.





Sources: ICR

In 2012, it consumed 2,160 million tonnes, 58.0% of world's total consumption. Its per capita consumption stood at 1,518 kg (2011) which was 3 times the global average.

Heavy spending on infrastructure, housing boom boosting cement consumption

The rest of the world has seen tremendous growth in cement consumption especially from other emerging economies. Heavy infrastructure spending by governments and a housing boom in these economies has boosted cement demand. Cement consumption for the rest of the world was estimated at 1,114 million tonnes in 2012, up 4.3% from 1,068 million tonnes in 2011.

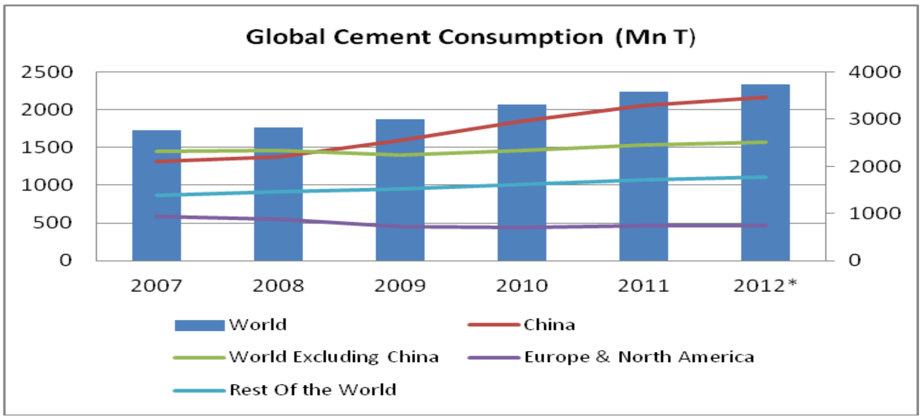
…looking into the future

Cement consumption is said to follow the same path as other widely consumed commodities that have a close correlation with economic expansion.

Consumption in the rich countries in a long-term decline

Most recently, consumption in the rich countries is in a long-term decline. This has been replaced by an increasing demand from the Emerging Markets (EM), as they urbanize and industrialize. The same article of The Economist estimated that the EM now consumes about 90.0% of the world's cement output.

EM now accounting for 90.0% of world's cement output



Source: ICR Database, Global Cement Report 10th Edition

Focus to increasingly shift towards Frontier Markets

However, the growth of cement consumption in the EM is definitely not infinite. As the EM continue to increasingly close the infrastructure gap compared to their well developed western counterparts, we expect to see the giant manufacturers of cement increasing capacities, some setting up green field plants and others acquiring cement companies in the frontier markets.

…coming down to Africa

Africa characterized by low consumption per capita level

The average consumption per capita is low at 165 kg compared to the global average of 513 kg.

Africa Development Bank (AfDB) estimates that Africa needs to spend USD 93 billion per annum on infrastructure for the next 10 years to bridge the infrastructure gap with the developed world. It is only spending USD 40 billion.

Wide infrastructure gaps …great upside potential for cement consumption

The gaps found in these markets provide a significant upside potential as the respective countries increase both public and private spending on the development of infrastructure. ICR estimates that consumption growth rate in sub-Saharan Africa will be the highest at 6.8% (2014) and 7.1%(2015)

East African region also promising

The growth story is still the same even across the East African economies. The low consumption per capita levels coupled with huge infrastructure gaps and growing government expenditure signify significant upside potential for increased demand for cement going forward.

The outlook for GDP growth rate in the region is good, with IMF's projections as shown below:

Strong GDP growth rates expected to be sustained

GDP Growth Rates	2012	2013	2014F	2015F
Kenya	4.6%	5.6%	6.3%	6.3%
Rwanda	8%	5%	8%	8%
Tanzania	7%	7%	7%	7%
Uganda	3%	6%	6%	7%
Burundi	4%	4%	5%	5%

Source: IMF

The tables below gives a snapshot of the regional cement sector

Low consumption per capita…big headroom for growth

	Kenya	Uganda	Tanzania	Rwanda	Burundi
Population (mn)	43.0	35.6	47.7	10.8	10.6
Urbanisation	32.0%	15%	26%	17%	10%
Cement production(mtpa)	4.8	2.15	3.22	0.19	0.1
Cement consumption (mtpa)	4.2	1.95	2.92	0.41	0.48
Per capita consumption	92kg	48kg	67kg	34kg	39kg

*2013 est. Source: ICR

Key Players	Capacity (Mtpa)
Uganda	
1. Tororo Cement	2.2
2. Hima (Lafarge) Cement	0.85
Tanzania	
1. Tanzania Portland Cement Company	1.40
2. Tanga Cement Company	1.20
3. Mbeya Cement	0.35
4. ARM Cement	0.35
Rwanda	
1. Cimerwa	0.1
Burundi	
1. Bececo	0.1

There are key projects lined up in Uganda, which will result in increased consumption of cement. They include the USD 2 bn 600MW Karuma hydro power dam, 188 MW Isimba dam, the USD 350mn Entebbe Kampala highway.

In Tanzania, the National Housing Corporation estimates the current housing deficit to be 3m units and growing by 200,000 annualy. The satisfaction of this deficiency coupled with infrastructural developments by both the government and the private sector will boost cement consumption.

KENYA CEMENT SECTOR OVERVIEW

Industry Structure

Players

The sector is characterized by 6 cement companies namely; Bamburi Cement Ltd (BCL), ARM Cement Ltd (ARM), East African Portland Cement Company Ltd (EAPCC), National Cement Company Ltd (NCCL), Mombasa Cement Ltd (MCL) and Savannah Cement Ltd (SCL).

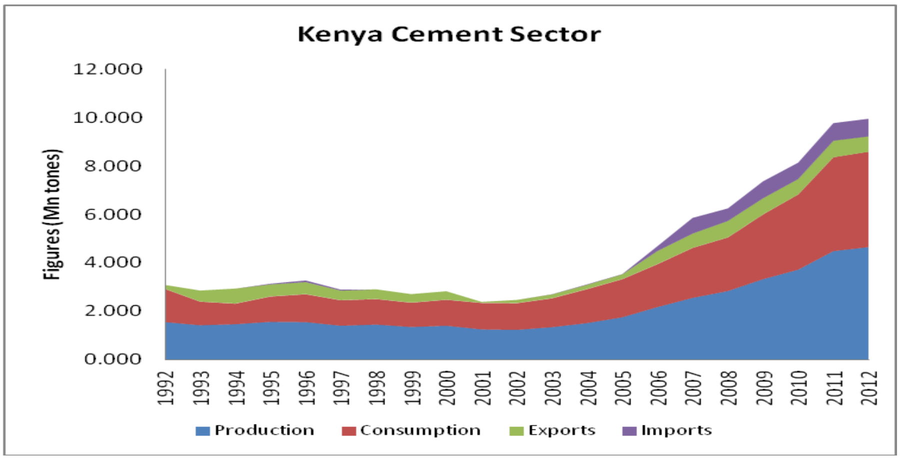
The table below shows the regional capacities of the 6 Kenyan companies.

Company	Country	Plant Type/Location	Cement Capacity(2013 Mta)	No. Of Plants(2013)	Cement Brand
ARM	Kenya	Integreted/Kaloleni	0.35	2	Rhino
		Grinding/Athi River	0.65		
	Tanzania	Grinding/Dar es Salaam	0.75		
		Integrated/Tanga (Commissioning in 2H2014)	0.75	1	
	Rwanda	Grinding/Kigali	0.10	1	
	TOTAL		**1.85**	**4**	
Bamburi	Kenya	Integrated/Mombasa	0.8	2	Nguvu,Powermax,Power Plus
		Grinding/Athi River	1.5		
	Uganda	Integrated/Hima	0.9	1	Hima Multipurpose,PowerMax, PowerPlus
	TOTAL		**3.2**	**3**	
EAPCC	Kenya	Integrated/Athi River	1.3	1	Blue Triangle
Mombasa Cement/Tororo Cement(Uganda)	Kenya	Grinding Athi River	0.8	2	Nyumba
	Uganda	Integrated/Tororo	2.2	1	New Rock Brand
	TOTAL		**3.0**	**3**	
National Cement	Kenya	Grinding/Athi River	0.35	1	Simba
		Integrated/Kajiado(to be built)	1.65		
Savannah	Kenya	Grinding/Athi River	1.5	1	Savannah
TOTAL CURRENT CAPACITY			**9.9**		

Source: Company reports

As depicted above, Bamburi, the market leader had the highest capacity installation. This is despite the fact that the other companies have been increasing capacity. We expect Bamburi to maintain market leadership with the intended capacity increase in the region.

Trend analysis (production vs. consumption)



Source: ICR, KNBS

Kenya's cement production grew by 15.9% in the last decade

Cement production dropped during the 1992-2002 decade, registering a CAGR of -2.5% (to 1.23 million tonnes). This is the opposite of the trend in the global market place, indicating that the industry is a regional one and not a global and correlated one across different markets.

Increase in output driven by capacity expansion by incumbents and new entrants

However, in the 2002-2012 decade, cement production recovered, growing at a CAGR of 15.9%. to 4.64 million tonnes. Cement companies have been increasing capacity in the last decade, thereby boosting total output both for the domestic market and the regional market.

In addition, the industry has witnessed new entrants such as National Cement, Mombasa Cement and Savannah Cement.

Capacity utilization at 66.3% compared to global average of 73.0%

By the end of 2013, Kenya had an installed cement capacity of 7.25 mtpa. According to Kenya National Bureau of Statistics (KNBS), total cement produced in 2013 stood at 4.8 million tonnes. This resulted in a capacity utilization of 66.3% compared to the global capacity utilization of 73.0%.

Capacity to grow to 11.1mtpa by 2017

Cemweek estimates that production capacity in Kenya will grow to 11.1 million tpa by 2017.

Consumption grew by 15.2% in last decade

Consumption during the 1992-2002 decade dropped, registering a CAGR of -2.4% (to 1.1 million tonnes). However, consumption grew at a CAGR of 15.2% (to 3.94 million tonnes) over the last decade, driven mainly by the growth in the building and construction sector.

Low per capita consumption at 92kg compared to global average of 513 kg

Kenya's cement per capita consumption grew from 85 kg in 2011 to 92 kg in 2012. However, this is still lower compared to 108 kg in Nigeria, 222 kg in South Africa, 240 kg in Angola and 554 kg in Egypt. Its regional neighbors fair poorly, with Tanzania's per capita consumption at 67 kg, Rwanda 34 kg and Uganda at 48kg. This export market provides additional growth potential.

The global industry average stood at 513 kg per person.

Consumption to grow to 6.3 mtpa by

Cemweek estimates cement consumption in Kenya to grow by 10.0% on average, hitting 6.3 million mtpa by 2017.

