

NCBA INVESTMENT BANK

EABL: INITIATION OF COVERAGE

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EABL Overview

East African Breweries Limited (EABL) is a Kenyan based holding company founded on 8th November 1922. It is East Africa's leading branded alcohol beverage business with an outstanding collection of brands that range from beer, spirits and adult non-alcoholic drinks (ANADs) reaffirming its stand as a total adult beverage (TAB) company.

EABL is a regional leader in local alcoholic and non-alcoholic beverages with an exceptional collection of brands across beer and spirits. The business is concentrated in the core markets of Kenya, Uganda and Tanzania. The products are sold in more than 10 countries across Africa. The market footprint spans across six countries in the larger East Africa region. The brands have a mix of local brews and international premium spirits. These include Tusker, Guinness, Bell Lager, Serengeti Lager, Kenya Cane, Uganda Waragi, Smirnoff XI and Johnnie Walker.

EABL has 5 production sites and over 30 brands across beers and spirits. The network of breweries, distilleries, and distribution facilities spans across the six markets which operate in East Africa with concentration in three core markets which are: Kenya, Uganda and Tanzania. EABL's plants are located in these core markets with distribution networks in Rwanda, South Sudan, Burundi and the Eastern Democratic Republic of Congo (DRC).

The group owns 100% of Kenya Breweries Limited, 98.2% of Serengeti Brewers Limited, 98% of Uganda Breweries, 100% of East Africa Maltings (Kenya & Uganda) and 46% of United Distillers and Vintners (Kenya) Limited, 100% of International Distillers Uganda, 100% EABL International (responsible for exporting), 100% of East African Maltings, 100% EABL Foundation and 100% of Salopia Limited. The group is owned by Diageo currently controlling 50.03% stake. The group's diversification is a key factor in delivering quality brands to East African consumers and long-term value to its investors.

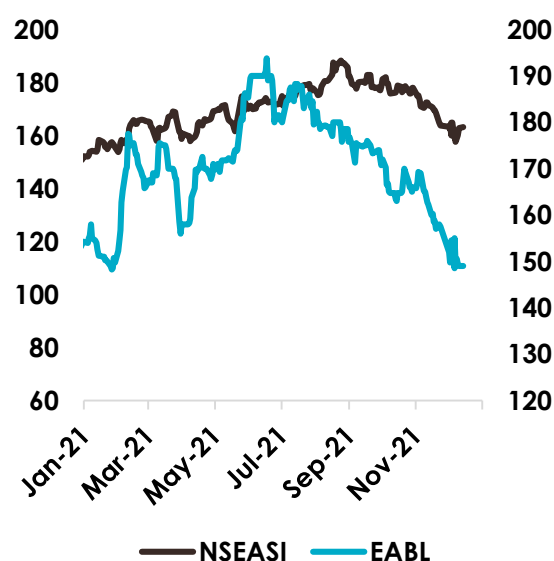
EABL has an annual turnover of over KES 40Bn and it has the largest share of the beer industry in Kenya accounting for 65% of total NSV as at FY21. Uganda is the second largest market, representing 19% of FY21 total NSV. We further estimate UBL market share at 25% and Tanzania market share at 40% in 2021.

Share Data

NSE Code	EABL
BIC	EABL KN
RIC	EABL NR
Recommendation	BUY
Last Price (As at 11 th Jan 2022)	161.00
Target Price	179.63
Upside (Excl. DY)	12%
Market Cap (KES'bn)	1,273
Free Float	49.98%

Source: NSE, Bloomberg & NCBAIB Research

Share Price



Source: Bloomberg & NCBAIB Research

EABL grows stronger in the region

EABL remains the largest brewing and alcoholic beverage group in East Africa with the main subsidiary Kenya Breweries producing around 4.6 million hectoliters and accounting for 68% of the total volume sold and 79% of net profit. The acquisition of Serengeti Breweries (Tanzania) and prospects in Southern Sudan provides significant expansion opportunities in the near term. Higher excise taxes undoubtedly poses some downside risk on volumes in its main market. This is likely to weigh down on margins. This situation will be countered by the positive economic growth brought about by growth across all sectors of the economy. Tanzania offers strong growth prospects while competition in its main market Kenya should remain benign over the medium term.

