DYER & BLAIR INVESTMENT BANK
COMPANY UPDATE

Founder Member of the Nairobi Securities Exchange

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INVESTMENT BANK
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EAST AFRICAN BREWERIES: 1H20 EARNINGS UPDATE

Dear all,

East African Breweries released its 1H20 results, recording a 9.1% y-o-y increase in Profit after Tax (PAT) to KES 7.2 BN. Basic earnings per share (EPS) edged up 7.4% y-o-y to KES 7.00 per share. Trailing EPS stands at KES 15.32 per share. The Board recommended an interim dividend of KES 3.00 per share, representing a 20.2% y-o-y increase from the KES 2.50 interim dividend reported in the previous period.

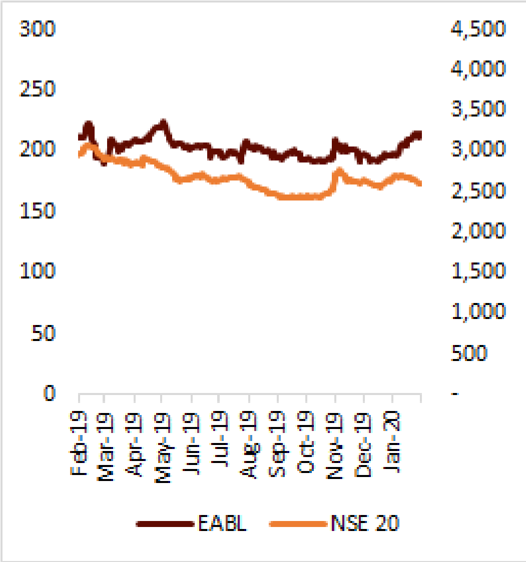
Key Highlights:

- **Gross sales advanced by 7.0% y-o-y to KES 81.9 BN in 1H20** following a 5.6% growth in volume to 7.5 EUs. Volume growth was spurred by Senator Keg and mainstream spirits in Kenya and the continued growth of the Serengeti brand in Tanzania. The performance of these segments offset the negative impact of mainstream spirits in Uganda and bottled beer in Kenya as a result of up-pricing due to the excise increase. Excise duties, on the other hand, rose 4.0% y-o-y to KES 36.0 BN, representing 44.0% of the group's gross sales.

- **Gross margin edged up by 152 bps to 47.6% in 1H20.** Gross profit advanced 13.9% y-o-y to KES 21.8 BN courtesy of a 10.3% y-o-y growth in revenue to KES 45.9 BN and a 7.2% y-o-y rise in cost of sales to KES 24.0 BN in line with our forecasts. Net sales grew owing to the improved mix in Uganda and Tanzania. Cost of sales were partly driven by the opening of the Kisumu brewery which is currently not at full utilization thus operating at a relatively high cost point. Additional productivity savings of KES 1.5 BN in cost of sales from lower distribution costs, process loss reduction, procurement and the local sourcing initiative offset the increase.

- **Profit before income tax (PBT) rose 9.1% y-o-y to KES 10.6 BN** in 1H20 following an 18.9% y-o-y increase in total costs to KES 11.2 BN. Selling and distribution costs went up 7.0% to KES 3.9 BN y-o-y courtesy of the company's investment behind its brands. On the other hand, administrative costs rose 9.0% y-o-y to KES 4.5 BN owing to additional headcount in sales.

EABL: 52 WEEK PRICE PEFORMANCE



(Source: NSE, DBIB Research)

Price Return	Absolute Return	Excess Return
3 months (%)	2.1	7.0
6 months (%)	5.0	4.5
12 months (%)	1.7	14.5

KEY METRICS

Recommendation	BUY
Current price (KES)	214.25
Target price (KES)	230.83
YTD Return (%)	7.9
52 week low (KES)	190.50
52-week high (KES)	224.25
Issued Shares	790,774,356
Market Cap (KES '000')	162,108,743

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- **Net borrowings edged up 10.0% y-o-y to KES 26.2 BN** as a result of continued investment in capital expenditure and the implementation of IFRS 16. The group reported lease liabilities totalling to about KES 1.5 BN as borrowings in the balance sheet as per the new accounting standards. Upon reviewing the capital structure, the group's net debt to EBITDA target ratio changed from between 1.0 and 1.25 to between 0.75 to 1. Finance costs went up 9.0% y-o-y to KES 1.9 BN as in the prior year, the group had capitalized interest that they had incurred from the loans used to finance the Kisumu brewery. This was partially offset by the reduction of the effective interest rate from 11.7% to 11.1% that will have a long term impact on medium term loan repayments going forward.

- **Income tax expense** saw a 9.1% y-o-y upswing to KES 3.4 BN. In 1H18, the group had benefited from a capital allowance deduction available from the investment of the Kisumu brewery plant.

- **Operating cash conversion saw a 2600 bps y-o-y drop to 102.0% in 1H20.** Management aims to maintain this high level of cash management through stricter working capital management.

