Guinness Nigeria Plc

PAC Holdings
| A PROPRIETARY INVESTMENT COMPANY |

Nigeria | Equities | Consumer Goods | March 26, 2019 PAC RESEARCH

Weak Operating Performance in a Strong Competitive Industry

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Price:	
- Current	**₦64.00**
- Target	**₦63.01**
Recommendation:	**HOLD**

** As at Monday March 25, 2019*

Fig. 2: Stock data

FYE	June
Price Mov't: YtD / 52wk	-11.11%/-39.05%
52-week range	₦104.00- ₦63.00
30-day Average vol.	90,687
Shares Outstanding ('mn)	2,190.38
Market Cap. (₦bn)	140.18
EPS, ₦- 12months trailing	3.27
DPS, ₦- FY2018	1.84

Source: NSE, Company's Annual Reports, PAC Research

Fig. 3: Key ratios

	H1'19	H1'18
Gross profit margin	30.23%	34.01%
Net profit margin	3.80%	3.02%
Equity multiplier	1.91x	4.32x
Asset turnover	0.41x	0.45x

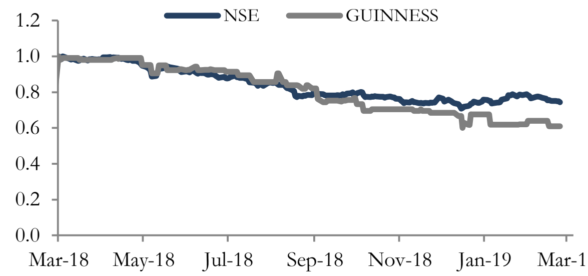
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2017	FY2018	FY2019F	FY2021F
P/E	72.87	20.87x	21.48x	19.73x
P/B	3.26x	1.60x	1.52x	1.38x
Sale Per Share	57.49%	65.27%	63.32%	69.65%
EV/EBITDA	9.15x	6.47x	7.43x	6.92x
P/Sales	1.11x	0.98x	1.01x	0.92x
ROE	4.48%	7.67%	7.09%	6.98%
ROA	1.32%	4.38%	4.24%	4.20%
Div. Yield	1.00%	2.88%	1.52%	1.38%

Source: NSE, PAC Research

Fig. 5: Guinness vs NSE, 52-wk Movement (Rebased)



Source: Bloomberg, PAC Research

INVESTMENT SUMMARY

The unaudited half year 2018/19 report released by the Guinness Nigeria Plc showed a setback in its top-line as revenue fell by 3.91% to ₦67.80 billion (vs. ₦70.57 billion in half year 2017/18). The decline in the top-line can be attributed to the lower volume during the period as the Beer and RTDs (Ready-to-Drinks) segment of the company continued to suffer from low consumers' purchasing power. However, the growth in Spirits and APNADs (Adult Premium Non-Alcoholic Drinks) mitigated the effects of decline from the Beer and RTDs segments. We are not impressed with the company in the area of input cost as cost of sale increased by 1.59% to ₦47.30 billion in H1'18/19 (vs. ₦46.56 billion in H1'17/18). Meanwhile the company attributed the higher cost of sales to high inflation environment during the period. Consequently, gross profit fell by 14.59% to ₦20.49 billion (vs. ₦23.99 billion in H1'17/18). The unimpressive performance mirrored on EBITDA as it declined by 13.28% to ₦9.65 billion in the review period, from ₦11.13 billion reported in the corresponding previous period.

The company benefitted from the right issues concluded in 2018 as net finance cost depressed significantly by 72.78% to ₦0.85 billion (vs. ₦3.11 billion in H1'17/18). The improved non-operating performance outweighed the weak operating performance and as a result, profit before tax increased by 7.10% to ₦3.79 billion (vs. ₦3.54 billion in H1'17/18). A provision of ₦1.21 billion was made for tax in H1'18/19 (H1'17/18: ₦1.41 billion). Consequently, profit after tax rose by 21.06% to ₦2.58 billion in H1'18/19, from ₦2.13 billion reported in H1'17/18. Impressively, 12-month trailing EPS increased by 272.52% to ₦3.27 from ₦0.88 reported in the previous period. Based on the recent figures released by the company, we recommend a **HOLD** rating on the stock as present forward estimates places the company share price at ₦63.01.