INDUSTRY KEY THEMES

Limestone Deposits: Adequate raw material

Limestone deposits to last for 200 years!

Kenya is well endowed with most of the raw materials for cement manufacturing. Key deposit areas (limestone belts) include northern parts of Mombasa county, Kitui county and Kajiado county.

In Kitui, the limestone belt lies within the Mutomo and Ikutha Districts. According to Olive Leaf Foundation (a Kenyan Non-Governmental Organization that enables sustainable community development), the area has deposits that could last for 200 years.

We note that there have been some disputes over the land in Kitui. There were a number of demands raised by the local residents, such as availing employment opportunities, construction of social amenities and clarity on the proceeds sharing formula.

We believe that access to this raw material will continue to be a key driving factor for growing margins.

Optimal Operations

Crucial to have plants operating efficiently

One of the key elements of cement production is having plants that are operating efficiently and at optimal levels, considering the high cost of manufacturing. As a result, and to be able to safeguard margins, a cement plant should ideally be built near the site of raw material, relatively closer to the bigger portion of the customer group (because of the high transportation costs).

In addition, the size of the plant matters. As alluded to earlier, the smallest plant worth building should be a 1 million tonnes per year plant. Therefore, this makes it easier for incumbents to expand, especially if initial plants are located near the key raw materials.

Bamburi Cement, ARM Cement and EAPCC have plants near their limestone deposits. ARM has 2 plants in Kenya (Kaloleni plant in Mombasa and Athi River. EAPCC has a plant in Athi River. Both ARM and Bamburi have a plant in Mombasa, which makes it easier for shipment to the export markets.

Capacity utilization key when pricing the product

Capacity utilization in Kenya stood at 66.3% (2013). This is low compared to the global average capacity utilization of 73.0%. Research indicates that selling prices are tightly linked to capacity utilization, with a one year lag, i.e capacity utilization changes in one year will be seen in cement price changes a year later.

To ensure optimal operations, companies must ensure their plants have minimal stoppages.

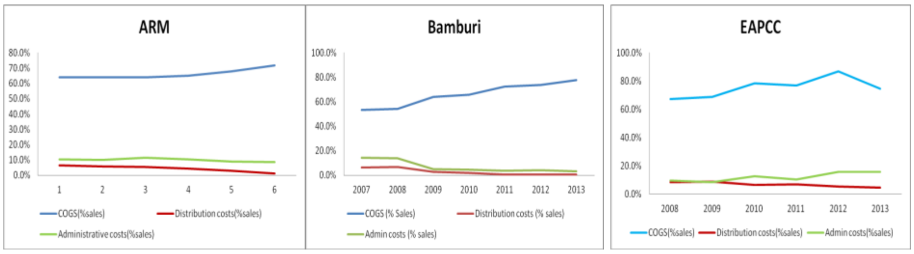
Costs containment…

Owing to the rising competition in the sector, cement companies continue to focus on costs to protect and or improve margins. Key costs in the manufacture of cement include energy costs (for grinding clinker and cement), freight of raw materials and importation of clinker (for those that don't manufacture their own clinker) various administrative costs as well as distribution costs.

Cost of importing clinker sometimes goes up by as much as 72.0%

For firms that import clinker, the cost of importation goes up by as much as 72.0% according to some industry players. As a result, any disruption of the kiln leads to clinker importation and consequently depressed margins.

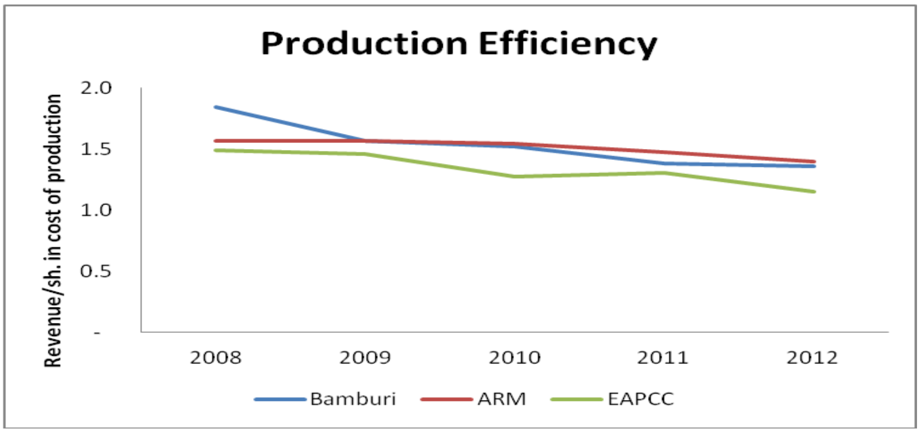
The charts below indicate the trend on the costs for the 3 firms.



Sources: Company reports, FIB data base

…..so who's winning the game??
All the 3 listed companies seems to be trending in the same direction in terms of enhancing production efficiencies. Cost of production went up, thereby reducing revenue generated per shilling used in the cost of production.

ARM winning the production efficiency game



Sources: Company reports, FIB data base

From the chart, Bamburi's production efficiency seems to have deteriorated the most, with revenues per shilling in cost of production declining by 26.3%, followed by EAPCC at 22.8% and ARM at 11.1%.

Competition, limitation to price wars?

Revenues over the last 5 years have been on an upward trend but that was not the case for profitability margins. This has been partly attributed to price wars, following capacity increases by some of the incumbents as well as the new entrants.

Is there a limitation to price wars?

We note that one of the reasons the new entrants were able to undercut was due to the fact they only set up grinding plants, which are relatively cheaper and faster to set up.

The price wars will very much depend on one's ability to maintain sustainable bottom-line margins, for long term business sustainability

However, we believe that there are limitations to these price wars. Cement industry has relatively high barriers to entry. Companies need relatively high margins to sustain strong business models that are capable of tapping into emerging opportunities which more often require capital-intensive expansion.

Combined with the high cost of production in the country, and a relatively costly route to market to avail products to the customers, it will become increasingly difficult to continue reducing the price of the final product to ensure sustainability and ability to scale up business operations in the longer term.

More importantly, companies that will continue to rely on others for clinker (or importation from external markets), will find it almost impossible to play the price undercutting game.

Competition to shift

Going forward, we expect competition to shift to product innovation and diversification, production efficiency, consistency in quality as well as reduction in the cost of route to market.

Alternative energy sources

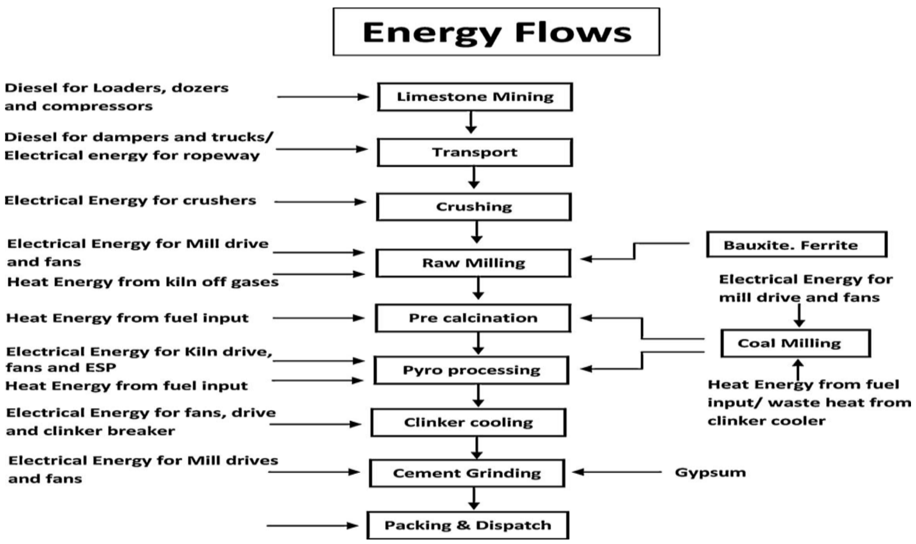
Use of alternative energy sources key in reducing costs

Cement production is an intensive energy-consuming process. Bamburi's cost of energy consumption accounted for about 29.5% of the cost of goods sold. EAPCC's accounted for 30.1%.

The grinding of clinker (to produce cement) has been estimated to be the most energy consuming process in cement manufacturing. According to Dr Alex Jankovic, and Dr Walter Valery from Metso Mineral Process Technology, of all the total electrical energy consumed in cement production, about 30.0% is consumed in the preparation of raw materials, 40.0% is consumed in clinker grinding.

According to some industry players in Kenya, 1 tonne of clinker consumes about 3.5 - 4 units of energy. 1 unit of energy costs between USD 20 – USD 24. Therefore to produce 1 million tonne of clinker, energy costs range between USD 70 million to USD 80 million.

The flow chart below indicates electrical and thermal energy flows and their uses in the cement production chain.



Source: Elsevier

Firms implementing various strategies to reduce their cost of energy

**pet-coke: a carbonaceous solid residue obtained as a final product in the distillation of crude petroleum*

To reduce this cost of energy, firms are seeking alternative energy sources. Bamburi plans to introduce the use of pet-coke* in some of its plants, which it hopes will cut energy costs by as much as 50.0%. 1 unit of pet-coke-produced energy costs about USD 8.00 – USD 10.00, which is lower than that of electrical energy.

In addition, it has plans to use waste energy in Kenya, which will account for 10.0% of total energy consumed. It recently entered into a KES 4.8 billion partnership with Mombasa County to implement a project in waste management (which it intends to use for generation of alternative energy).

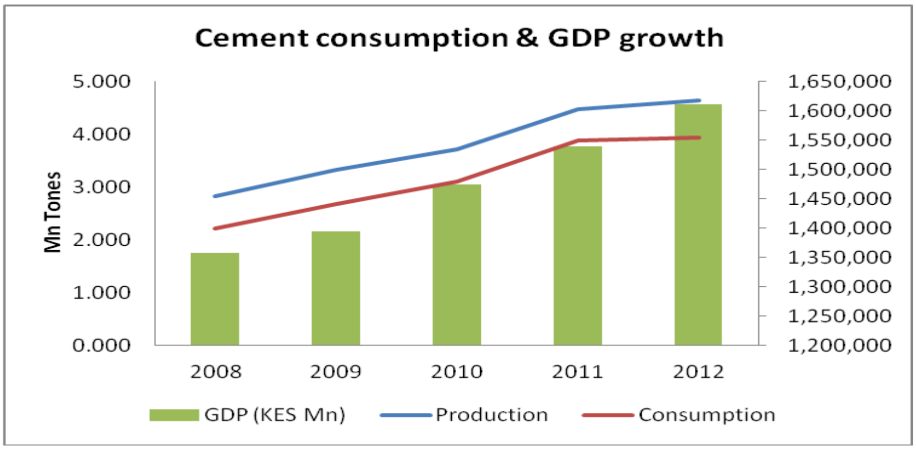
EAPCC plans to implement energy saving and generation measures by tapping the hot gases generated by the kiln.

