

DYER & BLAIR INVESTMENT BANK

COMPANY UPDATE

Founder Member of the Nairobi Securities Exchange

30TH JULY 2020



DYER & BLAIR
INVESTMENT BANK

WE KNOW. YOU KNOW.

EAST AFRICAN BREWERIES: FY20 EARNINGS UPDATE

Dear all,

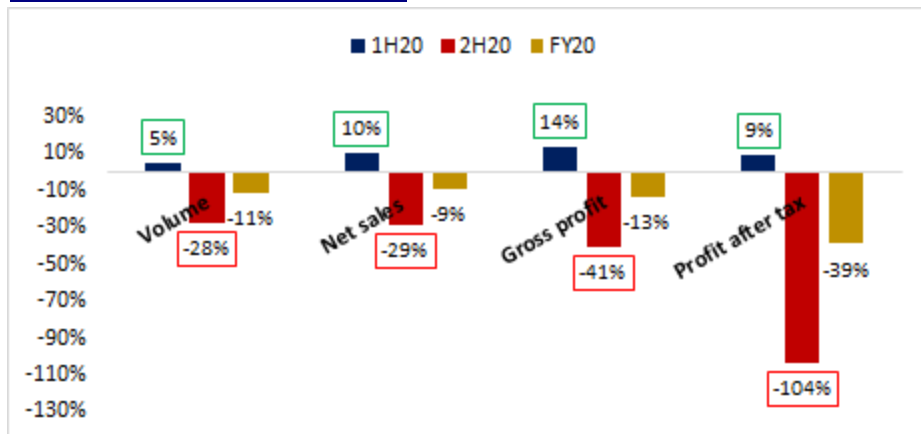
East African Breweries released its FY20 results, recording a 39.0% y-o-y downswing in Profit after Tax (PAT) to KES 7.0 BN owing to the tough business environment instigated by the COVID-19 pandemic. Basic earnings per share (EPS) declined 54.0% y-o-y to KES 5.17 per share. In a bid to conserve cash and remain secure during the uncertain environment, the directors did not recommend a final dividend. As such, the interim dividend (KES 3.00 per share) is deemed the full and final dividend for the year.

Key Highlights:

- The table below is a clear representation of the detrimental impact COVID-19 has had on the company in just under 4 months since the first positive cases were announced in March in East Africa. The brewer made a KES 188.0 MN loss after tax in 2H20 compared to a PAT of KES 7.2 BN in 1H20 (a striking 102.6% h-o-h decline). The graph below depicts how the group's strong trajectory in 1H20 was completely off-set come 2H20 in the wake of the pandemic.

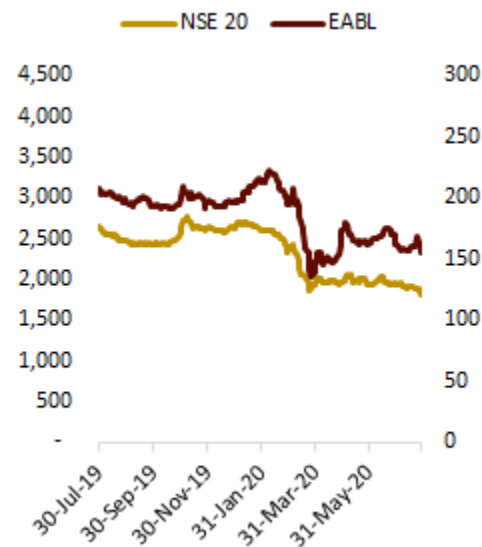
KES 'MN'	1H20	2H20	FY20	h-o-h ch (%)
Revenue	45,856	29,060	74,916	(36.6)
Cost of sales	(24,013)	(17,883)	(41,896)	(25.5)
Gross profit	21,843	11,177	33,020	(48.8)
Total costs	(11,241)	(11,124)	(22,365)	(1.0)
Profit before income tax	10,602	53	10,655	(99.5)
Income tax expense	(3,393)	(241)	(3,634)	(92.9)
Profit for the year	7,209	(188)	7,021	(102.6)

EABL: 1H20 vs 2H20 PERFORMANCE



Source: (Company filings, DBIB Research)

EABL: 52 WEEK PRICE PERFORMANCE



(Source: NSE, DBIB Research)