We see EABL growing market share in Tanzania to c.40% in FY21 (28% in 2020) underpinned by an upgraded brewing and distribution infrastructure. Additionally, a wider portfolio including Senator and Diageo spirits should further spur Tanzania volume growth. As EABL's investment in SBL matures, we expect reduced inefficiencies, increased sourcing of cereals locally from more contracted farmers, non-recurrence of integration costs and increased sale volumes to boost profitability.

Meanwhile, we envisage competition in Kenya (65% of EABL FY21 NSV) remaining benign over the medium term with Heineken and SAB Miller targeting the premium segment, which only contributes 5% to EABL total sale volumes. We also see a rebound in Uganda growth aptly supported by the December 2020 commissioning of the mash filter facility, expected to increase brewing capacity.

Taxation to undermine growth in consumption

In Kenya, a 17-fold increase in spirit tax in 2008 was rescinded after it negatively affected businesses and drove consumers to illicit harmful alcohol. Spirits have since enjoyed tax remission in Kenya over the years.

The Director General of the Kenya Revenue Authority (KRA) has proposed to levy tax on all bottled alcoholic drinks beginning in fiscal year 2021/2022. This is due to reduced tax revenues which continue to widen the fiscal deficit. The tax on beer, fermented beverages, non-alcoholic beverages and spirits increased by 5%. Spirits of ethyl alcohol and spirit liqueurs also increased by the same percentage.

The KRA is of the view that consumers have traded down to the much cheaper beers, escaping the tax. As such, they have proposed taxing these cheaper beers. We however foresee resistance from civil society as cheap beers' popularity has helped stem consumption of harmful illicit alcohol. In aggregate, a tax increase may prove counterproductive, reducing consumption and hence reducing revenues.

The COVID-19 pandemic brought about socio-economic challenges that disrupted consumers, strained consumer wallets and interrupted the distribution channels. Beyond the pandemic, there were also macro-economic pressures, with the depreciation of the Kenyan currency and the roll-back of COVID tax relief measures. The impact of the pandemic led to unpredictable times, which required innovation to invest effectively in advertising and distribution channels to drive sustainable sales growth.

Renovation and innovation of brands has proven successful over the years. In a bid to stop revenue decline, product rebranding captures the market's attention, renewing consumer interest. A market segment could also be created through innovation and introduction of new appealing brands. EABL has been active in introducing new brands, and rebranding the existing ones to attract consumers.

Competition remains stiff in the primary market

SAB has not announced any major capex plans in Kenya over the medium term, implying they will continue to import alcohol products from Tanzanian Breweries Limited (TBL). Their presence in Kenya is through subsidiary Crown Beverages (formerly Crown foods, a water distributor). In addition, SAB has currently availed premium brands in the Kenya market. These include Castle Lite, Castle Milk Stout and Redds. With mainstream and value brands accounting for 95% of EABL's portfolio, we do not see SAB as competition in this regard. The same holds for Heineken.

Keroche Industries market share in Kenya is estimated at c.2-3%, according to our research. Its non-sugar beer Summit Lager has gained considerable traction especially in Keroche's bastion, the Rift Valley. EABL has introduced its own non-sugar brand Balozi Lager to counter this. It is part of EABL's emerging/value brands whose NSV grew by 22% in FY21.

We note that EABL gross margins have steadily declined from 67% in FY05 to 47% in FY21. This is attributable to increased energy costs, weakened domestic currencies (inflating import costs) and generally higher global commodity prices over the period. Cereals and sugar account for c.50% of total COGS, according to management. Poor weather patterns and supply constraints regularly necessitate importation. More recently, the 150bps decline in FY21 gross margins was partly blamed on increased importation of barley as EABL was unable to maximize yields despite good rainfall. Relatedly, the growth in the premium segment came with higher production costs.

In a bid to contain production costs, EABL has contracted 26,000 farmers to source cereals inputs across East Africa. This marks a 78% increase to the 14,615 contracted in FY11. Of these 14,615 farmers, 10,000 (68%) were in Kenya with a total acreage of 35,000ha, according to Diageo's CSR Africa Report for 2021. Overall, increased local sourcing should negate imports. Sugar on the other hand is primarily imported therefore its costs are dependent on global sugar prices and domestic currency strength.

Domestic Medium-Term Note

The company issued a domestic medium term note of KES 11Bn in October 2021. The medium term note has an annual interest rate of 12.25% payable semi-annually for 5 years. The previous medium-term note of KES 6Bn (set to mature in March 2022) had an annual interest rate of 14.17%, was retired in June 2021 ahead of maturity. The cash injection from the issue will enable the company to repay borrowings taken in the ordinary course of business and provide working capital for the Group.