In the medium to long term, we expect the ability of cement firms to buy power in bulk directly from the generator to result in significant energy savings.

INDUSTRY KEY GROWTH DRIVERS

GDP growth

The consumption of cement has been closely correlated with the growth in GDP. The graph below illustrates this:



Source: ICR, IMF, KNBS

Over the review period, cement consumption grew at a faster rate than the growth in GDP (11.2% above GDP growth in terms of CAGR). Over the 5 year period, a growth in real GDP of 3.8%, resulted in a 1.1x growth in consumption.

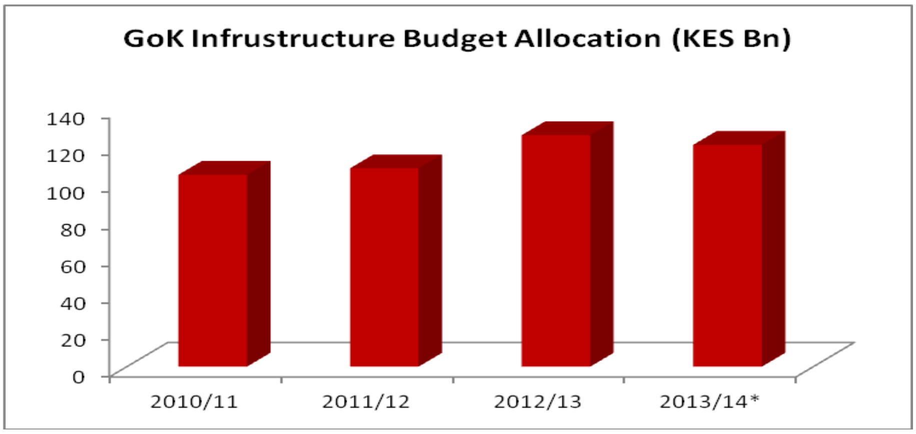
Continued increase in infrastructural development such as roads, airports, ports and railway lines, as alluded to, will accelerate growth in cement consumption. As a consequence, the multiplier effect of these developments will lead to more cement uptake, as people are drawn to well developed areas leading to increased construction of houses.

Kenya's GDP projected to grow by 6.2% (2014), 6.3% (2015)

We therefore expect growth in consumption to continue even as GDP continues with the upward momentum. The International Monetary Fund (IMF) forecasts GDP growth of 6.3% (2014), 6.3% (2015), 6.6% (2016), 5.8% (2017) and 6.1% (2018).

Government expenditure/big ticket projects

In the last 3 years, the government has increased expenditure on infrastructure, as depicted below.



Source: Treasury

Government sets aside KES 97.9b for roads in the next budget

In the 2013/14 budget, we see a 20.8% drop in allocation to roads (to 97.9 bn) and a significant increase in allocation to railway construction (1,366.7%) because of the planned standard gauge railway.

Under the Vision 2030 economic blue print, Kenyan government has lined up big flagship projects, which include:

a. The standard gauge railway (SGR)

SGR to contribute about USD 9.4m in revenue to the industry

This is a 3,300 km railway that will run from Mombasa to Ethiopia and Uganda. The project is estimated to cost USD 18.1 billion, with some resources coming from the railway development levy and a USD 3.3 billion loan from the EXIM Bank of China. The government of Kenya has set aside KES 22 billion in the FY2013/14 budget for the uptake of the project and which it hopes to complete by the year 2020.

The railway line sleepers will be constructed out of high quality concrete. Some industry players have estimated that the railway line from Mombasa to Nairobi will require at least 800,000 sleepers. Each sleeper needs about 90 kg of cement (72,000 tonnes of cement).

Based on the current production levels, the SGR uptake accounts for 1.0% of Kenya's total industry production. With the price of cement placed at between USD 120-130 per tonne by industry players, this translates to about USD 8.6 million to USD 9.4 million for the industry.

b. LAPSSET (Lamu Port Southern Sudan Ethiopia Transport) corridor project

This project aims at opening up northern Kenya for economic development. It is estimated to cost KES 1.5 trillion, and will entail the following;

- A 1,730 km road connecting Lamu-S. Sudan- Ethiopia
- 1,500 km 1M standard gauge railway
- 2,240 km oil pipeline from Lamu to Juba
- A refinery with capacity of 120,000 bpd

- Isiolo international airport
- A 32-berth port
- Resort cities in Lamu, Isiolo and Lake Turkana

The government has set aside KES 3.7 billion for the project in the FY2013/14 budget.

LAPSSET to inject a growth value of 3.0% of GDP into the economy

This project is expected to inject a growth value of close to 3.0% of GDP into the economy. Between 2008-2012, GDP grew at an average of 3.8%, while cement consumption grew by 1.1x. Using the 3.8% GDP as the base line level, an injection of 3.0% from this project would imply an increase in cement consumption by 2.0x (i.e an increase of 8.0 million tonnes. This would translate to at least USD 960 million for the industry.

c. Expansion of road networks

This entails upgrading of the national and county roads network. Kenya's Vision 2030 Second Medium Term Plan (2013-2017) envisages construction and rehabilitation of 5,500 km of roads, comprising of 3,825 km national trunk roads and 1,675 km county roads.

About 1,700 km for non-motorized transport (paths and walkways) will be needed. 800 km of road will be designed and 4,257 km and 1,735 of national trunk roads and county roads will be periodically maintained respectively. Additionally, 200,000 km will be routinely maintained.

The government of Kenya in the FY2013/14 budget has set aside KES 97.9 billion for road construction and maintenance.

Planned road network (2013-2017) to contribute about USD 33m to the industry

The 50 km Thika Superhighway is estimated by industry players to have consumed approximately 10,000-15,000 tonnes of cement. Based on this figures and assuming 25.0% of what is planned in the 2nd medium term plan would entail construction of new roads, cement consumption would stand at least 275,000 tonnes, which is USD 33 million for the industry.

d. Development of multipurpose dams

These will be dams that will also be used for power generation. They include the KES 150 billion High Grand Falls dam along Tana River (700MW), KES 75 billion Magwagwa dam in Nyamira District (120MW), Arror dam in Elgeyo Marakwet county (60MW) and KES 50 billion Nandi forest dam in Kericho West (50 MW).

Multipurpose dams to inject about USD 9.5m in revenues to the industry

According to industry players, the USD 860 million Bujagali dam in Uganda consumed about 20,000 to 30,000 tonnes of cement. Using similar cement consumption levels, the above 5 dams may consume up to 79,000 tonnes of cement. This translates to about USD 9.5 million for the industry.

Commercial/private sector infrastructural development

Increased urbanization, a growing middle class, increased entry of expatriates and large global corporations has continued to increase the demand for housing and good commercial properties in the urban centers.

Increased supply of housing to boost cement consumption

According to the Centre for Affordable Housing Finance in Africa (CAHF), an estimated 50,000 units were produced in 2012, but still not enough to meet the estimated annual demand of 150,000. According to the World Bank estimates, Kenya's mortgage sector has the potential to grow to KES 800 billion (USD 9.9 billion) (about 7 times more than the current level of KES 122.2 billion-2012).

CAHF estimated that there was a housing backlog of 2 million units by end of 2013.

Nairobi county approved buildings worth KES 236.8 b in 2013

In Nairobi County alone, the buildings approved by the city council grew by 24.9% to KES 236.8 billion in 2013.

There has been efforts by various stakeholders such as Housing Finance (mortgage lender), National Housing Corporation (government body) to increase the supply of housing to satisfy the growing demand. We expect such efforts to continue to increase cement consumption.

Urbanization

Urbanization to put more pressure on the need for housing, leading to increased uptake of cement to satisfy the demand for housing

Kenya's population growth rate has been estimated at 2.7%, with urbanization growing at a rate of 4.4%. Current urban population stands at 24.4%. According to a research by Muungano Wa Wanavijiji, a slum dwellers umbrella body, 70.0% of Nairobi's housing stock comprises single 10 square metres shacks made of wood, mud, tin, galvanized sheets.

Some private sector players have joined in on the campaign to build technologies that make housing affordable. Housing Finance recently introduced new housing designs aimed at helping land owners build homes at a minimal cost of KES 1.6 million per unit. Reduced cost of housing has the potential of accelerating the growth of the real estate sector as affordability gets into the hands of a wider population.

Due to the low levels of mortgage penetration, we expect barriers that inhibit mortgage uptake to be broken, leading to a mortgage revolution on the long term. This revolution will accelerate growth in cement consumption by the real estate sector.

RECOMMENDATION: BUY

Bloomberg Ticker: ARML KN

Share Statistics

Fair Value (KES)	**141.07**
Price (KES)-11.04.2014	84.50
Issued shares (m)	495
Market cap (KES bn)	41.9
Market cap (USD m)	483.5
Year end	Dec
Free float (%)	76.9%

KES/USD=86.56

Shareholding (Dec 2012)

Amanat Investment Ltd	27.8%
Paurana Pradeep Harjivandas	18.1%
CFC Stanbic Nominees Ltd A/C Nr-01503	7.7%
ARM ESOP	5.0%
Standard Chartered Nominees Non-res. A/C 9867	3.2%
Orthodox Archbishop of Kenya & Irinoupolis	1.9%
Standard Chartered Nominees A/C 9230	1.5%
Wilfred Murungi	1.2%
Standard Chartered Nominees Ltd Non-res. A/C 9697	1.1%
NSSF Board of Trustees	0.9%
Others	31.7%
Total*	100.0%

ARM CEMENT LIMITED (ARM)

Source: Bloomberg

Investment Summary

We initiate coverage on ARM Cement with a **BUY recommendation** on the stock, with a target price of KES 141.07, providing a 66.9% upside potential from the current share price level of KES 84.5 (11.04.2014).

The stock is trading at projected forward multiples of 18.8x (P/E) and 14.8x (EV/EBITDA).

We are optimistic about the sustained growth of the company. We expect the following to be some of the key drivers that will accelerate growth going forward:

Limestone deposits: ARM has limestone deposits that could last for 100 years. The combination of access to this raw material and investments in integrated plants will boost clinker production, leading to lower cost of producing cement.

Capacity expansion: Cement capacity from 1.85 million tpa to 2.664 million tpa by 2017 increasing market share from 15.0% to 18.0% in the region. Clinker capacity from 450,000 tpa to 1.65 million tpa by 2H2014, increasing clinker market share from 9.0% to 21.0% by 2017.