Fig. 1: Quarterly results highlights

	2Q2019	1Q2019	2Q2018	Q/q Δ	Y/y Δ
Revenue (₦'mn)	39,702	28,094	40,653	+41.32%	-2.34%
Operating profit (₦'mn)	2,978	1,660	3,998	+79.34%	-25.51%
Net profit (₦'mn)	1,744	836	2,089	108.64%	-16.54%

Source: Bloomberg, PAC Research

Revenue falls by 3.91% YoY, driven by slow growth in Beer and RTD

In July to December 2018, Guinness Nigeria recorded a negative growth in the top-line as revenue fell by 3.91% to ₦67.80 billion, compared with ₦70.56 billion generated in July to December 2017. The negative growth in the top-line could be attributed to lower volume, particularly from the Lager (Harp Premium Lager, Satzenbrau Premium Pilsner Lager, Royal Kingdom and Guinness Foreign Extra Stout) and RTDs (Smirnoff Ice, Snapp and Orijin) segments. Revenue from Beer declined by 16.13% to ₦26.00 billion (vs. ₦31.00 billion in H1'17/18) while revenue from RTDs fell by 14.00% to ₦4.30 billion in H1'8/19 (vs. ₦5.00 billion reported in H1'17/18). However, Revenue from APNADs (Malta Guinness, Origin Zero and Dubic Malt) increased by 20.00% to approximately ₦12.00 billion (vs. ₦10.00 billion in H1'18/17) while Spirits (McDowell's, Smirnoff, Gordon's, Masters Choice, Orijin Bitter, Ciroc, Baileys and Red Label) increased significantly by 20.00% to approximately ₦12.00 billion in H1'18/19 (vs. ₦10.00 billion in H1'17/18). Although Nigerian economy has returned to growth, but this has been slow and it continues to affect some brands in the breweries industry. This sluggish growth in the economy put pressure on the consumers spending and this reflected on negative growth in the Beer segment, negative growth in RTDs segment and positive growth of Spirits segments of the business. Spirits tend to do better than Beer in a fragile economy as consumers, who could not afford Beer due to low purchasing power, quickly switch over to Spirits because of its affordability. For APNADs, we believe that new products and different varieties are the key drivers of the higher revenue of the segment.

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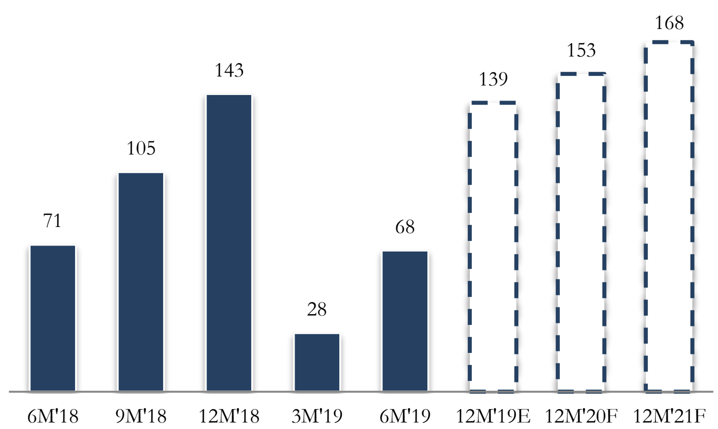
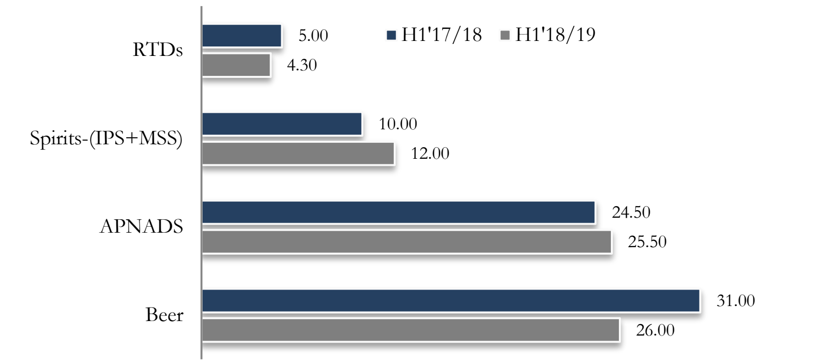
Fig. 6: Net Revenue – 6M'18- 12M'21F (Billion NGN)