We note that both interest rates on government debt and commercial bank loans are on an upward trend on the basis of fiscal and macro-economic considerations, and issuing a corporate bond in the current interest rate regime appears to be a favorable financing option. Coupon payments can easily be matched with cash flows generated from business.

Diversifying financing options away from commercial bank financing while spreading repayments over a longer period of time, reduces the annual finance costs to the business. Our earnings estimates put EABL's FY2022 EBIT at approximately KES 60Bn which will be sufficient to meet both operational and finance costs, including debt obligations arising from this MTN.

Bond Ownership as at 31st December 2021	Bond Value	Percentage
Kenya Commercial Bank Limited	2,021,630,000	18.38%
Nic Custodial Services A/C 166	1,877,230,000	17.07%
The Co-Operative Bank Of Kenya Limited	866,450,000	7.88%
I & M Bank Limited	288,860,000	2.63%
National Bank Of Kenya Ltd	288,860,000	2.63%
Standard Chartered Nominees A/C 9386	202,220,000	1.84%
Stanbic Nominees Ltd A/C R3590814	202,220,000	1.84%
Standard Chartered Nominees Resd A/C Ke11443	199,330,000	1.81%
Cfc Stanbic Bank	173,340,000	1.58%
Standard Chartered Nominees A/C 9309B	144,460,000	1.31%
Other 367 Local Institutions	4,547,270,000	41.34%
Sub-Total	10,811,870,000	98.29%
177 Local Individuals	185,620,000	1.69%
2 Foreign Investors	2,510,000	0.02%
Grand Totals	11,000,000,000	100%

Source: NCBAIB Research, NSE

Share Ownership as at 30th November 2021	Number of Shares	Percentage
Diageo Kenya Limited	395,608,434	50.03%
Standard Chartered Kenya Nominees Ltd A/C Ke004667	21,335,194	2.70%
Standard Chartered Nominees Non-Resd. A/C Ke10085	20,804,500	2.63%
Kenya Commercial Bank Nominees Limited A/C 915B	9,575,144	1.21%
Stanbic Nominees Limited R6631578	7,947,017	1.00%
Standard Chartered Nominees Resd A/C Ke11401	7,435,169	0.94%
Standard Chartered Kenya Nominees Ltd	6,241,665	0.79%
Stanbic Nominees Limited A/C Nr1031461	6,206,364	0.78%
Stanbic Nominees Ltd A/C Nr3530153-1	5,564,400	0.70%
Standard Chartered Kenya Nominees Ltd A/C Ke003534	5,435,811	0.69%
Stanbic Nominees Limited Nr7522171	5,327,622	0.67%
Standard Chartered Kenya Nominees Ltd A/C 9122-Gcs	5,198,600	0.66%
The Permanent Secretary To The Treasury	4,829,436	0.61%
Standard Chartered Kenya Nominees Ltd A/C Ke002742	4,722,909	0.60%
Standard Chartered Nominees Resd A/C Ke11443	4,029,020	0.51%
Standard Chartered Kenya Nominees Ltd	3,663,850	0.46%
Eabl Group Employee Share Ownership Plan	3,626,120	0.46%
Standard Chartered Nominees Resd A/C Ke11450	3,218,524	0.41%
Standard Chartered Nominees Non-Red. A/C 9827	3,200,000	0.40%
Stanbic Nominees Ltd A/C Nr4323488	3,071,042	0.39%
Sub-Total	527,040,821	66.64%
26,201 Other Shareholders	263,733,535	33.3600%
Grand Totals	790,774,356	100%

Source: NCBAIB Research, NSE

Valuation

We initiate our coverage on EABL with a BUY recommendation based on our 12-month target price of KES 179.63 which presents an upside potential of 12% to the current market price of KES 161.00.

This value is supported by strategic positioning in the region and a commendable ROE and growth opportunities ahead. We use a triangulated blend of our TP values derived from DCF, EV/EBITDA and PE valuation methodologies.

We make the following assumptions;

- Risk free rate of 12% based on one year ahead average 10yr Treasury bond yield.
- Beta of 1.0
- Cost of debt of 14%
- Tax rate of 30%
- Equity risk premium of 5.0%
- Long term growth rate of 5%.