Improving production efficiency: Through substitution of imported clinker (which is about 70.0%-80.0% more expensive) with locally produced clinker. We expect ARM to increase revenue per shilling in cost of production. 2013 was KES 1.4 compared to Bamburi's 1.3 and EAPCC's 1.3.

Debt levels, a cause for concern?: Although ARM is the most leveraged listed cement firm, its coverage ratios are healthy and so this raises no significant concern for us. We expect Free Cash Flows (FCF) to improve as capex reduces and capacity increases boosts margins in the medium term.

Brief History

ARM Cement was founded by H J. Paunrama in 1974, as a mining company. It initially dealt with agricultural lime, processed minerals for paint, rubber and glass. In 1984, P H. Paunrama, the son of the founder joined the company.

The company was listed at the Nairobi Securities Exchange (NSE) in 1997. Between 200-2005, ARM expanded in the East African region, by establishing a footprint in Tanzania as well as venturing into South Africa (for the manufacture of liquid silicate).

ARM's Growth Drivers

Limestone deposits

According to Holcim, one of the big global cement companies, about 1.6 tonnes of limestone is required to obtain 1 tonne of clinker. According to a 2009 research by the European Cement Association, Cembureau, 1 tonne of clinker produces 1.25 tonnes of cement.

ARM with access to limestone deposits that could last for 100 years

ARM has limestone deposits that could last for 100 years. It currently has 2 plants in Kenya (Kaloleni and Athi River plants) and 1 plant in Tanzania. In addition, the company intimated that they have land in the limestone belt area of Kitui.

The commissioning of the Tanga plant in Tanzania in 2H2014, is expected to bring on-stream a clinker production capacity of 1.2 million tpa.

Capacity expansion

Capacity expansion to increase market share, boost margins

ARM plans to increase cement capacity from the current 1.85 million tpa to 2.664 million tpa by 2017. According to management, this will increase its market share from 15.0% to 18.0% in the region. The commissioning of the USD 120 million investments in the Tanga (Tanzania) plant is expected to increase cement capacity by 750,000 tpa in 2014.

In addition, ARM plans to increase clinker capacity from the current 450,000 tpa to 1.65 milion tpa by 2H2014. This will come from the Tanga plant. Surplus clinker will be sold to non-clinker manufacturing cement firms, thereby providing additional revenue for the company. The market share for clinker is expected to increase from the current 9.0% to 21.0% by 2017.

This increase in clinker production is expected to increase the revenue base as well as boosting the company's margins considering that the cement production in Tanzania was mainly done using imported clinker. The Dar es Salaam plant in Tanzania was commissioned in October 2012, and operated with imported clinker.

We expect the commissioning of the Tanga plant to boost revenues in the medium term.

Diversified products

About 85.0% of the business revenues comes from cement, and other business lines account for the remaining 15.0%. This business lines include;

Product diversification to boost revenues

- Manufacture of fertilizers. The company manufactures crop specific and soil specific fertilizers under the brand name Mavuno. Theses fertilizers contain 11 essential plant nutrients. There are special formulations for every crop as well as the normal planting and top dressing fertilizers. For distribution, the company has partnered with key organizations such as the Ministry of Agriculture (Kenya), farmers' groups and other non-governmental organizations.
- Manufacture of industrial minerals used by paint companies and mattresses companies.
- Manufacture of sodium silicate used in the manufacture of soaps and detergents.

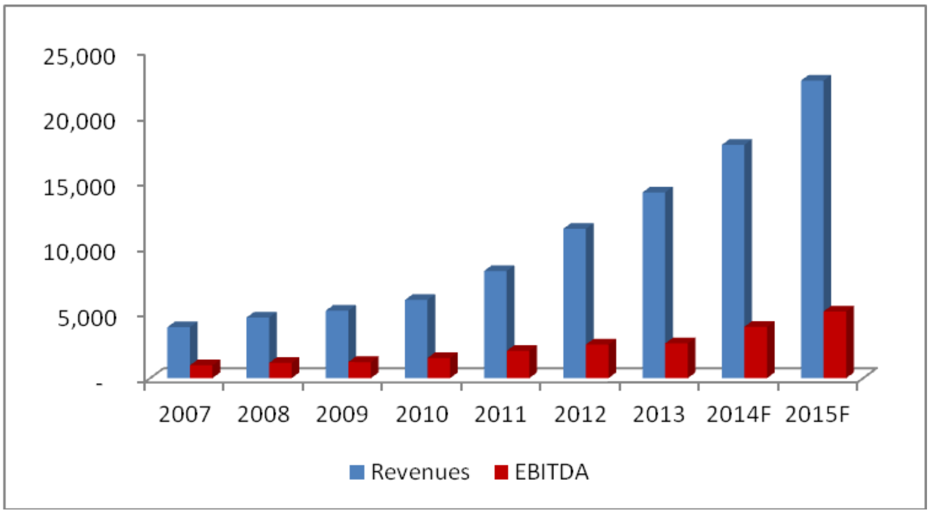
By the end of 2012, contribution of these business lines to the top-line stood at 17.7%.

Financial Performance

Steady revenue growth to continue

Sustained revenue growth: We expect ARM to continue with the steady revenue and EBITDA growth, mainly boosted by capacity increases. In the immediate term, this will be realized by the increase in its regional clinker capacity to 1.65 million tpa and cement production capacity increase to 2.6 million tpa by end of 2014.

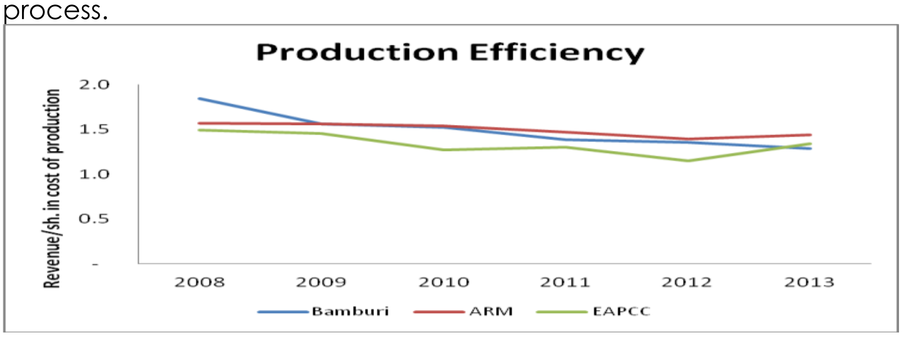
We therefore project revenue of KES 17.8 billion and EBITDA of KES 3.9 billion in FY2014.



Source: Company reports, FIB estimates

Better improvement in production efficiency

Improving efficiency: We expect ARM to continue to improve efficiency in terms of production. With locally produced clinker, we expect margin widening going forward. According to ARM management, imported clinker is about 70.0% - 80.0% more expensive than locally produced clinker. As alluded to earlier, ARM has shown significant improvement in terms of efficiency in the production process.

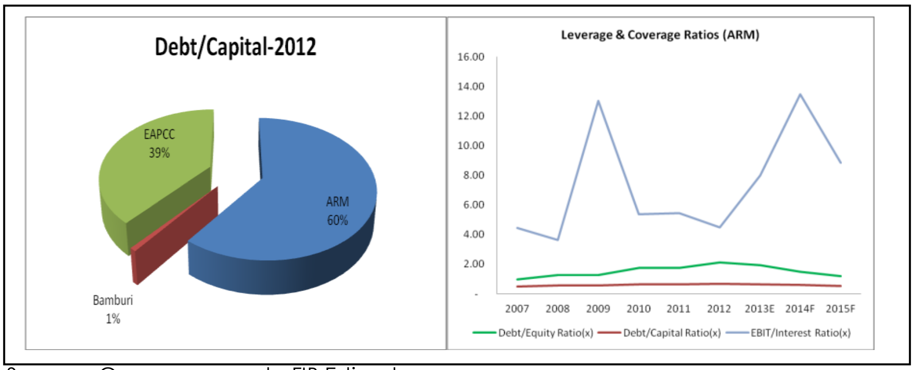


Source: Company reports, FIB database

Although production efficiency deteriorated for all the listed cement companies, Bamburi's deteriorated the most, with revenues per shilling in cost of production declining by 29.9%, followed by EAPCC at 10.2% and ARM at 8.3% in 2013.

Debt levels not a big concern

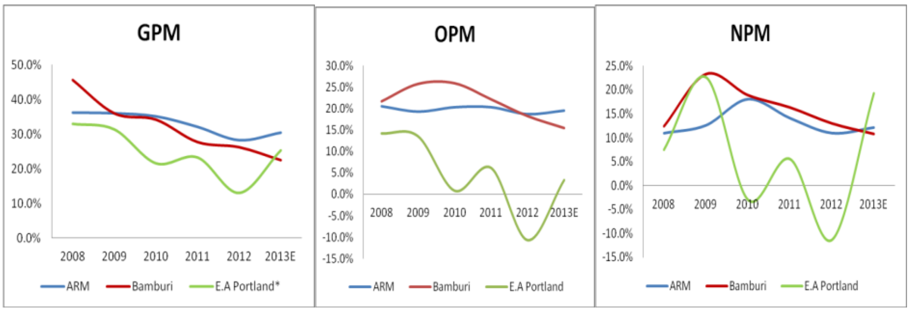
Debt levels, a cause for concern…..?: Although ARM is the most leveraged listed cement firm, its coverage ratios are healthy and so this raises no significant concern for us. We expect FCF to improve as capex reduces and capacity increases boosts margins in the medium term.



Sources: Company reports, FIB Estimates

Better margins going forward: The increased competition that led to price wars resulted in industry-wide margin compression. However, ARM has managed to maintain relatively better margins. We expect this trend to continue, with better strategy in cost containment and efficiency improvements.

As depicted below, Bamburi experienced the biggest drop in margins while ARM continues to maintain relatively higher margins compared to peers.



Production efficiency to continue improving margins

From a production efficiency perspective, ARM's improved the most, recording higher gross profit margins. We expect this trend to continue, once the 1.2 million tpa Tanga plant comes onstream. This will cause a margin widening, improving the other profit margins.