Price	Absolute	Excess
Return	Return	Return
3 month (%)	(10.4)	(2.6)
6 month (%)	(28.0)	2.6
12 month (%)	(24.1)	7.2
KEY METRICS		
Current Price (KES)		154.75
52 week High (KES)		221.75
52 week Low (KES)		135.25
YTD Return (%)		(22.0)
Issued Shares (MN)		790.77
Market Cap (USD MN)		1,136.16
Recommendation		BUY
Target Price (KES)		Under Review
Trailing EPS (KES)		8.88
NAV (KES)		17.70
P/E (x)		17.4
P/B (x)		8.7
Dividend yield (%)		1.9

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BUSINESS HIGHLIGHTS

The COVID-19 pandemic has proved to be a huge impediment to the group's growth and business operations. The brewer's route-to-market (RTM) model was entirely disrupted due to COVID-related constraints and management was forced to re-structure and upscale its off-trade channels (e-commerce platforms, convenience stores) following the closure of its on-trade channels i.e. the traditional retail outlets. The current macroeconomic environment has posed various constraints to the EABL consumer i.e. increased occurrence of furloughs, constrained disposable income, consumer down-trading and a slippage to illicit alcohol.

Regional Performance:

On a regional front, the group's dominant market, Kenya, was severely affected as a result of the closure of bars and restaurants and the implementation of a national curfew since March 2020. The 8.0% y-o-y growth in net sales recorded in 1H20 was offset by a 37.0% y-o-y decline in 2H20. As a result, FY20 growth settled at -14.0%. During the most recent presidential address, dated July 27, 2020, the sale of alcoholic drinks and beverages in eateries and restaurants was banned for 30 days. This implies that only off-trade establishments (supermarkets, convenience stores, e-commerce channels) have the carte blanche to sell alcoholic drinks for the next month or so, between 9:00 am and 7:30 pm.

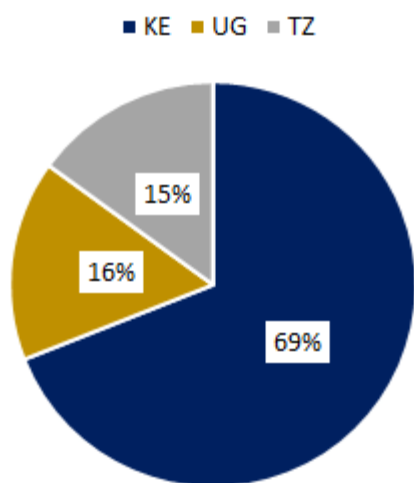
Management assured that the e-commerce channels are now 10x bigger than before by partnering up their distributors with online aggregators and boda-boda channels. The group is also keen on increasing the presence of its portfolio in supermarkets, convenience stores, liquor stores etc. In a bid to make this a success, the group has repackaged its beer brands into various 'take-home' forms i.e. cans, one-way bottles etc. The brewer has also upgraded the availability of their spirits brands on off-trade channels.

Uganda registered a 5.0% y-o-y decline in net sales in FY20. Whilst the market had recorded a 10.0% y-o-y growth in 1H20, the introduction of a total lockdown from March 2020 led to a 21.0% y-o-y decline in 2H20. In a bid to supply against demand, the group has developed on-trade channels that will boost sales. Tanzania's net sales grew by 14.0% y-o-y in FY20 courtesy of the governments 'herd-immunity' approach to the pandemic with very minimal containment measures enacted. Whilst the Tanzanian numbers registered double digit growth in 1H20 and 2H20, the market contributed c. 15.0% to overall sales.

Portfolio Performance:

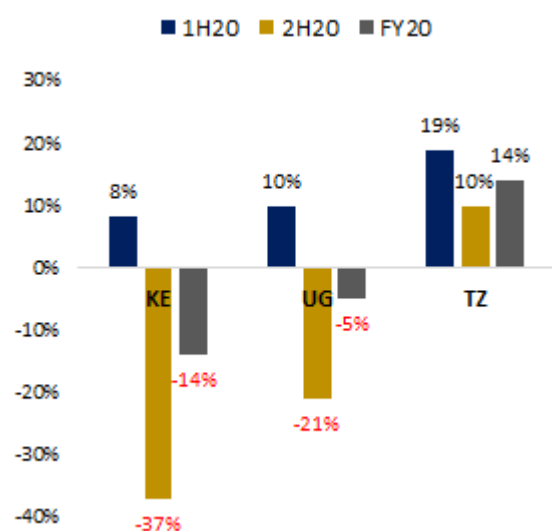
Several themes have emerged from the EABL consumer during this COVID-stricken environment. First and foremost, down-trading has been evidenced across the brewer's portfolio. The premium segment (scotch) saw a 17.0% y-o-y decline in net sales in 2H20, compared to a 13.0% y-o-y increase in net sales that the segment had recorded in 1H20. However, once things settle, management asserts that this will be the first segment to bounce right back to growth.