Source: NSE, PAC Research

Fig. 7: Revenue by Segment – H1'18 – H1'19 (Billion NGN)



Source: NSE, PAC Research

Higher cost of sales margin impacts gross profit

During the period, the company had a major challenge in the cost of inputs as the cost of sales increased by 1.59% to ₦47.30 billion in H1'18/19 (vs. ₦46.56 billion in H1'17/18) and this translated to higher cost of sales margin of 69.77% in the half year of 2018/19 (vs. 65.99% recorded in the half year of 2017/18). However, the management attributed the higher cost of sales to inflation and unfavourable exchange rate regime, particularly on the imported inputs such as hops and yeast. Though, the company reiterated its efforts in using as much of local materials as possible, we do not expect the cost of sales to reduce over a short period of time as most of the company's inputs are still being imported. The cost pressure on inputs reflected on gross profit of the company as it declined by 14.59% to ₦20.49 billion in H1'18/19 (vs. ₦23.99 billion in H1'17/18).

However, the company's management of operating expenses during the period is impressive. Marketing and distribution expenses declined significantly by 10.33% to ₦11.55 billion in H1'18/19 (vs. ₦12.88 billion in H1'17/18) while administrative expenses increased marginally by 0.79% to ₦4.78 billion in H1'18/19 (vs. ₦4.74 billion in H1'17/18). The company attributed the significant lower marketing expenses to the conscious decision of the management to carefully select the brands to drive with advertisement.

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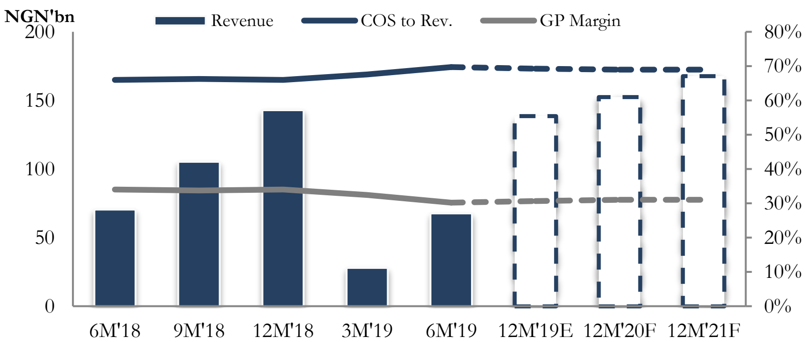
Fig. 8: Revenue, COS to Rev. and GP Margin – 6M'18- 12M'21F



Source: NSE, PAC Research

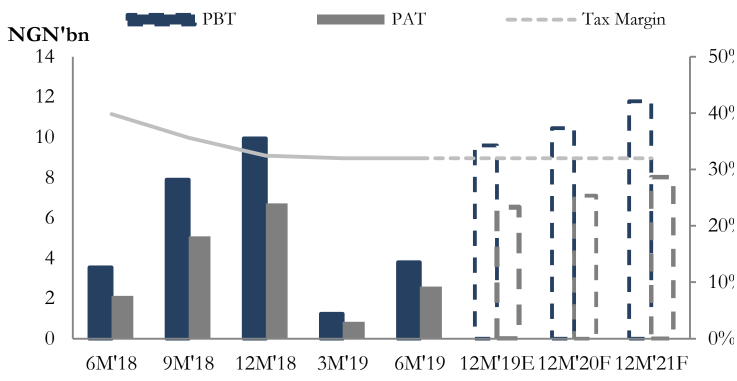
Impressive non-operating performance overshadows poor operating performance as profit before tax rises by 7.10% YoY