Financial Performance Summary

KES Million	2009	2010	2011	2012	2013*	2014F	2015F	2016F
Revenues	5,145	5,965	8,181	11,401	14,179	17,806	22,718	24,227
Y-o-y growth	*11.4%*	*15.9%*	*37.2%*	*39.4%*	*24.4%*	*25.6%*	*27.6%*	*6.6%*
COGS	(3,290)	(3,866)	(5,550)	(8,171)	(10,207)	(12,108)	(15,221)	(15,748)
Y-o-y growth	*11.7%*	*17.5%*	*43.6%*	*47.2%*	*24.9%*	*18.6%*	*25.7%*	*3.5%*
Gross Profit	1,855	2,099	2,631	3,229	3,972	5,698	7,497	8,480
EBITDA	1,222	1,536	2,085	2,568	2,647	3,917	5,091	5,888
Y-o-y growth	*5.7%*	*25.6%*	*35.8%*	*23.2%*	*3.1%*	*48.0%*	*30.0%*	*15.7%*
EBIT-excluding exceptionals	996	1,215	1,668	2,141	2,127	3,380	4,539	5,326
PBT	949	1,113	1,363	1,790	2,000	3,307	4,232	4,964
Y-o-y growth	*34.5%*	*17.3%*	*22.5%*	*31.4%*	*11.7%*	*65.3%*	*28.0%*	*17.3%*
Gross Profit Margins (GPM)	36.1%	35.2%	32.2%	28.3%	28.0%	32.0%	33.0%	35.0%
Net Profit Margin (NPM)	12.6%	18.0%	14.1%	10.9%	9.5%	12.5%	12.6%	13.8%

*Some estimates

Ratio Analysis

RETURN RATIOS	2009	2010	2011	2012	2013*	2014F	2015F	2016F
ROaE(%)	20.6%	23.7%	20.9%	18.8%	17.6%	24.5%	25.6%	24.6%
ROaA(%)	7.0%	7.5%	6.2%	5.2%	4.8%	7.2%	8.6%	9.5%
ACTIVITY RATIOS								
Inventory turnover (x)	3.5	3.5	4.4	3.5	3.0	3.1	3.5	3.4
Receivables turnover (x)	4.4	3.8	4.5	6.0	6.6	7.4	9.0	9.1
Average collection period (days)	82.7	96.9	81.2	60.6	55.4	49.3	40.4	40.3
Payables turnover(x)	3.8	3.3	3.7	4.5	3.7	3.7	4.3	4.4
Days payable outstanding (days)	97.1	109.9	98.0	80.9	99.4	98.6	84.9	82.7
LIQUIDITY RATIOS								
Current Ratio (x)	1.0	1.3	0.8	1.2	0.9	1.1	1.4	1.6
Quick Ratio(x)	0.7	1.0	0.5	0.7	0.4	0.6	0.8	1.0
LEVERAGE RATIOS								
Debt/Equity Ratio(x)	1.3	1.8	1.7	2.1	1.9	1.5	1.2	1.0
Debt/Capital Ratio(x)	0.6	0.6	0.6	0.7	0.7	0.6	0.5	0.5
Debt/Total assets Ratio(x)	0.4	0.5	0.5	0.6	0.5	0.5	0.4	0.4
COVERAGE RATIOS								
EBIT/Interest Ratio(x)	13.03	5.37	5.45	4.49	8.01	13.48	8.86	9.17
EBITDA/interest Ratio(x)	16.0	6.8	6.8	5.4	10.0	15.6	9.9	10.1

Valuation

We have used an equal weighting of the P/E multiple valuation and the EV/EBITDA multiple valuation, as shown below.

P/E Multiple Valuation	
Current Market Price (11.04.14)	84.50
Historical EPS: FY2013	2.73
Historical P/E	31.0
Forecasted EPS: 2014f	4.51
Target Price	**139.71**

EV/EBITDA Multiple Valuation	
Market Cap-KES '000	41,850,738
Market value of total debt-FY2013E-KES	15,876,471
Minority interest	99,692
EV	**57,826,900**
EBITDA-FY2013E	2,646,502
EV/EBITDA-FY2013E	21.9
Forecasted EBITDA-FY2014	3,917,008
Forecasted EV	85,587,854
Less:	
MV of Debt-FY2014	14,899,229
Minority interest	147,799
Forecasted Market Cap	70,540,827
Target Price	**142.43**

Valuation	Target Price	Weight	Value
P/E	139.71	0.5	69.86
EV/EBITDA	142.43	0.5	71.21
Value per share			**141.07**
Upside Potential			**66.9%**

Recommendation

We initiate coverage on ARM Cement with a **BUY recommendation** on the stock, with a target price of KES 141.07, providing a 66.9% upside potential from the current share price level of KES 84.5 (11.04.2014).

The stock is trading at projected forward multiples of 18.8x (P/E) and 14.8x (EV/EBITDA).

RECOMMENDATION: BUY

Bloomberg Ticker: BMBC KN

Share Statistics

Fair Value (KES)	**233.24**
Price (KES)-11.04.2014	195.00
Issued shares (m)	363
Market cap (KES bn)	70.8
Market cap (USD m)	817.7
Year end	Dec
Free float (%)	42.2%

KES/USD=86.56

Shareholding (Dec 2012)

Fincem Holding Ltd	28.5%
Kencem Holding Ltd	29.3%
Paramount Company Limited	7.4%
Standard Chartered Nominees Resd a/c KE 11422	2.8%
Standard Chartered Nominees Resd a/c KE 11415	2.4%
Standard Chartered Nominees Resd a/c11450	2.4%
Standard Chartered Nominees Resd a/c 11443	2.4%
Standard Chartered Nominees Resd a/c 11436	2.4%
Standard Chartered Nominees Resd a/c 11401	2.4%
Baloobhai Chhotabhai Patel	1.4%
Others	18.7%
Total	**100.0%**

BAMBURI CEMENT LIMITED (BCL)

Source: Bloomberg

Investment Summary

We initiate coverage on Bamburi Cement with a **BUY recommendation** on the stock, with a target price of KES 233.24, providing a 19.6% upside potential from the current share price level of KES 195.00 (11.04.2014).

The stock is trading at projected forward multiples of 17.02 (P/E) and 9.58x (EV/EBITDA).

The following are some of our investment considerations that we think will drive this modest value growth in the medium term:

Market leadership: By the end of 2013, Bamburi controlled a market share of 37.0% (clinker capacity) and 27.0% (cement capacity). With the planned expansion, we expect it to defend its position.

Leveraging on the parent company (Lafarge): For industrial support, brand strength and quality assurance.

Contractors market: This market is estimated to account for about 10.0%-15.0% of total cement consumption. It has relatively high margins (about 80.0% - 110.0%) compared to 40.0% - 70.0% on the normal products.

Export market: Cement prices and margins in these markets are relatively high compared to Kenya. Prices range between USD 160-180 in Uganda, USD 180 – 200 (Rwanda) and USD 200 -220 per tonne (Congo) compared to USD 120 – 130 in Kenya.

Brief History

Bamburi Cement Limited (BCL) was founded by Felix Mandi (a director of Cementia Holdings A.G. Zurich) in 1951. BCL later partnered with Blue Circle PLC (UK). Cementia was later acquired by Lafarge, making it an equal shareholder with Blue Circle. In 2001, Lafarge acquired Blue Circle to become BCL's principle shareholder. Lafarge owns 57.8% of BCL through Fincem Holdings Ltd (28.5%) and Kencem Holdings Ltd (29.3%)

BCL's first plant, located in Mombasa, began production in 1954, with an annual capacity of 140,000 tonnes of cement.

In 1998, a new 1 million tonnes p.a clinker grinding plant was added in Athi River, Nairobi, bringing the company's total production capacity to 2.1 million tonnes.

The company's export markets include: Uganda, Mayotte, Mauritius, Sri Lanka, The Comoros, Madagascar and Congo.

The company has 3 active subsidiaries: Hima Cement Ltd, Bamburi Special Products Ltd and Lafarge Eco Systems Ltd.

The company's key products include:

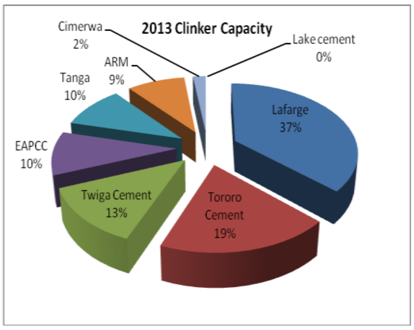
- Nguvu: pozzolanic cement with wide range of applications from domestic concrete to large building projects. Its strength makes it suitable for both general purpose and structural concrete applications.
- Power Plus: Traditionally called Ordinary Portland Cement, it's mainly used for large construction projects such as high rise buildings, bridges, silos.
- Power Max: a premium cement that combines strength performance at all ages with versatility and enhanced durability benefits. Power Max 42.5 combines high technical performance for large projects with all round versatility for small user.

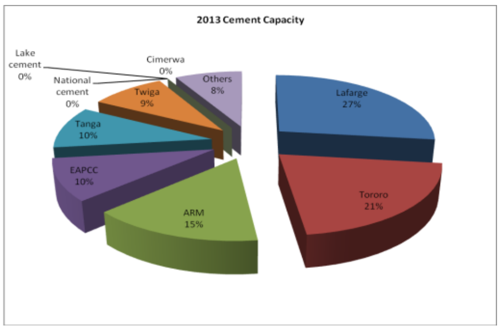
Bamburi's Growth Drivers

Market leadership

BCL to defend its market dorminance

The pie charts below indicate the current market share (2013) in the region

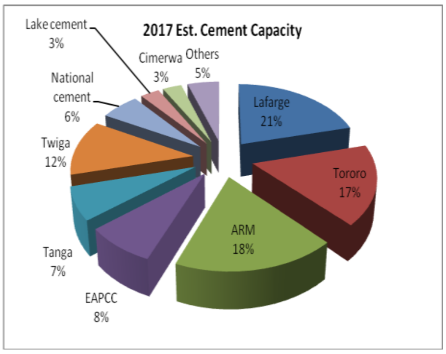


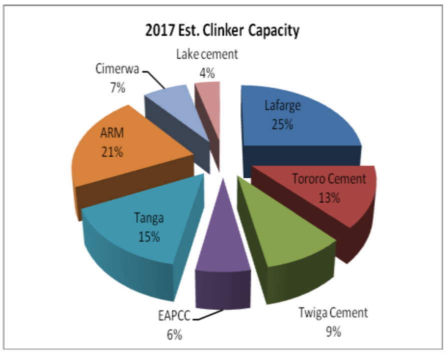


Sources: Various industry players reports

By the end of 2013, Bamburi controlled a market share of 37.0% (clinker capacity) and 27.0% (cement capacity).

Although market share is expected to come down in the next 3 years, we still expect it to be the leader in clinker and cement production capacity, as indicated below.





Leveraging on the parent company

Merits of the parent company

The parent company, Lafarge is one of the largest cement manufacturers in the world. Through Fincem Holding Ltd and Kencem Holding Ltd, it owns 58.6% of BCL. Bamburi benefits immensely from the parent company in areas such as;

- *Industrial support:* The parent company has technical centres that assist Bamburi cement in product innovation and development, installation of efficiently running plants, extracting costs. The financial strength, years of experience, and exposure in over 58 markets provides the Group with the relevant skill and expertise in terms of Research & Development (R&D), and the ability to innovate products suited for various markets.