EABL: REGIONAL CONTRIBUTION TO OVERALL GROWTH (%)



Source: (Company Filings , DBIB Research)

EABL: REGIONAL PERFORMANCE 1H20 VS 2H20



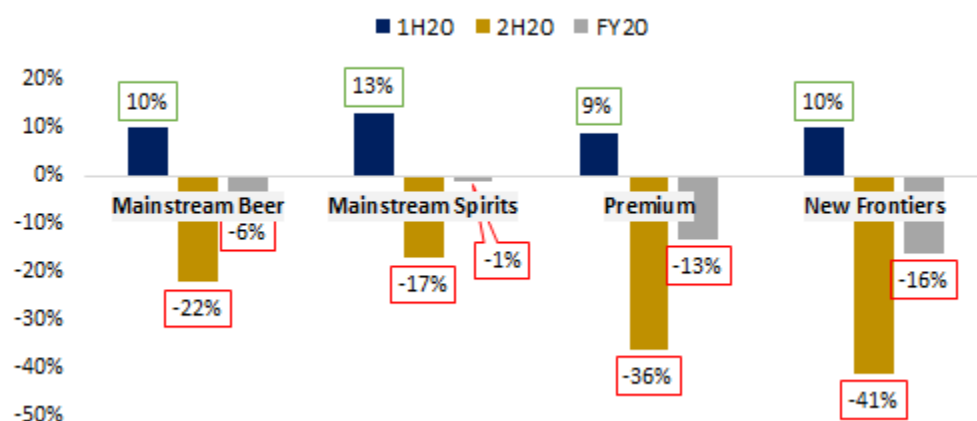
Source: (Company Filings , DBIB Research)

BUSINESS HIGHLIGHTS CONTD.

Preference of spirits: This is attributable to the non-portable nature of beer which is ideally consumed in on-premise outlets i.e. bars and restaurants. Mainstream beer saw a 22.0% y-o-y decline in net sales in 2H20. As beer was primarily packaged in returnable bottles, the brewer has rolled out beer in new packaging to bolster off-trade distribution i.e. cans and one-way bottles. **Mainstream spirits remained relatively resilient** having recorded a 1.0% y-o-y decline in net sales in 2H20 primarily due to the portability aspect.

A depressed value segment and the rise in illicit: Senator Keg saw a 13.0% y-o-y decline in net sales in FY20 owing to the closure of bars in 4Q20. Management is not keen on repackaging keg due to the niche target market it serves. To put it into perspective, keg is sold in over 23,000 bars which currently remain closed. As a result, EABL is losing its consumers to the illicit market. Thus, keg sales will remain below par, up until the bars are opened up.

EABL: PORTFOLIO PERFORMANCE 1H20 VS 2H20



Source: (Company Filings , DBIB Research)

FINANCIAL HIGHLIGHTS

Net sales declined 9.2% y-o-y to KES 74.9 BN courtesy of an 11.0% y-o-y decline in gross sales to KES 133.4 BN and a 13.0% y-o-y improvement in excise sales to KES 58.4 BN. This was partly driven by the depressed sales of the beer portfolio (-11.0% y-o-y) i.e. bottled beer and senator keg in 4Q20 occasioned by the pandemic. Cost of sales declined by 5.7% y-o-y to KES 41.9 BN as a result of productivity and fixed cost initiatives. Gross profit declined by 13.4% y-o-y to KES 33.0 BN.

Total expenses rose 10.2% y-o-y to KES 22.4 BN, partly driven by a 947.7% y-o-y increase in other expenses to KES 3.4 BN. **This was due to provisioning as per IFRS standards** i.e. the brewer made impairment provisions on debtors of c. KES 600.0 MN, inventory write-down provisions of c. KES 400.0 MN and also non-recoverable VAT of c. KES 1.3 BN. This line item also factors in EABL's commitment (KES 530.0 MN) as part of Diageo's 'Raising the Bar' global fund and other donations in kind (KES 700.0 MN). **Selling and distribution costs** declined by 8.6% y-o-y to KES 6.6 BN whilst administrative expenses declined by 8.9% y-o-y to KES 8.6 BN.