- **Capital expenditure shrunk by 8.3% y-o-y to KES 4.4 BN as the construction of the new Kisumu plant is currently in finalization.** CAPEX for the period was driven by the expansion in Uganda on both beer and spirit lines, the capacity expansion in Tanzania (SBL) on beer and the group's continued investment in returnables and coolers across all markets.

- **Upon review of the dividend policy, the Board decided to keep the dividend payout level unchanged.** However, there was a change in the calculation from 63.0% of profit after tax to 70.0% of profit attributable to equity holders of the company (excluding non-controlling interest).

Positive mix across its brand categories: All the eight focus categories in the brewer's portfolio were in the green.

- **The beer portfolio**: Premium beer was up 8.0% y-o-y this period recording an improvement from the 3.0% y-o-y growth recorded in 1H19. Mainstream beer saw a 10.0% y-o-y growth, significantly below the 17.0% y-o-y growth delivered in 1H19. This decline is attributable to the affordability or lack there-of of bottled beer following the up-pricing of various SKUs in 2019 following the increase in excise taxes in Kenya. The value segment recorded 11.0% y-o-y growth which is rather contrastable with the 16.0% y-o-y growth in 1H19. Management tagged this growth to senator keg following the commercialization of the Kisumu plant and the improved RTC network. The RTD segment recorded a 3.0% y-o-y growth in 1H20, an improved position from the 1.0% y-o-y growth recorded in 1H19.

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- **The spirits portfolio:** The reserve segment saw a 13.0% y-o-y growth, following the 54.0% y-o-y growth recorded in 1H19. The premium segment was up 14.0% y-o-y, recording a tremendous improvement from the segment's 3.0% y-o-y decline in the previous period. Mainstream spirits grew by 9.0% y-o-y, a notch lower than the 29.0% y-o-y growth recorded in the previous period. Value spirits recorded a 12.0% y-o-y growth, up from the 2% y-o-y decline recorded in 1H19.

- **The innovation category:** Innovations delivered a 50.0% y-o-y growth in the Kenyan market, way above the 18.0% y-o-y growth posted in 1H19. The Tanzanian market saw a 25.0% y-o-y growth, below the 45.0% y-o-y growth posted in the previous period. The Ugandan market, on the other hand, recorded a 16.0% y-o-y decline in its innovation numbers, a deterioration from the 10.0% y-o-y growth that was recorded in 1H19.

Improved regional performance: Healthy growth across all the main regions

- **Kenya**: EABL's dominant market contributed 71.0% to the brewer's overall performance. Net sales in the region rose 8.0% y-o-y in 1H20, slightly lower than the 12.0% y-o-y growth recorded in 1H19. Put into perspective, this is a positive trajectory as this market had recorded no growth in 1H17 and a 4% y-o-y decline in net sales in 1H18. In 1H20, innovations were the star of the market recording 50.0% y-o-y growth. Senator Keg recorded 21.0% y-o-y growth supported by the increased capacity unveiled by the new plant and the improved RTC initiatives. Mainstream spirits grew 17.0% y-o-y whilst scotch recorded 23% y-o-y growth. Bottled beer was in the red, recording a 1.0% decline owing to the 5.2% increase excise taxes in 1H20. Border delays constrained the growth of spirits (11.0% y-o-y growth)

- **Tanzania:** The market recorded a 19.0% y-o-y growth in net sales courtesy of the Serengeti brand which grew 27.0% y-o-y, Guinness which delivered 42% growth in premium beer, Pilsner which saw 14.0% y-o-y growth and Smirnoff x1 which drove the 42% growth in mainstream spirits. Since 1H17, this region has managed to record growth in net sales year-on year i.e. a 7% down in 1H17, 28.0% up in 1H18, 26.0% up in 1H19. Overall contribution has also edged up marginally over time from 9.0% in 1H17, 11.0% in 1H18 and 12.0% in 1H19 to 13.0% in 1H20. Management is confident that the market bears a lot of potential for growth.

- **Uganda:** Net sales advanced by 10.0% y-o-y in 1H20, slightly shy of the 12.0% y-o-y growth in 1H19. In 1H18, net sales had taken a 0.3% y-o-y decline whilst in 1H17, the market had recorded a 7.0% y-o-y growth in net sales. The reserve segment grew 65.0% in 1H20 compared to the 6.0% growth recorded in 1H19. Spirits recorded a 1% growth in 1H20, significantly lower than the 16.0% growth recorded in 1H19 following the sachet ban that was enforced in late 2019. Tusker Lite and Guinness delivered 27.0% growth in premium beer.

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Going forward: We foresee strong topline performance supported by the below stated factors. First and foremost, we expect Senator Keg to deliver strong double digit growth on the back of full utilization of the Kisumu brewery plant. Following the recent excise duty amendment on 90.0% remission on beer made from local agricultural produce, the brewer will enjoy this tax saving on Keg produced at the Kisumu plant thus ameliorating net sales further. Secondly, we expect a revival in bottled beer growth that was stifled by the up-pricing of various SKUs following the excise increase. Thirdly, as the group is committed to expand its repertoire with market sought innovations, we expect to this segment to deliver strong double-digit growth across the region. As the group navigates the sachet ban environment in Uganda, we expect mainstream spirits to pick up significantly towards the end of the year. Following the capacity expansions in Uganda and Tanzania, we expect that full utilization of these assets will lead to double-digit growth in these markets.