- *Brand strength:* Being the largest in the world, with years of experience and exposure in over 58 markets, the Lafarge brand is well known across the world. Due to this, most of the large contractors, especially foreign contractors carrying out big ticket projects across the East African region find it more reliable to work with Bamburi because of the parent company's brand strength.

- *Quality assurance:* Lafarge has invested heavily in product quality, and has the benefit of experience aligned to the best international standards. Thus it's easier for it to guarantee consistency in quality.

Low on leverage/high on capital

Low debt levels, rich in cash

Cement companies continue to increase their production capacities. Over the last 5 years, ARM relied heavily on debt to expand. Bamburi Cement on the other hand had very little debt on its balance sheet.

Lafarge plans to expand its sub-Saharan Africa capacity from the current 20 million tonnes to 30 million tonnes in the next 4 years. Some of this expansion will be in Kenya and Uganda.

Although the company has significantly high levels of cash compared to its peers, we expect to see some debt hit the balance sheet in the near term. Similar expansion was carried out in Uganda at a debt: equity ratio of 35%:65%. We expect similar ratio to be used in the planned expansion.

	D/E*	Cash (KES mn)*	Retained Earnings (KES Bn)*
BAMBURI	2.80%	8,800	18.9
ARM	210.50%	320	4.9
EAPCC	129.70%	49	2.3

*2012 figures

As depicted above, Bamburi, together with the parent company possesses the financial muscle and increases the company's flexibility to capture emerging opportunities.

Compared to ARM Cement, Bamburi's profitability has experienced minimal volatility, due to relatively lower debt in the capital structure. As a result, returns to equity holders have been comparatively higher.

Export market

Transportation of cement is very cumbersome and expensive over long distances. Bamburi's plant in Mombasa is therefore strategically positioned for its export market to countries such as Indian Ocean Islands, Reunion, Mayotte and Seychelles. Bamburi also exports to Uganda, South Sudan and Congo.

Export market to continue being a key revenue growth driver in the medium term

Not only are there current and emerging opportunities in Kenya, we see a growing export market in the region, which are relatively less developed compared to Kenya. We have virgin countries such as the newest African nation (South Sudan) and the stabilizing Somalia. In addition, the surrounding countries such as Uganda, Tanzania, Burundi, Congo and Rwanda are increasing their investments in infrastructure thus increasing export market opportunities.

The cement prices and margins in these markets are relatively high compared to Kenya. Prices range between USD 160-180 in Uganda, USD 180 – 200 (Rwanda) and USD 200 -220 per tonne (Congo) compared to USD 120 – 130 in Kenya.

Innovation/Re-launch of Powercrete

Product innovation

The company recently announced the re-launch of its highly specialized cement product suitable for constructing big ticket projects that require significant strength and durability. There is growing demand for this product across the region as countries embark on infrastructural growth and development.

Management expects this product to contribute about 10.0% to the company's top line.

Time to increase capacity?

Capacity increase

The parent company, during the release of its FY2013 results announced a 10 million tonne expansion in sub-Saharan Africa over the next 4 years. Management expects part of the capacity increases to be in Kenya and Uganda.

According to ARM Cement's analysis, the industry is expected to increase cement and clinker capacity by 26.5% and 50.0% respectively, by 2017. Bamburi's current cement production capacity is 3.2 million tpa. Clinker capacity is 1.5 million tpa

We expect Bamburi to increase capacity in line with growth of the industry, alignment with group's expansion program and positioning to capture emerging opportunities. This is evidenced by the company's decision to re-launch its Powercrete product.

Contractors market

The contractor's market

Big contractors are keen on quality and reliability. According to some industry players, this market accounts for about 10.0%-15.0% of cement consumption. Bamburi sells directly to contractors and this revenue source accounts for about 10.0%-15.0% of the company's sales volume.

The margins are relatively high (about 80.0% - 110.0%) compared to 40.0%-70.0% on the normal products. Direct selling also increases margins because costs on middle-men are greatly reduced.

With the slated big ticket projects that are being done by foreign contractors, we expect Bamburi, because of the strong brand name of the parent company, to control a larger market share.

Financial Performance

We see a recovery in the top line in 2014

Recovery in top-line: Following stabilization of its key export markets, we expect Bamburi's top line growth to recover in 2014 (to the levels of 2012). As a result, we forecast a top line growth of 10.2% in FY2014.

In addition, management indicated plans to increase production capacities in the region. We expect this to contribute to the growth in the top-line in the medium term, as capacity expansion takes a relatively shorter time compared to setting up new plants.

BCL needs to put more focus on the clinker and energy costs

Clinker & energy costs key in improving margins: The 2 key costs (which have not changed much over the years), in the company's production process are energy costs and the cost of clinker importation.

Bamburi currently has a clinker production capacity of 1.9 million tpa in the region. Throughout our review period, Bamburi imported clinker. In 2013, it imported close to 200,000 tonnes of clinker. We expect the intended expansion plans to entail increases in the production capacity of clinker

Energy costs grew by 107.8% between 2009 and 2012. This is an area of concern, if management is to improve production efficiency. Management indicated a raft of measures geared towards seeing these cost lines coming down. Alternative energy sources indentified include use of biomass and pet-coke.

Financial Performance Summary

KES Million	2009	2010	2011	2012	2013*	2014F	2015F	2016F
Revenues	29,994	28,075	35,884	37,491	33,928	37,393	41,649	44,417
Y-o-y growth	*9.2%*	*-6.4%*	*27.8%*	*4.5%*	*-9.5%*	*10.2%*	*11.4%*	*6.6%*
COGS	(19,179)	(18,457)	(25,920)	(27,635)	(26,281)	(28,044)	(31,237)	(33,312)
Y-o-y growth	*28.6%*	*-3.8%*	*40.4%*	*6.6%*	*-4.9%*	*6.7%*	*11.4%*	*6.6%*
Gross Profit	10,815	9,618	9,964	9,856	7,647	9,348	10,412	11,104
EBITDA	8,568	8,297	9,215	8,163	6,272	7,735	8,506	9,012
Y-o-y growth	*28.9%*	*-3.2%*	*11.1%*	*-11.4%*	*-23.2%*	*23.3%*	*10.0%*	*5.9%*
EBIT-*excluding exceptionals*	7,732	7,282	7,954	6,841	5,242	6,697	7,460	7,956
PBT	9,596	7,564	8,466	7,176	5,516	6,614	7,368	7,814
Y-o-y growth	*96.3%*	*-21.2%*	*11.9%*	*-15.2%*	*-23.1%*	*19.9%*	*11.4%*	*6.1%*
PAT	6,649	5,089	5,243	4,416	3,468	4,158	4,633	4,913
Gross Profit Margins (GPM)	36.1%	34.3%	27.8%	26.3%	22.5%	25.0%	25.0%	25.0%
Net Profit Margin (NPM)	23.2%	18.9%	16.3%	13.0%	10.8%	11.8%	11.8%	11.7%

*some estimates

Ration Analysis

RETURN RATIOS	2009	2010	2011	2012	2013*	2014F	2015F	2016F
ROaE (%)	37.1%	24.9%	25.6%	17.7%	12.1%	14.2%	14.9%	15.0%
ROaA (%)	23.1%	16.2%	17.5%	12.8%	9.2%	11.1%	11.0%	10.7%
ACTIVITY RATIOS								
Inventory turnover	4.1	4.7	6.6	5.6	8.4	25.8	16.8	15.0
Receivables turnover(x)	12.5	15.2	22.8	23.6	28.4	44.0	38.7	37.9
Average collection period (days)	29.3	24.0	16.0	15.5	12.9	8.3	9.4	9.6
Payables turnover (x)	4.6	3.4	6.5	4.7	10.5	8.5	7.8	6.9
Days payable outstanding	78.6	107.9	55.8	78.1	34.9	43.0	46.9	52.7
LIQUIDITY RATIOS								
Current Ratio (x)	2.6	1.7	2.6	2.3	4.0	2.6	2.6	2.3
Quick Ratio (x)	1.7	1.3	1.8	1.5	3.7	2.3	2.2	1.9
LEVERAGE RATIOS								
Debt/Equity Ratio (x)	0.2	0.1	0.1	0.0	0.0	0.1	0.1	0.1
Debt/Capital Ratio (x)	0.2	0.1	0.1	0.0	0.0	0.1	0.1	0.1
Debt/Total assets Ratio (x)	0.1	0.1	0.0	0.0	0.0	0.1	0.1	0.1
COVERAGE RATIOS								
EBIT/Interest Ratio (x)	552.3	80.0	21.3	27.3	43.2	13.0	13.0	13.0
EBITDA/interest Ratio (x)	612.0	91.2	24.6	32.5	51.6	15.0	14.8	14.7

Sources: Company reports, FIB analysis

Valuation

We have used an equal weighting of the P/E multiple valuation and the EV/EBITDA multiple valuation, as shown below.

P/E Multiple Valuation	
Current Market Price (11.04.14)	195.00
Trailing EPS: FY2013	9.55
Trailing P/E	20.41
Forecasted EPS: FY2014	11.46
Target Price	**233.84**

EV/EBITDA Multiple Valuation	
Market Cap-KES '000,000	70,777
Market value of total debt (KES)-FY2013e	727
Minority interest	2,580
EV	**74,085**
EBITDA-FY2013E	6,272
EV/EBITDA-FY2013E	11.8
Forecasted EBITDA-FY2014F	7,735
Forecasted EV	**91,357**
Less:	
MV of Debt-FY2014F	3,963
Minority interest	2,944
Forecasted Market Cap	84,451
Target Price	**232.65**

Valuation	Target Price	Weight	Value
P/E	233.84	0.5	116.92
EV/EBITDA	232.65	0.5	116.32
Value per share			**233.24**
Upside Potential			**19.6%**

Recommendation

We initiate coverage on Bamburi Cement with a **BUY recommendation** on the stock, with a target price of KES 233.24, providing a 19.6% upside potential from the current share price level of KES 195.00 (11.04.2014).

The stock is trading at projected forward multiples of 17.02 (P/E) and 9.58x (EV/EBITDA).

RECOMMENDATION: NEUTRAL

Bloomberg Ticker: EAPC KN

Share Statistics

Fair Value (KES)	**85.39**
Price (KES)-11.04.2014	97.00
Issued shares (m)	90
Market cap (KES bn)	8.7
Market cap (USD m)	100.9
Year end	June
Free float (%)	58.2%

KES/USD=86.56

Shareholding (June 2013)

NSSF	27.0%
GoK-PS to Treasury	25.3%
Cementia Holdings (Lafarge)	14.6%
Nairobi Nominees Ltd A/C Bcl	12.5%
Associated International Cement Ltd	14.6%
Kestrel Capital Nominees Ltd A/C Pauline Groom	0.4%
Kestrel Capital Nominees Ltd A/C 006	0.8%
Kestrel Capital Nominess Ltd A/C 007	0.6%
Kenya Commercial Bank Nominees Ltd A/C 885	0.5%
Nairobi Nominees Ltd A/C Msv	0.2%
Others	3.4%
Total*	100.0%

EAST AFRICAN PORTLAND LIMITED (EAPCC)

Source: Bloomberg

Investment Summary

We initiate coverage on EAPCC with a **NEUTRAL recommendation** on the stock, with a target price of KES 85.39, providing a 12.0% downside potential from the current share price level of KES 97.00 (11.04.2014).