Free cash flow to the firm (FCFF)												
Year to June (KES 'm)	2015	2016	2017	2018	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
EBIT(1-T)	31,764	32,872	31,502	34,209	38,052	34,809	40,568	40,973	41,383	41,797	42,215	42,637
Depreciation and amortization	-230	-290	-388	-419	-344	-916	-1,034	-1,044	-1,054	-1,065	-1,075	-1,086
Changes in working capital	-7,984	-6,262	6,906	-7,731	10,218	-16,943	-5,900	-5,959	-6,018	-6,078	-6,139	-6,201
Capex	-4,684	-1,330	-4,668	-10,492	-11,546	-8,330	-14,198	-14,340	-14,484	-14,628	-14,775	-14,922
FCFF	18,866	24,990	33,352	15,566	36,380	8,620	19,436	19,631	19,827	20,025	20,225	20,428
Discount period								1.0	2.0	3.0	4.0	5.0
Discount factor								0.87	0.76	0.66	0.57	0.50
Terminal Value		143,952.73						208,202	210,284	212,387	214,511	216,656
Prime value discounted		67,109						17,085	174,300	153,214	134,679	118,386
Total firm value		211,061										
Net debt		45,161										
Equity Value		165,901										
No. of shares (m)		790.77										
Fair Value		209.80										

Source: Company financials & NCBAIB Research

PE valuation	
Net Income	63,336.01
Historical PE multiple	2.00
Implied equity value - 12 months	126,672.02
Number of shares	790.77
Fair value per share	160.19

Source: Company financials & NCBAIB Research

EQUITY RESEARCH

EAST AFRICAN BREWERIES LIMITED (EABL)

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EV/EBITDA valuation

EBITDA - 24 months	59,576.96
Historical EV/EBITDA	3
Enterprise value	178,730.89
Total Enterprise value	133,570.30
Shares outstanding	790.77
Per share value	168.91

Source: Company financials & NCBAIB Research

Blended Valuation

	KES	Weighting	Weighted price
DCF Valuation	209.80	0.33	69.93
PE valuation	160.19	0.33	53.40
EV/EBITDA valuation	168.91	0.33	56.30
Triangulated valuation			179.63
Current share price			161.00
Upside/(downside)			12%

Source: NCBA IB Research

Peer comparable

EABL is trading on P/E multiple within its peers' range. Its P/E stands at 25.71x within its peers' range, although lower compared to its peers' average of 31.85x. Its P/B value stands at 19.05x against 5.29x peer average. Its ROE of 69.63% is higher compared to the 25.16% peer average.

Company	Ticker	Mkt Cap (USD)	P/E (%)	P/B	ROE (%)	ROA
ANHEUSER-BUSCH INBEV SA/NV	ABI BB Equity	117.34	20.17	1.68	8.96	2.60
HEINEKEN NV	HEIA NA Equity	60.13	47.21	3.67	8.01	2.52
AMBEV SA	ABEV3 BZ Equity	44.80	16.05	2.93	19.24	12.09
HEINEKEN HOLDING NV	HEIO NA Equity	25.00	39.22	3.09	8.13	1.26
CARLSBERG AS	CARLB DC Equity	24.04	25.23	3.81	15.56	4.97
TSINGTAO BREWERY CO LTD-A	600600 CH Equity	17.52	49.15	5.98	12.68	6.57
MOLSON COORS BEVERAGE CO	TAP US Equity	10.04	12.63	0.75	-3.32	-1.58
UNION CERV PERU BACK&JOHNS	BACKUSI1 PE Equity	7.09	8.21	2.51	37.61	22.00
BOSTON BEER COMPANY INC	SAM US Equity	6.37	46.21	6.17	10.18	7.14
ROYAL UNIBREW	RBREW DC Equity	5.17	26.13	10.42	38.94	13.44
BEIJING YANJING BREWERY CO	000729 CH Equity	3.29	75.51	1.52	2.04	1.39
GUANGZHOU ZHUJIANG BREWERY	002461 CH Equity	3.19	30.82	2.19	7.27	4.85
GRUPA ZYWIEC SA	ZWC PW Equity	1.26	11.65	13.26	137.27	15.73
EAST AFRICAN BREWERIES LTD	EABL KN Equity	1.04	25.71	19.05	69.63	4.61
NIGERIAN BREWERIES PLC	NB NL Equity	0.92	43.78	2.29	5.25	1.87
Mean	Mean	21.81	31.85	5.29	25.16	6.63
Median	Median	7.09	26.13	3.09	10.18	4.85

Source: Bloomberg & NCBAIB Research

The comparable analysis of EABL and other breweries reveals that EABL trades at a 23.86% discount to the average peer P/E of 31.85.