Guinness Nigeria recorded a lower operating profit in the half year of 2018/19 as it declined by 30.23% to ₦4.64 billion (vs. ₦6.65 billion in recorded in the half year of 2018/17). This poor performance from the operating activities of the company almost posed a threat to the profitability of the company during the period. However, the company continued to benefit from the Rights Issue of ₦40.00 billion which was concluded last year. This resulted in a lower finance costs as the company had a lower total loans & borrowing and overdraft to service. Finance costs declined significantly by 67.94% to ₦1.54 billion in H118/19, from ₦4.79 billion reported in H1'17/18). However, finance income declined by 59.02% to ₦0.69 billion (vs. ₦1.69 billion in H1'17/18), due to lower gain on re-measurement of foreign currency balances, lower interest income on bank deposits and zero interest income on distributors' overdue debts. Consequently, these translated to an improvement of 72.78% in non-operating performance of the company.

This poor performance from the operating activities of the company almost posed a threat to the profitability of the company during the period.

The improvement in non-operating activities of the company outweighed the poor performance of operating activities and as a result, profit before tax increased by 7.10% to ₦3.79 billion in H1'18/19 (vs. ₦3.54 billion reported in H1'17/18). However, the company made a lower provision of ₦1.21 billion for tax in the half year of 2018/19 (vs. ₦1.41 billion in the half year of 2017/18). Consequently, profit after tax increased by 21.06% to ₦2.58 billion in H1'18/19 (vs. ₦2.13 billion in recoded in H1'17/18). The impressive bottom-line reflected on 12-month trailing EPS increased by 272.52% to ₦3.27 from ₦0.88 reported in the previous period.

Fig. 9: PBT, PAT and Tax Margin – 6M'18 – 12M'21F



Source: NSE, PAC Research

Balance sheet remains Solid; Expectation of improved dividend

Guinness Nigeria Plc recoded impressive numbers in the balance sheets during the period and this reflected on the total asset and total liabilities of the company. Total assets increased by 4.23% to ₦164.14 billion (vs. ₦157.47 billion in Q2'17/18) while total liabilities increased by 4.65% to ₦78.00 billion in Q2'18/19 (vs. ₦74.53 billion in Q2'17/18). The increase in total assets of the company could be mainly ascribed to investment in property, plant and equipment while the increase in total liabilities could be attributed to higher current tax liabilities and higher short term loans & borrowing. However, the effect of improved total assets outweighed the effect of higher total liabilities and as a result net assets declined by 3.86% to ₦86.14 billion in Q2'18/19 (vs. ₦82.94 billion recorded in Q2'17/18). This translated to improved Net Assets per Shares (NAPS) of ₦39.33 in Q2'18/19 (vs. ₦37.86 realised in Q2'17/18). With the strong balance sheet and improved bottom line, we expect the company to pay improved dividend per share of ₦1.90 in FY'18/19F (vs. ₦1.84 dividend per share paid in FY'17/18.

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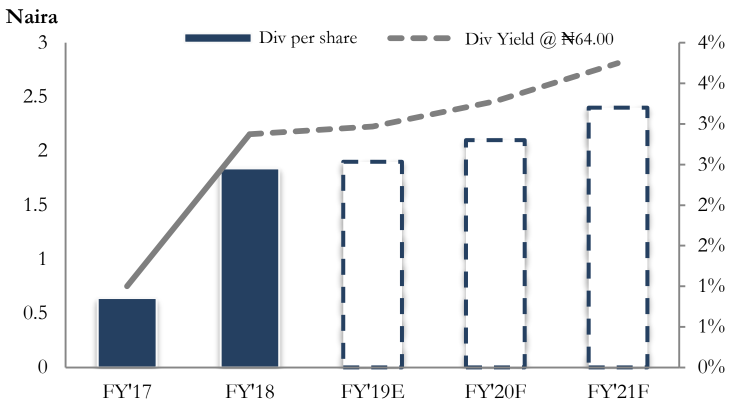
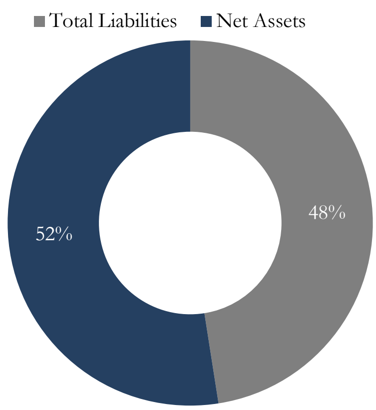
Fig. 10: Dividend Per Share and Dividend Yield - FY'17-FY'21F



