

## Disappointing Results due to Higher Excise Duty Rates and Challenging Pricing Environment

### INVESTMENT SUMMARY

Nigerian Breweries Plc released its 2018 full year audited report which showed a disappointing figure in the top line as revenue declined by 4.26% to ₦350.23 billion (vs. ₦365.80 billion in 2017). However, the increased excise duty rate which came into effect during the year affected the top line. As a result, revenue further depleted to ₦350.23 billion in 2018 as ₦25.84 billion was accounted for excise duty expense. In addition to the higher excise duty, the company also attributed the decline in the top line to the challenging pricing environment, as consumers responded to the higher prices introduced in June 2018. During the period, cost of sales fell by 1.77% to ₦197.48 billion (vs. ₦201.03 billion in 2017). As a result, gross profit fell by 11.56% to ₦126.90 billion in FY'18 (vs. ₦143.49 billion in FY'17). Marketing and distribution expenses rose by 4.77% to ₦70.05 billion (FY'17: ₦66.86 billion) while administrative expenses fell by 4.43% to ₦20.79 billion in FY'18 (FY'17: ₦21.75 billion)

The impacts of higher excise duty rate and challenging pricing environment reflected on profit before tax as it declined by 36.90% to ₦29.42 billion (vs. ₦46.63 billion in FY'17). A provision of ₦9.98 billion was made for tax in FY'18 (FY'17: ₦13.58 billion) and as a result, profit after tax declined by 41.18% to ₦19.44 billion in FY'18, from ₦33.05 billion reported in FY'17. The disappointing result showed on 12-month trailing EPS as it reduced by 41.16% to ₦2.43 from ₦4.13 reported in the previous period. The company recorded 100% payout ratio as it proposed a final dividend of ₦1.83 per share (2017 Final dividend: ₦3.13) after the payment of ₦0.60 as interim dividend per share in 2018 (2017 interim dividend: ₦1.00), totalling ₦2.43 in FY'18 (FY'17: ₦4.13). Based on the recent figures released by the company and challenging pricing environment, we downgrade to **HOLD** rating as present forward estimates places the company share price at ₦73.06.

Fig. 1: Quarterly results highlights

	4Q2018	3Q2018	4Q2017	Q/q Δ	Y/y Δ
Net Revenue (₦mn)	86,323	65,406	89,860	+31.98%	-3.94%
Operating profit (₦mn)	9,196	-3,889	13,840	-336.46%	-33.55%
Net profit (₦mn)	4,648	-3,645	9,038	-227.52%	-48.57%

Source: Bloomberg, PAC Research

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### Price:

- Current	₦80.00
- Target	₦73.06
<b>Recommendation:</b>	<b>HOLD</b>

\* As at Monday March 4, 2019

Fig. 2: Stock data

FYE	December
Price Mov't: YtD / 52wk	-6.43%/38.93%
52-week range	₦134.00- ₦74.00
30-day Average vol.	2,975,059
Shares Outstanding (mn)	7,996.90
Market Cap. (₦bn)	639.75
EPS, ₦- 12months trailing	3.47
DPS, ₦- FY2018	2.43

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

Fig. 3: Key ratios

	FY'18	FY'17
Gross profit margin	36.12%	41.66%
Net profit margin	5.99%	9.59%
Equity multiplier	2.33x	2.14x
Asset turnover	0.84x	0.90x