EABL's lower P/E multiple can be justified by the price multiple being a reflection of market sentiment and country specific circumstances.

Downside risks.

We see the following potential future risks.

- i) Competition by other players in the region.
- ii) Significant investments that will require additional capex.
- iii) An unfavorable tax regime.

Financial Performance

1. Cash Flow Statement

	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Cash from operating activities	22,565.80	3,346.85	14,611.77	14,757.89	14,905.47	15,054.52	15,205.07	15,357.12
Net cash used in Investing Activities	(11,546.21)	(8,330.26)	(14,198.24)	(14,340.22)	(14,483.62)	(14,628.46)	(14,774.74)	(14,922.49)
Net cash used in financing activities	(1,723.65)	(5,358.23)	3,464.07	3,498.71	3,533.70	3,569.04	3,604.73	3,640.78
Change in cash and cash equivalents	9,295.94	(10,341.64)	3,877.61	3,916.38	3,955.55	3,995.10	4,035.05	4,075.40
At the start of year	3,187.13	12,468.59	1,729.30	1,746.59	1,764.06	1,781.70	1,799.51	1,817.51
Foreign exchange impact	(14.48)	(397.65)	(1,185.88)	(1,197.74)	(1,209.72)	(1,221.82)	(1,234.04)	(1,246.38)
Cash equivalents at the end of year	12,468.59	1,729.30	4,421.02	4,465.23	4,509.88	4,554.98	4,600.53	4,646.54

2. Income Statement

	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Revenue	82,543.24	74,916.26	85,961.82	86,821.43	80,739.92	82,196.53	82,127.19	83,569.38
Cost of Sales	(44,426.10)	(41,896.23)	(48,548.12)	(49,033.60)	(49,523.94)	(50,019.18)	(50,519.37)	(51,024.56)
Gross Profit	38,117.14	33,020.03	37,413.69	37,787.83	38,165.71	38,547.37	38,932.84	39,322.17
EBIT	54,359.88	49,726.61	57,953.57	58,533.11	59,118.44	59,709.63	60,306.72	60,909.79
PBT	57,731.85	53,448.36	61,812.78	62,430.91	63,055.22	63,685.77	64,322.63	64,965.86
Tax	6,299.52	609.11	275.26	278.01	280.79	283.60	286.43	289.30
PAT	64,031.37	54,057.47	62,088.04	62,708.92	63,336.01	63,969.37	64,609.06	65,255.15
EPS	11.23	5.17	5.51	8.89	8.98	9.07	9.16	9.25

3. Balance Sheet

	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Long-term Assets	57,463.25	62,689.99	66,024.48	67,344.97	68,691.87	70,065.71	71,467.02	72,896.36
Current Assets	29,602.38	25,968.42	34,092.53	34,774.38	35,469.87	36,179.27	36,902.86	37,640.91
Total Assets	87,065.63	88,658.41	100,117.01	102,119.35	104,161.74	106,244.98	108,369.88	110,537.27
Current Liabilities	33,659.38	31,044.60	39,702.31	40,496.36	41,306.29	42,132.41	42,975.06	43,834.56
Long-term Liabilities	37,251.50	43,620.54	45,562.27	46,473.52	47,402.99	48,351.05	49,318.07	50,304.43
Total Liabilities	70,910.88	74,665.14	85,264.58	86,969.88	88,709.27	90,483.46	92,293.13	94,138.99
Shareholders' funds	16,154.75	13,993.27	14,852.43	15,149.48	15,452.47	15,761.52	16,076.75	16,398.28
Total Equity and Liabilities	87,065.63	88,658.41	100,117.01	102,119.35	104,161.74	106,244.98	108,369.88	110,537.27

Source: Company financials & NCBAIB Research

About NCBA Investment Bank

NCBA Investment Bank is a subsidiary of NCBA Group. The services offered by the brokerage department include equities trading for listed securities, fixed income trading for both corporate and government bonds, Over the Counter (OTC) equity transactions as well as execution of equities transactions across the East African countries. Additionally, NCBA Investment Bank backs these activities with solid advice from the research team to enable investors meet their return objectives. NCBA Investment Bank deploys simple and convenient client driven technologies, robust risk management, highly competent and experienced staff and has the backing of robust research capabilities to differentiate itself from other players in the market.

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Certification

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