The stock is trading at projected forward multiples of 17.03 (P/E) and 13.19x (EV/EBITDA).

In our review of the company, we looked at the following:

Where is the value? Holding other factors constant, if EAPCC was to grow market cap to the levels of ARM, price appreciation would be 379.4% from the current level of KES 97.00 (11.04.14). We believe that a significant upside can be unlocked. But does the company in its current form have what it takes to get there?

…board wrangles: In late December 2011, board disagreements led to an industrial action by unionisable staff forcing the company to stop operations for over 3 weeks.

…promising top-line growth but volatile trend on bottom line: The trend in the bottom line has not been impressive. We attribute this to the various disruptions the company has encountered in the recent past, slowing the smooth running of the business.

Takeover candidate? There are speculations that EAPCC may be a acquired by Dangote Cement. We believe that acquiring EAPCC and steering it in the direction would unlock the inherent value for the shareholders

Erosion of shareholder value: There has been no value addition in terms of growing shareholder value in the recent past.

Brief History

East African Portland Cement Company Limited (EAPCC) was incorporated in Kenya in 1933. It set its first factory at Industrial area with a capacity of 60,000 tpa of cement. It began construction of its Athi River plant in December 1956, which was later commissioned in 1958, raising cement production to 120,000 tpa.

In 1974, a new rotary wet kiln was commissioned, raising capacity to 300,000 tpa. In 1979, a fourth mill was added, raising capacity to 340,000 tpa.

In 1996, a brand new kiln was commissioned and a new mill, a bigger limestone crusher and a pre-blending system was added, doubling capacity to 600,000 tpa.

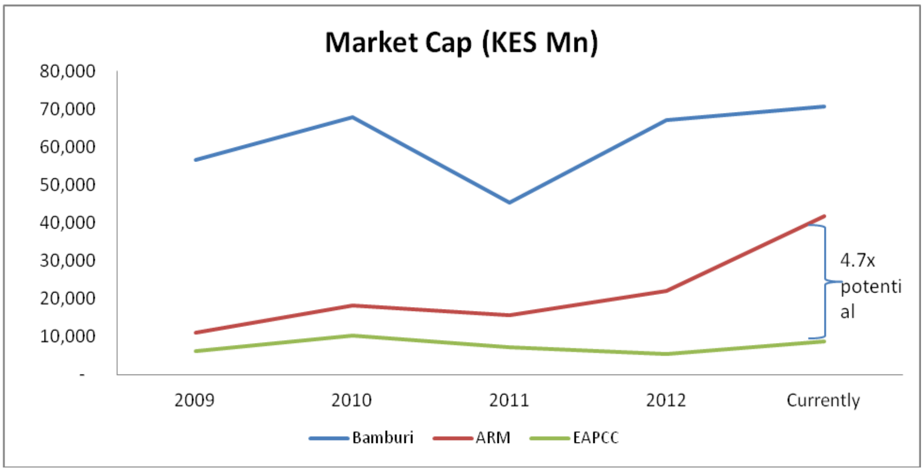
In 2009, a new mill was commissioned which increased capacity to 1.3 million tpa.

Currently, the government owns 52.3% while Lafarge owns 41.8%.

Where is the value?

Where do we see value?

At a time when the market cap of the other listed cement companies grew, EAPCC's market cap declined by 38.6%.



Does the company in its current form have what it takes…?

Holding other factors constant, if EAPCC was to grow market cap to the levels of ARM, price appreciation would be 379.4% from the current level of KES 97.00 (11.04.14). We believe that a significant upside can be unlocked. But does the company in its current form have what it takes to get there?

…board wrangles

Board wrangles disrupting smooth business operations

EAPCC has been plagued with management wrangles, from the board level, in the recent past. In late December 2011, board disagreements led to an industrial action by unionisable staff, which forced the company to stop operations for over 3 weeks (from January 2012). It took about 3 months to restore full operations.

Most recently, another board wrangle erupted following the appointment of Mr Bill Lay as the new chairman of the board by the President.

However, the court went ahead to annul the appointment citing lack of following the due process. The government had also attempted to increase the number of board members from the current 7 to 11, to increase its voting power.

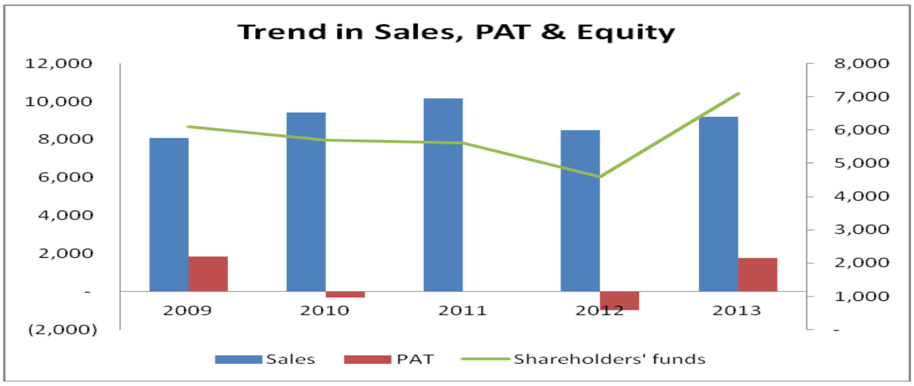
The disruption resulted in a 19.7% drop in cement sales in 2012

This disruption from the board level has interfered with the smooth running of the business. During the December 2011 unrest, the company's sales volume dropped by 19.7% from 900,000 metric tonnes (2011) to 723,000 metric tonnes (2012).

Because of the government holding the majority stake in the company, appointments in the senior management positions have become political. We believe that this structure has interfered with the smooth running of the company, hampering aggressive growth and thus not improving the value of other shareholders.

…promising top-line growth but volatile trend on bottom line

Volatile bottom-line

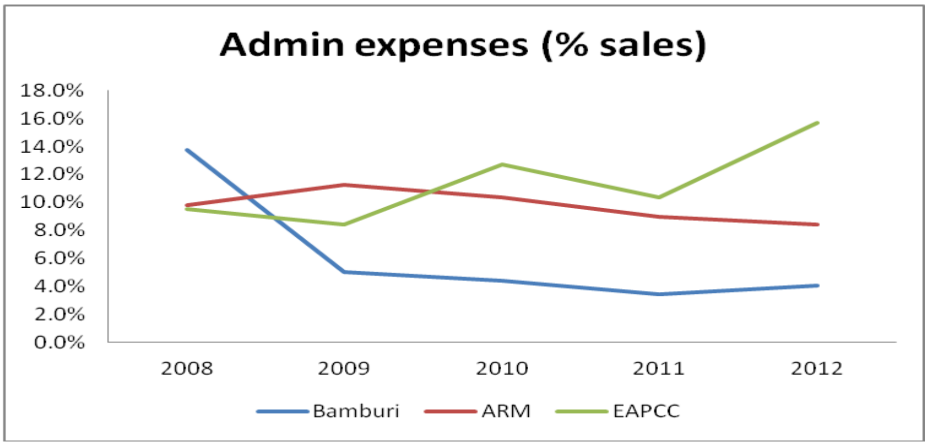


Over the last 5 years (FY2009-FY2013), EAPCC registered top line growth in the first 3 years (FY2009-FY2011), a 16.4% dip in the 4th year (FY2012) before an 8.3% recovery in FY2013. The dip in FY2012 was attributed to fraudulent activities which resulted in loss of cement.

In our view, the steady top line growth is a clear indication of growing industry opportunities.

The trend in the bottom line has not been impressive. We attribute this to the various disruptions the company has encountered in the recent past, slowing the smooth running of the business.

When Bamburi and ARM cement managed to reduce their administration expenses, EAPCC's admin related expenses went up as shown.



In addition, apart from what we consider as a blip in FY2013 (where bottom-line was boosted by a KES 730 million gain in fair value of land), EAPCC never grew shareholders' funds.

Management outlines a 5 year strategy, will it achieve it?

As a result, the company has been finding it challenging to grow market share, which dropped from 24.0% (2012) to the current 20.0%

Under its 2011-2016 strategic plan, management targets:

- To grow market share to 37.0% by 2016
- To cut operating expenses via efficiency in use of power and raw materials
- To put in new management team to drive the company to the next level
- To invest KES 1.8- 2.0 billion in kiln upgrade to boost clinker production by 150,000 tpa (to 1.5 million tpa), install pre-cast plant for production of paving blocks to diversify and increase revenue sources base, introduce a 3rd packaging line that is expected to increase cement dispatch by 400,000 mt.
- To optimize funding structure to reduce finance costs and increase flexibility in financing model
- To acquire new reserves in Kitui and Kajiado counties
- A new grinding mill by 2014, to increase cement production capacity to 2 million tpa by 2015.

Based on the current structure, and the way the company is run, we are not too optimistic about the ability of the company to achieve the stated objectives within the stipulated timelines.

Or is it just a good take over candidate….?

Takeover candidate?

At the point of approving the privatization of EAPCC in 2008, the following are some of the objectives the government had;

- Enhancement of transparency and corporate governance
- Shareholding broadening in the economy
- Development of capital markets in Kenya
- Raising of resources to support the government budget

With the announcement of Dangote's plans of investing KES 34.9 billion (USD 403 million) in a cement factory, there are speculations that EAPCC may be a company that he may acquire. Dangote's local subsidiary (Dangote Quarries Kenya Ltd) applied for an exclusive prospecting license in Kilifi County.

We believe that acquiring EAPCC and steering it in the direction would unlock the inherent value for the shareholders.