On a trailing basis, East African Breweries is trading at P/E and P/B multiples of 14.0x and 9.5x respectively. On a peer-to-peer basis, the P/E and P/B multiples average at 18.7x and 3.6x respectively. The counter's ROE ranks the highest in the bourse at 67.6% whilst its ROA stands at 13.0%. We therefore maintain our **BUY** recommendation.

INCOME STATEMENT

	1H20	1H19	1H18	1H17	1H16	y-o-y ch (%)
Revenue	45,856	41,574	36,800	35,156	37,514	10.3
Cost of sales	(24,013)	(22,402)	(20,831)	(18,556)	(20,085)	7.2
Gross profit	21,843	19,172	15,969	16,600	17,429	13.9
Total costs	(11,241)	(9,453)	(8,686)	(8,567)	(9,507)	18.9
Profit before income tax	10,602	9,719	7,283	8,033	7,922	9.1
Income tax expense	(3,393)	(3,110)	(2,331)	(2,448)	(2,438)	9.1
Profit after tax (continuing operations)	7,209	6,609	4,952	5,585	5,484	9.1
Profit from discontinued operation	-	-	-	-	2,249	na
Profit after tax (for the year)	7,209	6,609	4,952	5,585	7,733	9.1
Basic Earnings per share	7	7	5	6	6	7.4
Dividend per share (KES) - Interim	3	3	2	2	9	20.0

Source: Company, DBIB Research

BALANCE SHEET

	1H20	2H19	1H19	2H18	1H18	2H17	1H17	y-o-y ch (%)
Total equity	17,924	16,155	14,321	11,652	12,682	11,988	11,947	11.0
Non-current liabilities	38,527	37,251	35,315	33,811	34,999	32,695	23,110	3.4
Non-current assets	60,756	57,463	52,499	49,721	47,681	44,532	40,178	5.7
Current assets	32,612	29,602	28,391	21,526	32,828	22,135	26,585	10.2
Current liabilities	(36,917)	(33,659)	(31,254)	(25,784)	(32,266)	(21,984)	(31,706)	9.7
Net assets	56,451	53,406	49,636	45,463	47,681	44,683	35,057	5.7
Net assets	56,451	53,406	49,636	45,463	47,681	44,683	35,057	5.7

Source: Company, DBIB Research

CASH FLOW STATEMENT

	1H20	1H19	1H18	1H17	1H16	y-o-y ch (%)
Cash generated from operations	15,158	15,733	13,005	10,588	16,278	(3.7)
Net interest paid	(1,841)	(1,664)	(1,954)	(1,516)	(1,726)	10.6
Tax paid	(4,390)	(1,471)	(3,864)	(3,025)	(2,882)	198.4
Net cash generated from operating activities	8,927	12,598	7,187	6,047	11,670	(29.1)
Net cash used in investing activities	(4,652)	(4,681)	(5,002)	(1,738)	2,465	(0.6)
Net cash used in financing activities	(4,714)	(2,483)	(1,312)	(4,449)	(6,717)	89.9
Net (decrease)/increase in cash and cash equivalents	(439)	5,434	873	(140)	7,418	(108.1)
At start of period	12,469	3,187	3,318	(3,954)	(1,392)	291.2
Foreign exchange impact of translation	62	135	393	727	(224)	(54.1)
Net (decrease)/increase in cash and cash equivalents	(439)	5,435	873	(140)	7,418	(108.1)
Cash and cash equivalents at end of period	12,092	8,757	4,584	(3,367)	5,802	38.1

Source: Company, DBIB Research

RATIOS

Ratios	1H20	1H19	1H18	1H17	1H16	y-o-y bps ch
ROA*	15.44	16.34	13.90	16.73	na	(90)
ROE*	80.44	92.30	78.09	93.50	na	(1186)
Gross Margin	47.63	46.12	43.39	47.22	46.46	152
EBT Margin	23.12	23.38	19.79	22.85	21.12	(26)
Net Profit Margin	15.72	15.90	13.46	15.89	20.61	(18)

Source: Company, DBIB Research

**Annualized*

APPENDIX

COMPANY INVESTMENT RATINGS

Buy: Share price may generate more than 15.0% upside over the next 12 months

Overweight: Share price may generate between 5.0% and 15.0% upside over the next 12 months

Hold: Share price may fall within the range of <+5.0/ -10.0% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels. Company fundamentals however remain strong

Underweight: Share price may generate between 10.0% and 15.0% downside over the next 12 months

Sell: Share price may generate more than 15.0% downside over the next 12 months, significant business and/or financial risks present, industry concerns

Not Rated: Counter is not within regular research coverage

SECTOR INVESTMENT RATINGS

Overweight： Industry performance better than that of the whole market

Equal weight： Industry performance about the same as that of the whole market

Underweight： Industry performance worse than that of the whole market

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