FINANCIAL HIGHLIGHTS

Finance costs rose 14.3% y-o-y to KES 3.9 BN. The group reduced its effective borrowing rate by refinancing the medium term note (14.0%) which matured in March with a bank loan at a favorable rate (under 10.0%) following the revision of the CBR. As of this year, the group ceased to benefit from capital allowances associated with the Kisumu brewery plant. **Income tax expense dropped by 42.3% y-o-y to KES 3.6 BN**, partly due to the revision of corporate tax from 30.0% to 25.0%.

EABL's working capital position deteriorated by 25.1% y-o-y to a negative position of KES 5.1 BN. On the current assets front; inventories rose by 48.2% y-o-y to KES 10.9 BN, receivables declined by 30.9% y-o-y to KES 5.7 BN and cash and bank balances declined by 54.6% y-o-y to KES 5.7 BN. On the current liabilities front; payables declined by 22.0% y-o-y to KES 21.7 BN and borrowings declined by 21.1% y-o-y to KES 4.1 BN. The brewer also posted a bank overdraft position of KES 3.9 BN.

Non-current liabilities edged up by 17.1% y-o-y to KES 43.6 BN, partly driven by an 18.6% y-o-y increase in borrowings to KES 36.9 BN. Non-current assets saw a 9.1% y-o-y increase to KES 62.7 BN, partly driven by a 7.0% y-o-y increase in property, plant and equipment to KES 56.7 BN.

Net cash from operating activities declined by 85.2% y-o-y to KES 3.3 BN following a 52.1% y-o-y decline in cash generated to KES 13.6 BN and a 179.4% y-o-y increase in income tax paid to KES 6.5 BN. **Net cash used in investing activities** declined by 27.9% y-o-y to KES 8.3 BN, primarily driven by the purchase of PP&E to the tune of KES 7.9 BN.

Net cash used in financing activities rose 210.9% y-o-y to KES 5.4 BN, partly driven by a 62.4% y-o-y increase in repayment of borrowings to KES 18.7 BN. Overall, cash and cash equivalents decreased by KES 10.3 BN in FY20. As the company's cash position at the end of the year deteriorated by 86.1% y-o-y to KES 1.7 BN from KES 12.5 BN in FY19, we are of the opinion that the lack of a final dividend payment is a sound decision for the company's stability. Overall, The group's operating cash position declined by 4300 bps to 68.0%.

On a trailing basis, E.A. Breweries is trading at a P/E multiple of 17.4x and a P/B multiple of 8.7x. The counter's ROE stands at 50.2% whereas the ROA stands at 7.9%. Dividend yield currently stands at 1.9%. **As we foresee a strong recovery once the dust settles, we maintain our BUY recommendation, with a long-term view.**

INCOME STATEMENT (KES 'MN')

	FY16	FY17	FY18	FY19	FY20	y-o-y ch (%)
Revenue	64,322	70,247	73,457	82,543	74,916	(9.2)
EBITDA	19,118	20,075	18,845	25,114	18,787	(25.2)
EBIT	16,884	16,481	15,101	21,187	14,481	(31.6)
Net finance costs	(3,265)	(3,174)	(3,359)	(3,372)	(3,826)	13.5
Pretax profit	13,619	13,307	11,742	17,815	10,655	(40.2)
Attributable Profit	10,271	8,515	7,256	11,515	7,021	(39.0)

Source: Company, DBIB Research

BALANCE SHEET (KES 'MN')

	FY16	FY17	FY18	FY19	FY20	y-o-y ch (%)
Total Equity	10,867	11,988	11,652	16,155	13,993	(13.4)
Long-term borrowings	21,474	27,488	30,547	31,115	36,900	18.6
Other non-current liabilities	5,373	5,206	3,264	6,136	6,721	9.5
Net assets	37,714	44,683	45,463	53,406	57,614	7.9
PPE	35,607	37,317	45,364	53,038	56,735	7.0
Intangible assets	4,563	3,885	3,614	3,828	3,914	2.3
Other non-current assets	3,958	3,330	743	598	463	(22.5)
Non-current assets	44,127	44,532	49,721	57,463	62,690	9.1
Inventory	8,131	7,473	7,883	7,368	10,916	48.2
Trade & other receivables	11,572	9,928	7,946	8,223	5,681	(30.9)
Cash & cash equivalents	1,221	3,907	3,588	12,469	5,662	(54.6)
Other current assets	632	826	2,109	1,543	3,709	140.4
Current assets	21,556	22,135	21,526	29,602	25,968	(12.3)
Trade & other payables	21,921	20,814	24,629	27,864	21,731	(22.0)
Short term borrowings	-	-	119	5,205	4,106	(21.1)
Other current borrowings	6,049	1,170	1,036	591	5,207	781.7
Current liabilities	27,969	21,984	25,784	33,659	31,045	(7.8)
Net assets	37,714	44,683	45,463	53,406	57,614	7.9