Source: NSE, PAC Research

Fig. 11: Total Liabilities Vs Net Asset in H1'18



Source: NSE, PAC Research

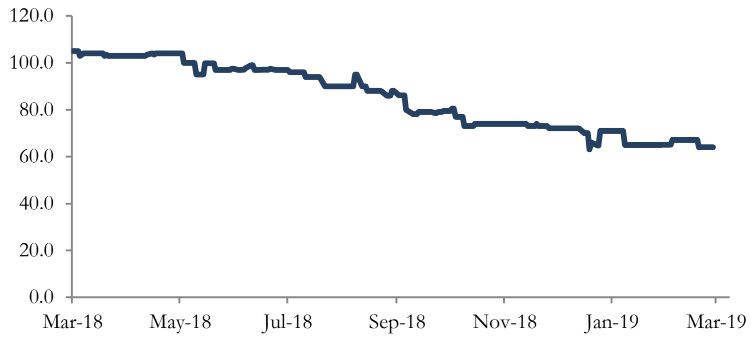
Valuation

Our valuation puts the target price of the stock at ₦63.01, representing a decline of 1.55% from the current price of ₦64.00. In arriving at the target price, we employed discounted cashflow valuation methodology. Consequently, we maintained **HOLD** recommendation on the stock of the company.

Our valuation and forecasts considered several factors (both quantitative and qualitative) among which are; the previous financial reports of the company, the current figures released by the company, the challenging operating environment in Nigeria and increased competition within the industry.

Our valuation puts the target price of the stock at ₦63.01, representing a decline of 1.55% from the current price of ₦64.00.

Fig. 12: Share Price History (Naira)



Source: NSE, PAC Research

Fig. 13: Statement of Profit or Loss, N'mn

	2017	2018	2019E	2020F
Revenue	125,920	142,976	138,687	152,555
Change		*13.55%*	*-3.00%*	*10.00%*
Cost of sales	77,605	94,350	96,110	105,263
Change		*21.58%*	*1.86%*	*9.52%*
Gross profit	48,315	48,625	42,577	47,292
Change		*0.64%*	*-12.44%*	*11.07%*
Other income	847	668	999	1,144
Change		*-21.12%*	*49.40%*	*14.58%*
Marketing & Distr. Exp.	25,287	26,012	23,577	25,934
Change		*2.87%*	*-9.36%*	*10.00%*
Administrative expenses	13,690	9,895	9,015	10,679
Change		*-27.72%*	*-8.90%*	*18.46%*
Results from op. activities	10,186	13,386	10,984	11,823
Change		*31.41%*	*-17.95%*	*7.64%*
Net Finance costs	7,524	3,443	1,387	1,373
Change		*-54.24%*	*-59.72%*	*-1.00%*
Profit Before Taxation	2,662	9,943	9,597	10,450
Change		*273.51%*	*-3.48%*	*8.89%*
Taxation	738	3,226	3,071	3,344
Change		*336.85%*	*-4.79%*	*8.89%*
Profit After Taxation	1,924	6,718	6,526	7,106
Change		*249.20%*	*-2.85%*	*8.89%*

Fig. 14: Statement of Financial Position, N'mn

	2017	2018	2019E	2020F
PPE	87,325	97,602	95,430	104,973
Intang. assets and goodwill	1,364	1,000	1,109	1,220
Other receivables	2	0	0	0
Prepayments	121	43	69	76
Inventories	23,094	19,032	22,190	24,409
Trade and other receivables	22,967	23,890	24,131	26,545
Cash and cash equivalents	6,595	7,451	7,239	7,963
Total Assets	146,038	153,255	153,984	169,367
current tax liabilities	151	2,842	2,774	3,051
Dividend payable	3,483	3,211	3,023	3,326
Trade and Other payables	43,053	31,176	26,628	28,680
Loans and Borrowings	24,889	8,116	6,934	7,628
Employee benefits	980	1,105	1,054	1,159
Deferred tax liabilities	13,506	13,599	13,869	15,256
Total liabilities	103,095	65,667	61,910	67,490
Net Assets	42,943	87,588	92,074	101,876