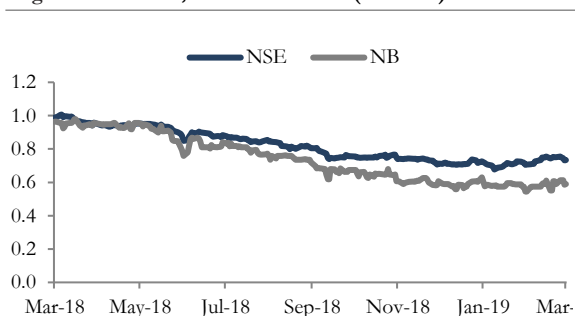
Source: NSE, PAC Research

Fig. 4: Valuations

	FY2017	FY2018	FY2019F	FY2021F
P/Sales	1.86x	1.97x	1.91x	1.82x
P/E	19.36	32.91x	27.40x	23.81x
PEG	1.19x	-0.80x	1.36x	1.58x
EV/EBITDA	7.04x	9.64x	8.87x	8.13x
P/B	3.59x	3.38x	3.78	3.69x
ROE	18.54%	11.65%	13.80%	15.50%
ROA	8.65%	5.01%	5.97%	6.61%
Div. Yield	5.16%	3.65%	3.94%	4.25%

Source: NSE, PAC Research

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



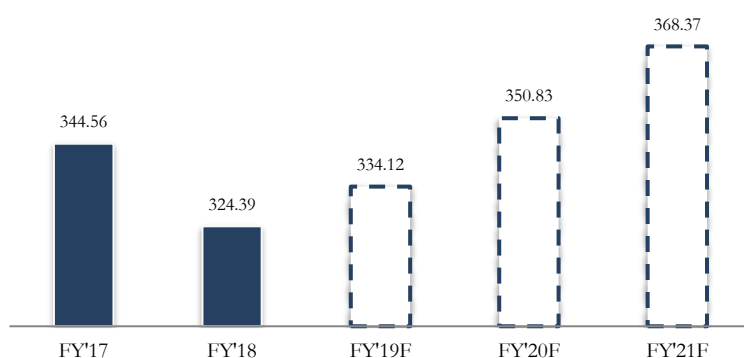
Source: Bloomberg, PAC Research

### Higher excise duty rate and lower volume weighs on company's performance; net revenue down by 5.85% YoY

In 2018, the result of the Nigerian Breweries was adversely impacted by the increased excise duty rates which came into effect during the year, coupled with a challenging operating environment. The company recorded lower revenue of ₦350.23 billion during the year, compared with ₦365.80 billion generated in the year 2017. However, revenue further depleted to ₦324.39 billion in 2018 as the company paid higher excise duty of ₦25.84 billion during the period. This represents excise duty payment of 7.38% on total gross revenue generated in 2018. In addition to the excise duty, the company also attributed the lower revenue to the lower volume, particularly in the third quarter of 2018, as consumers responded to the higher price introduced by the company in June 2018. Of the net revenue generated by the Nigerian Breweries Plc, 99.94% was generated from Nigeria in 2018 (2017: 99.98%) while 0.06% was generated from other countries in 2018 (2017: 0.02%).

*In addition to the excise duty, the company also attributed the lower revenue to the lower volume, particularly in the third quarter of 2018...*

Fig. 6: Net Revenue – FY'17- FY'21F (Billion NGN)



Source: NSE, PAC Research

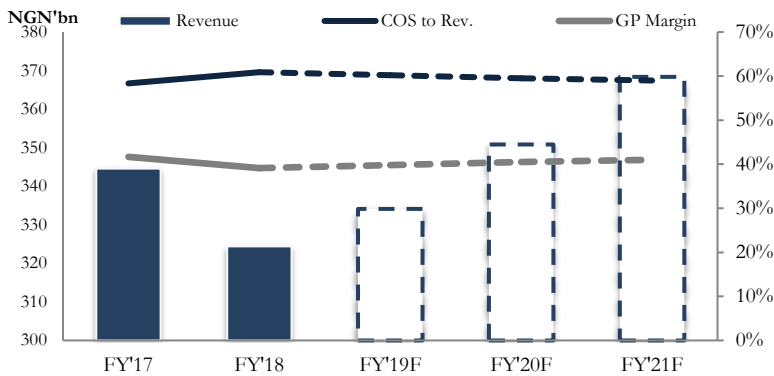
### Continued cost pressure on inputs as cost of sales to revenue rises