Source: Company, DBIB Research

CASH FLOW STATEMENT 'KES MN'

	FY16	FY17	FY18	FY19	FY20	y-o-y ch (%)
Operating Cash flows	18,577	13,914	13,559	22,566	3,347	(85.2)
Investing Cash flows	(1,330)	(4,668)	(10,492)	(11,546)	(8,330)	(27.9)
Financing Cash flows	(18,225)	(992)	(4,336)	(1,724)	(5,358)	210.9
Change in cash	(978)	8,255	(426)	9,296	(10,342)	(211.2)
Cash at the start	(1,392)	(3,954)	3,318	3,187	12,469	291.2
Cash at the end	(3,954)	3,318	3,187	12,469	1,729	(86.1)
Net Profit Margin	15.72	15.90	13.46	15.89	20.61	(18)

Source: Company, DBIB Research

RATIOS: FINANCIAL STABILITY, OPERATING PERFORMANCE AND INVESTOR RETURN

	FY16	FY17	FY18	FY19	FY20F	y-o-y bps ch
Return on Assets (%)	15.6	12.8	10.2	13.2	7.9	(531)
Return on Equity (%)	94.5	71.0	62.3	71.3	50.2	(2,111)
Return on Common Equity (%)	91.0	68.7	127.7	133.2	111.1	(2,214)
Return on Capital Employed (%)	27.2	19.1	16.0	21.6	12.2	(938)
Net debt to Capital (%)	70.1	66.8	70.2	59.6	73.7	1,411
Net debt to Assets (%)	38.7	36.3	38.6	27.4	44.3	1,691
Gross Profit margin (%)	50.1	44.3	44.1	46.2	44.1	(210)
EBITDA margin (%)	29.7	28.6	25.7	30.4	25.1	(535)
EBIT margin (%)	27.1	23.7	20.8	26.0	19.8	(619)
EBT margin (%)	21.2	18.9	16.0	21.6	14.2	(736)
Net Profit margin (%)	16.0	12.1	9.9	14.0	9.4	(458)
Operating Cash Conversion (%)	146.1	107.2	115.2	113.4	72.6	(41)

Source: (Company, DBIB Research)

	FY16	FY17	FY18	FY19	FY20F	y-o-y bps *
Financial Leverage (x)	2.5	2.3	2.7	2.2	3.2	1
Net Debt to EBITDA (x)	1.3	1.2	1.5	0.9	2.1	1
Current ratio (x)	0.8	1.0	0.8	0.9	0.8	(0)
Quick ratio (x)	0.5	0.6	0.4	0.6	0.4	(0)
Cash ratio (x)	0.0	0.2	0.1	0.4	0.2	(0)
Times Interest Earned Ratio (x)	3.0	3.4	3.4	3.4	4.0	1
Times Interest Earned (cash- basis) Ratio (x)	10.3	8.3	7.8	10.3	4.5	(6)
CAPEX to Operating Cash Ratio (x)	3.8	2.5	1.0	1.9	(4.5)	(6)
Operating Cash Flow Ratio (x)	1.0	1.0	0.8	0.8	0.4	(0)
Inventory turnover (x)	3.9	5.2	5.2	6.0	3.8	(2)
Receivables turnover (x)	5.6	7.1	9.2	10.0	13.2	3
Payables turnover (x)	1.5	1.9	1.7	1.6	1.9	0
Working Capital turnover (x)	(10.0)	465.6	(17.3)	(20.3)	(14.8)	6
Fixed asset turnover (x)	1.9	2.1	1.8	1.7	1.4	(0)
Total asset turnover (x)	1.0	1.1	1.0	0.9	0.8	(0)

Source: (Company, DBIB Research)

N/B: * Arithmetic change

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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