Fig. 15: Profitability Ratio

	2017	2018	2019E	2020F
Gross profit margin	38.37%	34.01%	30.70%	31.00%
Net Profit Margin	1.53%	4.70%	4.71%	4.66%
operating profit margin	8.09%	9.36%	7.92%	7.75%
Return on Equity	4.48%	7.67%	7.09%	6.98%
Return on Assets	1.32%	4.38%	4.24%	4.20%
Return on Assets	15.23%	15.82%	14.32%	14.05%
ROCE	12.37%	12.12%	9.64%	9.39%

Fig. 16: Asset Utilisation

	2017	2018	2019E	2020F
cash/.sales	0.05	0.05	0.05	0.05
Sales to inventory (x)	5.45	7.51	6.25	6.25
Sales to total assets (x)	0.86	0.93	0.90	0.90
sales/EBITDA	6.57	6.32	6.98	7.12
Sales to total fixed assets	1.44	1.46	1.45	1.45
Equity multiplier	3.40	1.75	1.67	1.66

Fig. 17: Liquidity Ratios

	2017	2018	2019E	2020F
Quick ratio	*0.54*	*0.83*	*0.88*	*0.89*
Current ratio	*0.90*	*1.27*	*1.43*	*1.45*
Cash ratio	*0.10*	*0.17*	*0.18*	*0.18*
Interest Coverage	*0.27*	*1.76*	*3.15*	*2.85*
Op. Cash Flow Ratio	*0.16*	*0.31*	*0.27*	*0.27*
Debt/net income	*21.79*	*2.04*	*2.23*	*2.25*
Debt/operating profit	*4.12*	*1.03*	*1.33*	*1.35*
Debt to asset	*0.29*	*0.09*	*0.09*	*0.09*
Debt to equity	*0.98*	*0.16*	*0.16*	*0.16*
Total liabilities/equity	*2.40*	*0.75*	*0.67*	*0.66*
Total liaB./ Total Assets	*0.71*	*0.43*	*0.40*	*0.40*
Inventory turnover	*1.56*	*2.24*	*2.33*	*2.26*
Inventory days	*169.86*	*81.49*	*81.57*	*80.79*
Account rec. days	*66.57*	*60.99*	*63.51*	*63.51*

Fig. 18: Shareholders' Investment Ratios

	2017	2018	2019F	2020F
Earnings per share	0.88	3.07	2.98	3.24
DiV per share	0.64	1.84	1.90	2.10
NAVPS	19.61	39.99	42.04	46.51
Earnings yield	1.37%	4.79%	4.66%	5.07%
FCFPS	32.92	32.89	33.22	33.56

Source: Company's Annual Reports, PAC Research

Equity research methodology employed in this report

Views documented in this equity research report stem from conclusions reached through the use of multiple valuation methodologies, industry-wide knowledge, company specific information and our near to medium term expectations of industry and company performance, as well as market outlook. Our forecasts are based on a combination of top down and bottom up analysis, alongside historical trends in industry and company financials. Where appropriate, we factored in available forecasts and business direction provided by company management.

Our recommendation tends towards value investing. Therefore, our investment rank gauge—a customized scale we use to judge how well a firm under coverage has performed—is determined using major value parameters as well as relevant ratios and multiples computed with figures from the company's most recent financials.

The variables used to arrive at the company's investment rank cover a wide range of measures which characterize liquidity, operational efficiency, profitability, profit margins, growth, economic viability, gearing, relative valuation ratios, capital structure and management performance. Our investment recommendation is underpinned by the upside or downside potential of a stock under coverage. This potential is estimated by comparing the stock's current market price to its price target and fair value, on a percentage increase or decrease basis as summarized below:

Deviation from current price	Recommendation
>30%	STRONG BUY
10% to < 30%	BUY
-10% to < 10%	HOLD
<-10%	SELL

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