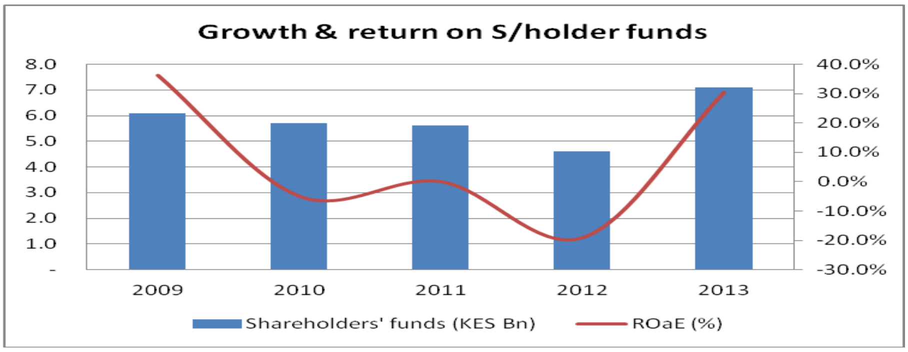
Financial Performance

Recorded worst margins over the review period

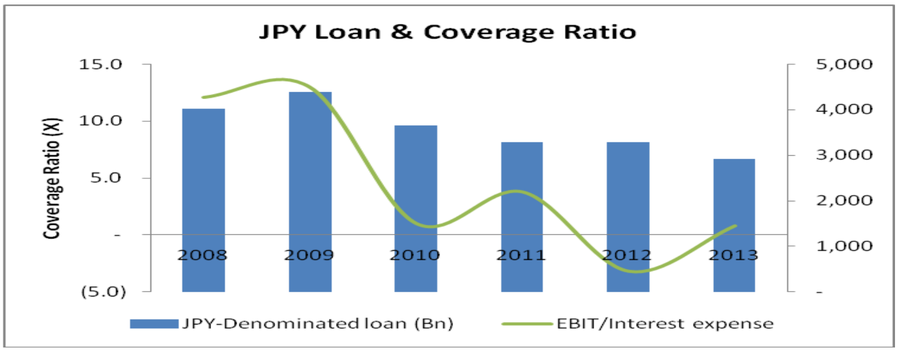
Lowest margins: As indicated in the charts on margins, EAPCC recorded the lowest margins over the years. Only in FY2013 did the margins improve, better than the other 2 cement firms, mainly because of a revaluation of land. In the company's current form, we believe margins will continue to underperform compared to peers.

Eroded shareholder value

Erosion of shareholder value: As depicted in the figure below, we again see a significant spike in the growth of shareholders' funds as well as the return on average equity in FY2013. Prior to that, EAPCC did not improve the return on shareholders' funds. We expect growing this to be a challenge in case of business disruptions.



Healthy debt levels? Although EAPCC has managed to reduce its Japanese Yen denominated loan, debt coverage ratios declined over the same period. The outstanding debt as at FY2013 was JPY 2.9 billion (with 50% hedged in a JPY/USD currency swap).



Little room for additional debt

A sustained poor profitability combined with the planned expansion (that might force it to take on more debt) and any significant depreciation of the Kenya shilling against the U.S Dollar and the Yen may depress the ratios further. At current levels of profitability, we are not confident that EAPCC can take on more debt.

1H2014 Results Analysis

KES Mn	1H2013	1H2014	% Change
Revenue	4,549,385	4,567,292	0.4%
Cost of sales	(3,204,266)	(3,247,919)	1.4%
Gross Profit	**1,345,119**	**1,319,373**	**-1.9%**
Other operating income	42,447	126,428	197.8%
Admin. and selling expenses	(1,000,298)	(1,260,462)	26.0%
Profit from Operations	**387,268**	**185,339**	**-52.1%**
Finance income	158,750	130,630	-17.7%
Finance costs	(169,498)	(144,939)	-14.5%
Profit Befeore Tax	**376,520**	**171,030**	**-54.6%**
Income tax credit/(expense)	(49,327)	12,430	-125.2%
Net Income	**327,193**	**183,460**	**-43.9%**

Revenue grew marginally by 0.4%, characterized by a combination of 3.0% increase cement volumes and a 2% product price reduction.

Cost of goods sold rose by 1.4%, resulting, resulting in a 1.9% drop in gross profit margin.

We expect a fairly flat growth in the top line of 0.5% (2014), as the company struggles to recover and maintain a consistency growth in revenues.

Financial Performance Summary

KES Million	2009	2010	2011	2012	2013	2014F	2015F	2016F
Revenues	8,101	9,409	10,172	8,508	9,211	9,259	9,844	10,498
Y-o-y growth	*12.4%*	*16.1%*	*8.1%*	*-16.4%*	*8.3%*	*0.5%*	*6.3%*	*6.6%*
COGS	(5,563)	(7,376)	(7,803)	(7,391)	(6,878)	(6,759)	(7,186)	(7,664)
Y-o-y growth	*15.1%*	*32.6%*	*5.8%*	*-5.3%*	*-6.9%*	*-1.7%*	*6.3%*	*6.6%*
Gross Profit	2,538	2,033	2,369	1,117	2,333	2,500	2,658	2,835
EBITDA	1,491	483	938	(332)	856	1,016	1,068	1,101
Y-o-y growth	*14.5%*	*-67.6%*	*94.3%*	*-135.4%*	*-357.8%*	*18.6%*	*5.1%*	*3.2%*
EBIT-excluding exceptionals	1,086	82	479	(914)	248	403	429	457
PBT	1,882	(339)	(119)	(1,033)	1,419	638	629	692
Y-o-y growth	*162.8%*	*-118.0%*	*-64.8%*	*767.6%*	*-237.4%*	*-55.0%*	*-1.5%*	*10.0%*
PAT	1,834	(292)	2	(973)	1,775	513	505	556
Gross Profit Margins (GPM)	31.3%	21.6%	23.3%	13.1%	25.3%	27.0%	27.0%	27.0%
Net Profit Margin (NPM)	22.6%	-3.1%	0.0%	-11.4%	19.3%	5.5%	5.1%	5.3%

Ratio Analysis

RETURN RATIOS	2009	2010	2011	2012	2013	2014F	201F	2016F
ROaE (%)	36.2%	-5.0%	0.0%	-19.0%	30.4%	7.0%	6.5%	6.7%
ROaA (%)	17.4%	-2.4%	0.0%	-7.1%	11.8%	3.0%	2.8%	3.0%
ACTIVITY RATIOS								
Inventory turnover (x)	6.1	7.4	5.7	4.5	3.5	3.1	3.1	3.2
Receivables turnover (X)	13.27	13.89	13.13	12.11	13.07	8.87	7.77	7.79
Average collection period(days)	27.5	26.3	27.8	30.1	27.9	41.1	47.0	46.8
Payables turnover (x)	5.0	5.8	5.3	5.1	4.5	3.4	3.9	4.8
Days payable outstanding (days)	73.12	62.46	69.10	71.99	81.99	106.99	94.46	76.22
LIQUIDITY RATIOS								
Current Ratio (x)	2.1	1.6	1.5	1.0	1.1	1.2	1.4	1.7
Quick Ratio(x)	1.5	0.9	0.7	0.3	0.4	0.6	0.7	0.9
LEVERAGE RATIOS								
Debt/Equity Ratio(x)	0.5	0.6	0.9	1.3	0.7	0.6	0.6	0.6
Debt/Capital Ratio(x)	0.3	0.4	0.5	0.6	0.4	0.4	0.4	0.4
Debt/Total assets Ratio(x)	0.3	0.3	0.4	0.4	0.3	0.3	0.3	0.3
COVERAGE RATIOS								
EBIT/Interest Ratio(x)	13.0	1.0	3.8	(3.2)	0.8	1.1	1.1	1.2
EBITDA/interest Ratio(x)	17.8	5.9	7.4	(1.2)	2.7	2.7	2.8	2.8

Sources: Company reports, FIB analysis

Valuation

We have used an equal weighting of the P/E multiple valuation and the EV/EBITDA multiple valuation, as shown below.

P/E Multiple Valuation

Current Market Price (11.0.14)	97.00
Trailing EPS-Adjusted: FY2013	11.61
Trailing P/E	8.35
Forecasted EPS: FY2014	5.70
Target Price	**47.56**

EV/EBITDA Multiple Valuation

Market Cap-KES '000	8,730,000
Market value of total debt-KES FY2013	4,669,455
Minority interest	-
EV	**13,399,455**
EBITDA-FY2013	856,343
EV/EBITDA-FY2013	15.6
Forecasted EBITDA-FY2014	1,016,036
Forecasted EV	**15,898,212**
Less:	
MV of Debt-FY2014	4,808,036
Minority interest	-
Forecasted Market Cap	11,090,177
Target Price	**123.2**

Valuation	Target Price	Weight	Value
P/E	47.56	0.5	23.78
EV/EBITDA	123.22	0.5	61.61
Value per share			**85.39**
Downside Potential			**-12.0%**

Recommendation

We initiate coverage on EAPCC with a **NEUTRAL recommendation** on the stock, with a target price of KES 85.39, providing a 12.0% downside potential from the current share price level of KES 97.00 (11.04.2014).

The stock is trading at projected forward multiples of 17.03 (P/E) and 13.19x (EV/EBITDA).

COMPARABLE ANALYSIS

Company	Price (USD)	P/E(x)	P/B(x)	EV/EBITDA(x)*	Div Yield (%)	ROaE*	GPM*	EBITDA Margin*	NPM*
Dangote Cement (Nigeria)	1.46	19.83	7.35	13.27	2.98	43.80%	60.40%	58.30%	50.90%
Ashakacem (Nigeria)	0.10	11.91	0.75	4.16	2.41	6.50%	38.10%	29.60%	14.30%
Lafarge WAPCO (Nigeria)	0.66	11.25	3.42	6.7	2.87	23.60%	36.80%	35.20%	16.70%
Tanga (Tanzania)	1.52	4.25	1.09	1.89	4.03	28.60%	30.80%	23.70%	14.40%
Twiga (Twiga)	1.51	7.19	2.08	4.02	7.52	30.80%	49.10%	41.40%	24.70%
Lafarge Zimbabwe	0.75	11.24	1.53	4.9	7.52	16.00%	n/a	16.20%	6.60%
Lafarge Zambia	4.28	20.92	5.68	2.13	3.98	34.90%	61.80%	45.60%	25.10%
PPC (S.Africa)	2.89	16.97	10.17	8.42	5.13	79.40%	34.50%	30%	11.50%
ARM (Kenya)	***0.98***	***31.00***	***5.09***	***13.93***	***0.71%***	***18.80%***	***28.30%***	***22.50%***	***10.90%***
Bamburi (Kenya)	***2.25***	***20.41***	***2.38***	***7.56***	***5.68%***	***17.70%***	***26.30%***	***21.80%***	***13.00%***
EAPC (Kenya)	***1.12***	***8.35***	***0.54***	***NM***	***0.77%***	***-19.90%***	***13.10%***	***-3.90%***	***-11.40%***

Source: Bloomberg, company reports, FIB database. *2012

Our comparable analysis reveals that the Kenyan companies are trading at relatively higher trailing price multiples compared to other comparable companies in Africa. We attribute this to the expected high industry growth rates considering that the per capita consumption levels (as alluded to in the report) are lower. Investors are willing to pay a premium for the growth potential.