



STERLING INVESTMENT BANK
Members of the Nairobi Stock Exchange

East African Breweries Limited: (EABL)

Research Note

[February 18, 2011]

We recommend a HOLD in the short term.

- The dividend yield stands at 4.63% compared to 3.79% yield on the 364-day T-bill, making it a better investment in the short term compared to the treasury instrument, noting that it is a fairly stable stock.
- At a current P/E of 20.84 and the 1.68% drop in earnings, we revise our P/E valuation to Kshs 175.74, placing the short earnings forecast at Kshs 8.85 per share, 2.6% below last year's value of Kshs 9.08.
- The 2.6% forecasted drop in 2011 full year earnings is in tandem with the downward pressure on the topline arising from the tougher regulatory landscape and the negative impact on operating margins caused by the higher taxes.
- The price to book relative valuation indicates that, E A breweries is priced at Kshs 175.69; a downside risk of 4% based on the current market price of Ksh 189.00, current price to book value of Ksh 6.24 and a forward book value of Ksh 30.89.
- Our expectations of flat performance were echoed by the price reaction after the release of the results this morning, maintaining a tight range of between Kshs 188.00 and Kshs 190.00. We do not foresee any major price adjustment in the near term, in view of the consistent dividend payout and the unexpected growth in topline numbers achieved in the 1 H 2011.

Performance Highlights

EABL reported a marginal 3.18% growth in pre-tax profit in the six months to December 2010 to Ksh 6.16 billion supported by a 12% growth in sales volumes. Spirits recorded significant growth on the back of lower prices after a tax relief on the product by the government. Net sales grew by 9.9% to Ksh 20.5 billion with the Kenyan and Uganda subsidiaries registering 14% and 5% growth on their respective topline numbers.

On the positive side, operating performance remained strong with operating profit edging up 14.5% to Ksh 6.1 billion. Kenya which remains the main market, posted a 23% growth in operating profit while the Uganda subsidiary registered a 21% decline on the same. However, the 15.9% increase in operating expenses contributed strongly to the minimal growth in pre-tax profit (up 3%). Net profit dropped slightly to Ksh 4.15 billion from Ksh 4.22 billion weighed down by the 15% increase in tax. EPS dropped 8.6% to Ksh 4.03 from Ksh 4.41. Performance of the recently acquired Serengeti Breweries in Tanzania was not factored in the results given its 'too green' status.

The company stuck to its tradition of paying an interim dividend by declaring a Ksh 2.50 interim dividend payable to the shareholders in their books by 22nd March 2011.

Income Statement

Kshs (Millions)	IH 2010/11	IH 2009/10	% Growth
Revenue	20,463	18,617	9.92%
Cost of Sales	9,851	9,396	4.84%
Gross Profit	10,612	9,221	15.09%
Operating Profits	6,115	5,342	14.47%
Operating Expenses	4,497	3,879	15.93%
Pretax Profit	6,165	5,975	3.18%
Tax	2,013	1,752	14.90%
Net Profit	4,152	4,223	-1.68%
EPS	4.03	4.41	-8.62%
DPS	2.50	2.50	0.00%

Source: Cables

Balance Sheet

Kshs ('000')	IH 2010/11	IH 2009/10	% Growth
Non-current assets	24,272	14,419	68.33%
Current Assets	17,937	19,911	-9.91%
Total assets	42,209	34,330	22.95%
Share Capital & Reserves	18,898	20,310	-6.95%
Minority interest	2,829	2,552	10.85%
Non-Current Liabilities	2,787	3,057	-8.83%
Current Liabilities	17,695	11,887	48.86%
Non-current assets	24,272	14,419	68.33%

Source: Cables

Disclaimer

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Value Drivers

Growth and profitability for East African Breweries will largely be leveraged on;

- The integration of the East African region; widening the reach for EABL brands given the expected strong growth in regional Economies. The respective economies of Kenya, Uganda and Tanzania are projected to grow by 6%, 6.4% and 7.2%. Rwanda and Southern Sudan are also expected to record strong growth.
- Growing middle class population to support growth of premium brands
- Restructuring of the organization to boost operational efficiency. Recently, EABL contracted DHL to handle the distribution of its brands in the region to cut off the long supply chain.
- Headroom growth in new markets – Expansion into new markets to prevent the over-reliance on Kenya for revenues. To also open up new revenue streams to support its bottom line. Acquisition of a 51% stake in Serengeti breweries, second largest brewer in Tanzania to enhance its foothold and sales in the region.
- Effective Cost management – The brewer has started cost cutting measures to cushion its profitability as beer consumption in Kenya is faced with the challenge of a tough regulatory environment. EABL is incorporating sorghum in its beer production as it shifts from the expensive pure barley. This will help the brewer to develop more affordable brands to counter competition from the cheap traditional liquor which is now legal.

Existing Challenges

- Tough regulatory environment following the enacting of the Alcohol Control Bill
- High taxation on the premium brands

Strategic Outlook

- Focus on premium spirits and beers
- Brand equity enhancement and a strong focus on supply chain and cost of goods optimization to help maintain the company's margins.
- Beating competition and winning in new markets.

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