Although, the company reduced cost of sales by 1.77% to ₦197.48 billion in FY'18 (vs. ₦201.03 billion in FY'17), cost of sales to revenue ratio remains a major challenge as it increased to 60.88% in 2018, from 58.35% reported in 2017. Of all the components of total cost of sales, cost of raw materials and consumables continue to have adverse effect on the operating performance of the company. Though, cost of raw materials and consumables declined marginally by 0.84% to ₦127.77 billion in 2018 (vs. ₦128.86 billion in 2017), it contributed 64.70% to the total cost of sales during the period (2017: 64.10%). Consequently, gross profit declined by 11.56% to ₦126.90 billion in 2018, from ₦143.49 billion reported in 2017. As a result of higher advertising and sales promotion cost, marketing and distribution expenses increased by 4.77% to ₦70.05 billion in 2018 (vs. ₦66.86 billion in 2017).

*However, high cost of raw materials and consumables remains a major challenge in the operating activities of the company...*

However, administrative expenses declined by 4.43% to ₦20.79 billion in 2018 (vs. ₦21.75 billion in 2017).

Fig. 7: Revenue, COS to Rev. and GP Margin – FY'17- FY'21F



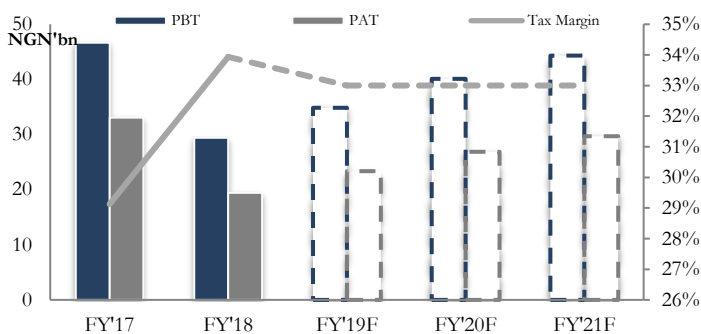
Source: NSE, PAC Research

**Even with impressive performance of non-operating activities, profit after tax falls by 41.18%**

During the period, the company benefited from a lower net loss on foreign exchange transactions as it reduced by 87.10% to ₦0.65 billion (vs. ₦5.03 billion in 2017). This reflected on the non-operating performance of the company as net finance cost declined by 28.23% to ₦7.53 billion in FY'18 (vs. ₦10.49 billion in FY'17). However, the impressive figure from net finance cost did not have any significant impact on the profitability of the company as the effects of disappointing results from operating activities outweighed the notable improvement in non-operating activities of the company. As a result, profit before tax declined by 36.90% to ₦29.42 billion in full year of 2018 (vs. ₦46.63 billion reported in full year of 2017). The company made a provision of ₦9.98 billion for tax (vs. ₦1.58 billion in 2017) and as a result, profit after tax fell by 41.18% to ₦19.44 billion in FY'18 (vs. ₦33.05 billion in recorded in FY'17). The disappointing result reflected on 12-month trailing EPS as it reduced by 41.16% to ₦2.43 from ₦4.13 recorded in the previous period.

*However, the impressive figure from net finance cost did not have any significant impact on the profitability of the company*

Fig. 8: PBT, PAT and Tax Margin - FY'17-FY'21F



Source: NSE, PAC Research

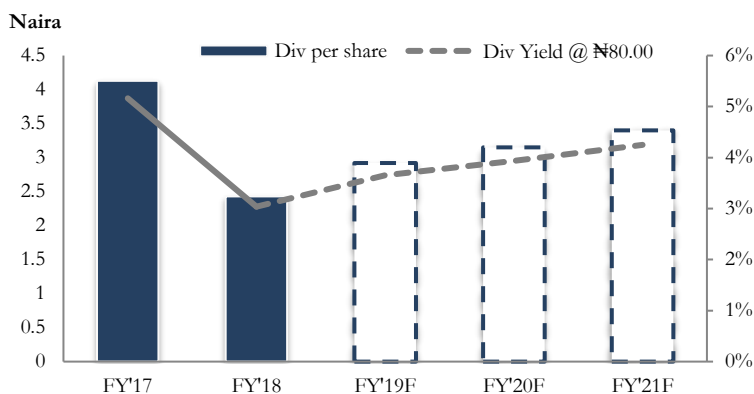
**Balance sheet remains strong; Shareholders rewarded with 100% dividend payout ratio**

Nigerian Breweries Plc recoded impressive figure for total asset as it increased by 1.58% to ₦388.26 billion in FY'18 (vs. ₦382.23 billion in FY'17). The increase in total assets of the company can be mainly ascribed to investment in property, plant and equipment. However, due to the significant increase of 414.09% in loans and borrowings (2018: ₦41.13 billion), total liabilities increased by 8.58% to ₦221.43 billion FY'18 (vs. ₦203.93 billion in FY'17). Consequently, net assets declined by 6.43% to ₦166.83 billion in 2018, from ₦178.30 billion recorded in 2017. This translates to lower Net Assets per Shares (NAPS) of ₦20.86 in FY'18 (vs. ₦22.30 realised in FY'17).

With the strong balance sheet, Nigerian Breweries Plc rewarded the shareholders with 100% dividend payout ratio in 2018 (2017: 100% dividend payout ratio). The company proposed a final dividend of ₦1.83 per share in 2018 (2017 Final dividend: ₦3.13) after the payment of ₦0.60 as interim dividend per share (2017 interim dividend: ₦1.00), totalling ₦2.43 in FY'18 (FY'17: ₦4.13).

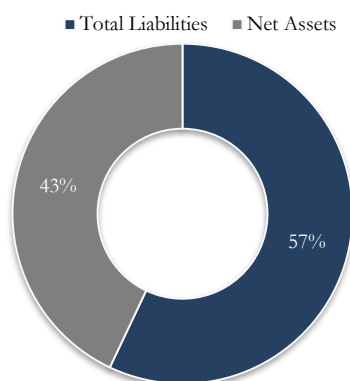
*The company proposed a final dividend of ₦1.83 per share in 2018 (2017 Final dividend: ₦3.13) after the payment of ₦0.60 as interim dividend per share (2017 interim dividend: ₦1.00), totalling ₦2.43...*

Fig. 9: Dividend Per Share and Dividend Yield - FY'17-FY'21F



Source: NSE, PAC Research

Fig. 10: Total Liabilities Vs Net Asset in FY'18



Source: NSE, PAC Research

### Valuation

Our valuation puts the target price of the stock at ₦73.06, representing a decline of 8.67% from the current price of ₦80.00. 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, increased competition within the industry and a cautious outlook from the management.

*Our valuation puts the target price of the stock at ₦73.06, representing a decline of 8.67% from the current price of ₦80.00*

**Fig. 11: Share Price History (Naira)**



Source: NSE, PAC Research

**Fig. 12: Statement of Profit or Loss, N'mn**

	2017	2018	2019F	2020F
Revenue	344,563	324,389	334,120	350,826
Change		-5.85%	3.00%	5.00%
Cost of sales	201,013	197,485	201,140	208,742
Change		-1.76%	1.85%	3.78%
Gross profit	143,549	126,904	132,980	142,085
Change		-11.60%	4.79%	6.85%
Other income	2,219	885	1,069	1,123
Change		-60.09%	20.76%	5.00%
Marketing & Distr. Exp.	66,899	70,052	70,833	73,673
Change		4.71%	1.12%	4.01%
Administrative expenses	21,748	20,785	21,384	22,453
Change		-4.43%	2.88%	5.00%
Results from op. activities	57,121	36,952	41,832	47,081
Change		-35.31%	13.21%	12.55%
Net Finance costs	10,491	7,530	6,983	6,981
Change		-28.23%	-7.26%	-0.02%
Profit Before Taxation	46,630	29,422	34,849	40,099
Change		-36.90%	18.44%	15.07%
Taxation	13,581	9,984	11,500	13,233
Change		-26.49%	15.19%	15.07%
Profit After Taxation	33,049	19,438	23,349	26,867
Change		-41.18%	20.12%	15.07%
	344,563	324,389	334,120	350,826

**Fig. 13: Statement of Financial Position, N'mn**

	2017	2018	2019F	2020F
PPE	195,230	203,493	207,154	214,004
Intangible assets	98,277	97,136	96,895	101,740
Investments	150	150	150	154
Other receivables	552	662	668	702
Prepayments	526	538	501	526
Inventories	42,729	32,507	33,412	34,938
Trade and other rec.	20,384	35,153	34,080	35,083
Cash and bank Bal.	15,867	14,793	15,386	16,155
Total Assets	382,228	388,263	391,108	406,305
current tax liabilities	19,606	14,579	15,035	15,787
Dividend payable	8,029	7,932	7,852	8,244
Trade and Other pa.	127,947	114,152	115,271	121,035
Loans and Borrowings	8,000	41,128	40,094	42,099
Employee benefits	13,210	16,057	17,374	18,243
Deferred tax liab.	26,667	24,554	24,892	26,137
Total liabilities	203,930	221,434	221,856	232,949
Net Assets	178,298	166,828	169,252	173,356

**Fig. 14: Profitability Ratio**

	2017	2018	2019F	2020F
Gross profit margin	41.66%	39.12%	39.80%	40.50%
Net Profit Margin	9.59%	5.99%	6.99%	7.66%
operating profit margin	16.58%	11.39%	12.52%	13.42%
Return on Equity	18.54%	11.65%	13.80%	15.50%
Return on Assets	8.65%	5.01%	5.97%	6.61%
Return on Assets	26.06%	21.34%	22.47%	23.37%
ROCE	25.26%	14.87%	16.63%	18.12%

**Fig. 15: Asset Utilisation**

	2017	2018	2019F	2020F
cash/.sales	0.05	0.05	0.05	0.05
Sales to inventory (x)	8.06	9.98	10.00	10.04
Sales to total assets (x)	0.90	0.84	0.85	0.86
sales/EBITDA	3.84	4.69	4.45	4.28
Sales to total fixed assets	1.76	1.59	1.61	1.64
Equity multiplier	2.14	2.33	2.31	2.34

**Fig. 16: Liquidity Ratios**

	2017	2018	2019F	2020F
Quick ratio	0.29	0.38	0.38	0.37
Current ratio	0.56	0.62	0.61	0.61
Cash ratio	0.10	0.11	0.11	0.11
Interest Coverage	4.37	3.73	4.74	5.44
Op. Cash Flow Ratio	0.37	0.26	0.30	0.32
Debt/net income	0.26	2.19	1.77	1.62
Debt/operating profit	0.15	1.15	0.99	0.92
Debt to asset	0.02	0.11	0.11	0.11
Debt to equity	0.05	0.26	0.24	0.25
Total liabilities/equity	1.14	1.33	1.31	1.34
Total liab./ Total Assets	0.53	0.57	0.57	0.57
Inventory turnover	2.72	2.62	3.05	3.05
Inventory days	67.16	68.00	59.81	59.76
Account rec. days	21.59	39.55	37.23	36.50

**Fig. 17: Shareholders' Investment Ratios**

	2017	2018	2019F	2020F
Earnings per share	4.13	2.43	2.92	3.36
DiV per share	4.13	2.43	2.92	3.15
NAVPS	22.30	20.86	21.16	21.68
Earnings yield	5.17%	3.04%	3.65%	4.20%
FCFPS	9.01	9.10	9.19	9.28

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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